

SECURITIES AND EXCHANGE COMMISSION
Release No. 34-62156; File No. SR-FINRA-2010-007

May 24, 2010

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Order
Approving Proposed Rule Change to Amend the By-Laws of NASD Dispute Resolution

On January 22, 2010, 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”), 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 NASD Dispute Resolution. The proposed rule change was published for comment in the Federal Register on March 2, 2010.³ The Commission received one comment on the proposed rule change.⁴ This order approves the proposed rule change.

I. Description of Proposed Rule Change

FINRA proposed to amend the NASD Dispute Resolution By-Laws to: (1) modify the composition of the FINRA Dispute Resolution Board; (2) adopt changes to conform the NASD Dispute Resolution By-Laws to the FINRA By-Laws; and (3) implement other conforming changes to reflect the corporate name change and other similar matters. The proposed amendments to the NASD Dispute Resolution By-Laws are modeled on those of the FINRA and FINRA Regulation By-Laws (which were both

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Exchange Act Release No. 34-61575 (Feb. 23, 2010); 75 FR 9459 (Mar. 2, 2010).

⁴ See letter from Barry D. Estell, Esq., dated March 24, 2010 (“Estell Letter”).

previously approved by the Commission), with modifications as appropriate to the particular functions of FINRA Dispute Resolution.

The following discussion addresses the proposed amendments to NASD Dispute Resolution's By-Laws under the article of the By-Laws of NASD Dispute Resolution in which the amendments would first appear.

Amendments to Article I - Definitions

Article I contains definitions of terms used in the By-Laws. FINRA proposed to add to or amend some of these definitions.

Broker and Dealer

FINRA proposed to amend the definitions of "broker" and "dealer" in Article I to conform them to the definitions of "broker" and "dealer" in the Act, as amended by the Gramm-Leach-Bliley Act of 1999.⁵ As proposed, FINRA would incorporate by reference the definitions of the terms "broker" and "dealer" as set forth in Sections 3(a)(4) and 3(a)(5), respectively, of the Act.⁶ The Commission approved the same change to definitions of the terms "broker" and "dealer" in the then-NASD Regulation's By-Laws in March 2001.⁷

Corporation

FINRA proposed to add the term "Corporation" to Article I to reflect the change of the Corporation's name from "NASD" to "FINRA." Proposed Article I(e) would

⁵ Pub. L. 106-102, 113 Stat. 1338 (1999).

⁶ 15 U.S.C. 78c(a)(4) and (a)(5).

⁷ See Securities Exchange Act Rel. No. 44052 (March 8, 2001), 66 FR 15157 (March 15, 2001) (File No. SR-NASD-01-13).

define Corporation to mean the National Association of Securities Dealers, Inc., the Financial Industry Regulatory Authority, Inc., or any future name of the entity.

Electronic Transmission

FINRA proposed to add the term “electronic transmission” to Article I to reflect the common usage of electronic transmission as a means of communication.⁸ The term “electronic transmission” would be defined to mean communicating or disseminating information or documents to individuals or entities by telegraph, telefax, cable, radio, wireless or other device or method. FINRA intends “other device or method” to include email, text messages, and related technologies, for example.

FINRA Member

FINRA proposed to add the term “FINRA member” to Article I.⁹ As proposed, the term “FINRA member” would mean “any broker or dealer admitted to membership in FINRA, whether or not the membership has been terminated or cancelled; and any broker or dealer admitted to membership in a self-regulatory organization that, with FINRA consent, has required its members to arbitrate pursuant to the Code of Arbitration Procedure for Customer Disputes (“Customer Code”) or the Code of Arbitration Procedure for Industry Disputes (“Industry Code”, and together with the Customer Code, “Codes”) and/or to be treated as members of FINRA for purposes of the Codes , whether or not the membership has been terminated or cancelled.”

Industry Director or Industry Member and Public Director or Public Member

FINRA proposed to modify the terms “Industry Director” or “Industry member”

⁸ The new term “electronic transmission” would be added as proposed Article I(k) of the By-Laws of NASD Dispute Resolution.

⁹ The new term “FINRA member” would be added as proposed Article I(o) of the By-Laws of NASD Dispute Resolution.

and “Public Director” or “Public member” in Articles I(k) and I(t), respectively. With regard to the term “Industry Director” or “Industry member”, the proposed rule change would amend the NASD Dispute Resolution’s By-Laws by separating these definitions into two definitions for ease of reference.¹⁰

FINRA also proposed to amend the revised terms “Industry Director” and “Industry Member” to limit the look-back test that characterizes committee members as industry if they have served as an officer, director, or employee of a broker or dealer, among other reasons, to the past twelve months. The current provision uses a three-year look-back test. The proposed change would make the definitions of “Industry Director” and “Industry Member” under the NASD Dispute Resolution By-Laws consistent with the definitions of “Industry Director”, “Industry Governor”, and “Industry committee member” in the FINRA By-Laws.¹¹

The proposal would also add the term “independent director” to the portion of the definitions of “Industry Director” and “Industry Member” that excludes outside directors of a broker or dealer. The term “independent director” is synonymous with outside director, but FINRA proposed to add it to the exclusionary clause to harmonize the NASD Dispute Resolution By-Laws with the definition of “Industry Governor” in the FINRA By-Laws.¹²

Similarly, FINRA proposed to modify the term “Public Director” or “Public

¹⁰ The term “Industry Director” will be defined in proposed Article I(r); “Industry Member” in proposed Article I(s).

¹¹ See FINRA By-Laws, Article I(s) and I(t).

¹² See FINRA By-Laws, Article I(t).

member” by separating it into two definitions for ease of reference.¹³ FINRA would also amend the proposed terms “Public Director” or “Public Member” to clarify that an individual’s service as a public director of a self regulatory organization does not disqualify that person from serving as a Public Director or Public Member under NASD Dispute Resolution’s By-Laws.

Person Associated With a Member or Associated Person of a Member

On June 5, 2009, FINRA filed a proposed rule change to amend Rules 12100(r), 12506(a), and 12902(a) of the Customer Code and Rule 13100(r) of the Industry Code to amend the definition of “associated person,” streamline a case administration procedure, and clarify that customers could be assessed hearing session fees based on their own claims for relief in connection with an industry claim.¹⁴ The Commission approved the proposal on October 26, 2009.¹⁵

Under that proposal, FINRA amended the definition of associated person under the Codes¹⁶ to match the definition in FINRA’s By-Laws.¹⁷ The proposal amended the

¹³ The term “Public Director” will be defined in proposed Article I(w); “Public Member” in proposed Article I(x).

¹⁴ See Securities Exchange Act Rel. No. 60159 (June 22, 2009), 74 FR 31779 (July 2, 2009) (File No. SR-FINRA-2009-041).

¹⁵ See Securities Exchange Act Rel. No. 60878, 74 FR 56679 (Nov. 2, 2009) (Notice of Filing of Amendment No. 1 and Order Granting Accelerated Approval of SR-2009-041, as Modified by Amendment No. 1).

¹⁶ Rule 12100(r) of the Customer Code and Rule 13100(r) of the Industry Code define “person associated with a member” to mean: (1) A natural person registered under the Rules of FINRA; or (2) A sole proprietor, partner, officer, director, or branch manager of a member, or a natural person occupying a similar status or performing similar functions, or a natural person engaged in the investment banking or securities business who is directly or indirectly controlling or controlled by a member, whether or not any such person is registered or exempt from registration with FINRA under the By-Laws or the Rules of FINRA.

definition of “person associated with a member” in the Codes in two ways: (1) by inserting the word “other” before the second reference to “natural person” to clarify that the definition does not include corporate entities; and (2) by inserting the criterion that a natural person includes someone who has applied for registration.

FINRA proposed to implement the same changes to the definition of associated person of a member in the NASD Dispute Resolution By-Laws, as have been approved recently by the Commission to same definitions under the Codes.

Amendments to Article IV – Board of Directors

FINRA proposed to make limited conforming changes to Article IV to parallel more closely the governance structure of the FINRA Board.

Section 4.3 - Qualifications

The proposed rule change would amend Article IV, section 4.3(a) to reflect FINRA’s current governance structure by establishing that NASD Dispute Resolution Board members would be drawn exclusively from the FINRA Board. The proposed rule change would also amend section 4.3(a) to streamline the composition of NASD Dispute

For purposes of the Code, a person formerly associated with a member is a person associated with a member.

¹⁷ FINRA’s By-Laws define “person associated with a member or associated person of a member” as (1) a natural person who is registered or has applied for registration under the Rules of the Corporation; (2) a sole proprietor, partner, officer, director, or branch manager of a member, or other natural person occupying a similar status or performing similar functions, or a natural person engaged in the investment banking or securities business who is directly or indirectly controlling or controlled by a member, whether or not any such person is registered or exempt from registration with the Corporation under these By-Laws or the Rules of the Corporation; and (3) for purposes of Rule 8210, any other person listed in Schedule A of Form BD of a member. See By-Laws of the Corporation, Article I, Definitions (rr).

Resolution's Board and implement a requirement that it contain more Public Directors than Industry Directors. Thus, section 4.3(a) would be amended to state that "the number of Public Directors shall exceed the number of Industry Directors." FINRA's By-Laws contain a similar requirement.¹⁸

The proposal would make other changes to Article IV, section 4.3 as follows:

- re-structure the Board to remove the President of NASD Dispute Resolution. The President would not be deemed a Director, and therefore, the proposed rule change would delete several references to the President of NASD Dispute Resolution;¹⁹
- clarify that the Chair of the FINRA Board and the Chief Executive Officer of FINRA shall be ex-officio non-voting members of the Board;
- transfer the task of selecting the Chair of the NASD Dispute Resolution Board from the Board members to NASD Dispute Resolution's stockholder;²⁰
- eliminate the requirement that the Board select a Vice Chair; and

¹⁸ See By-Laws of the Corporation, Article VII (Board of Governors), section 4(a).

¹⁹ See NASD Dispute Resolution 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, section 141(c)(2).

²⁰ See Delaware General Corporation Law section 142, which allows the sole stockholder to make this selection if expressly provided for in the By-Laws.

- state that the stockholder will designate the Chair at the same time that the Directors are elected.

Section 4.4 - Election

The proposed rule change would eliminate as unnecessary the reference to the first meeting of NASD Regulation at which Directors initially were elected.

Section 4.5 - Resignation

The proposal would remove the requirement that Directors submit written notice of resignation to the President. Under the proposal, such notice would be submitted to the Chair of the Board, instead of the President.

Section 4.6 - Removal

The proposed rule change would transfer the authority to remove Directors from a majority vote of the FINRA Board to the stockholder of FINRA Regulation.²¹ The proposed amendment would reflect Delaware law, which requires that a stock corporation vest the power to remove directors with the stockholder.²²

Section 4.7 - Disqualification

In connection with the proposed change to section 4.3(a), which would require the number of Public Directors to exceed the number of Industry Directors, the proposal would also amend section 4.7 to clarify that when a Director is disqualified from Board

²¹ The sole stockholder of the capital stock of FINRA Dispute Resolution, Inc. is FINRA, Inc. See Article VIII, section 8.1 (Sole Stockholder).

²² See Delaware General Corporation Law, section 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 Dispute Resolution) 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.

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.

Section 4.8 – Filling of Vacancies

Currently, Directors of FINRA Dispute Resolution are elected annually at the meeting of FINRA Dispute Resolution's stockholder meeting or at a special meeting dedicated to Board elections.²³ When the annual election of Directors is not held on the designated date, the NASD Dispute Resolution By-Laws charge the Directors to "cause such election" to be held.²⁴ The proposed rule change would confirm that the same process should be used by the FINRA Dispute Resolution Board when filling vacancies among its ranks. Thus, the proposal would amend section 4.8 to provide that the FINRA Board shall "cause the election" of a qualified Director to fill the vacant position.²⁵

Section 4.9 – Quorum and Voting

The proposed rule change would remove a cross-reference to section 4.14(b) in the quorum provision, and also amend the provision to clarify that, when there is a quorum, a majority vote of the Directors present at a meeting constitutes action of the Board.

Section 4.12 – Notice of Meetings; Waiver of Notice

²³ See current NASD Dispute Resolution By-Laws, Article IV, section 4.4 (Election).

²⁴ Id.

²⁵ Pursuant to Delaware law, FINRA, as the sole stockholder of FINRA Dispute Resolution, 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 Dispute Resolution Board will follow the advice of its controlling stockholder and elect the recommended individual. See Delaware General Corporation Law, section 223.

The proposal would clarify the conditions under which the NASD Dispute Resolution Board may meet. The current NASD Dispute Resolution By-Laws provide that a Director may 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.²⁶ FINRA proposed to amend section 4.12(c) to clarify 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.

The proposed rule change also would amend section 4.12(a) and (b) to replace the phrase “telegraph, telefax, cable, radio, or wireless” with the new term “electronic transmission.”²⁷ For an explanation of the term “electronic transmission,” see the discussion under “Amendments to Article I – Definitions” above.

Section 4.13 – Committees

As explained under the discussion of section 4.3(a), the proposal would implement a requirement that the FINRA Dispute Resolution Board contain more Public Directors than Industry Directors.²⁸ In furtherance of this change, references throughout Article IV to balancing “Industry” and “Non-Industry” Board members would be replaced with references to balancing “Industry” and “Public” Board members. Similarly, the proposal

²⁶ See current NASD Dispute Resolution By-Laws, Article IV, section 4.12(b) (Notice of Meeting; Waiver of Notice) and Article IX, section 9.3(b) (Waiver of Notice).

²⁷ FINRA proposed similar changes to Article IV, Section 4.12 (Notice of Meeting; Waiver of Notice) and Article XII, Section 12.3 (Waiver of Notice) of the FINRA Regulation By-Laws. See Securities Exchange Act Rel. No. 59696 (April 2, 2009), 74 FR 16020 (April 8, 2009) (File No. SR-FINRA-2009-020).

²⁸ See also proposed Article I(r) (Industry Director); proposed Article I(s) (Industry Member); proposed Article I(w) (Public Director); and proposed Article I(x) (Public Member).

would remove the requirement that the Executive Committee include at least one Non-Industry Member and institute the requirement that Public Directors shall exceed Industry Directors on FINRA Dispute Resolution’s Executive Committee of the Board.²⁹

Section 4.15 – Action Without Meeting

The proposal would make a related change to section 4.15 to eliminate the requirement that unanimous consent for taking action without a meeting specifically be in writing and filed with the minutes of the meeting. Instead, the proposal would require the consent to be “in accordance with applicable law,” which in the instance of FINRA Dispute Resolution, would be Delaware law.

Amendment to Article V – Officers, Agents, and Employees

Section 5.1 – Officers

As explained under the discussion of Article IV, section 4.3, the proposed rule change would re-structure the Board to remove the President of FINRA Dispute Resolution as a Director of the Board.³⁰ In connection with this change, the proposal would remove a reference to the President from section 5.1, so that the amended language would state, in relevant part, that none of the officers need to be Directors of FINRA Dispute Resolution.

Amendments to Article VIII – Capital Stock

Section 8.3 - Signatures

²⁹ See Article IV, section 4.12(f) (Executive Committee).

³⁰ Supra note 18.

The proposed rule change would amend several provisions regarding FINRA Dispute Resolution's capital stock. Currently, under section 8.3(a), FINRA's approach to the corporate law issue of signing certificates representing shares of FINRA Dispute Resolution capital stock is to have these shares signed by FINRA Dispute Resolution officers. Under the proposed re-structuring of the Board, FINRA Dispute Resolution would not have an officer as Chair of the Board. Thus, FINRA proposed to remove the provision that permits the Chair of the Board to sign stock certificates, and limit the authority to sign such certificates to the President, Vice President, Secretary or Treasurer of FINRA Dispute Resolution.

FINRA proposed to amend section 8.3(b) to remove the limitations on the type of signatures required on certificates of capital stock. The current provision states, in relevant part, that "if any such certificates are countersigned by a transfer agent other than NASD Dispute Resolution or its employee, or by a registrar other than NASD Dispute Resolution or its employee, any other signature on the certificate may be a facsimile." The proposed amendment would eliminate limitations on when signatures on certificates representing shares of FINRA Dispute Resolution's capital stock may be facsimiles and permit any signature to be a facsimile. Thus, under the proposal, the provision would be amended to state that "any signature on the stock certificate may be a facsimile."

Section 8.4 – Stock Ledger

Currently, section 8.4(a) of the NASD Dispute Resolution By-Laws requires that the FINRA Dispute Resolution Secretary, or another officer, employee, or agent, keep a record of FINRA Dispute Resolution's capital stock ownership and "the number of shares

represented by each such certificate.” FINRA proposed to change several references to “capital stock” to “certificates representing shares of capital stock” or similar constructions, instead of “certificates for shares of capital stock.”³¹

Amendments to Article IX – Miscellaneous Provisions

Section 9.3 – Waiver of Notice

FINRA proposed to amend section 9.3(a) of the NASD Dispute Resolution By-Laws to replace the phrase “telegraph, telefax, cable, radio, or wireless” with the new term “electronic transmission.”³²

Conforming Changes Relating to the New FINRA name and Other Technical Changes

FINRA proposed to implement certain other non-substantive changes to all articles of the NASD Dispute Resolution By-Laws, as follows:

- “the NASD” or “NASD” would be replaced with “FINRA” or “the Corporation;”
- “NASD Dispute Resolution” would be changed to “FINRA Dispute Resolution;”
- “the Rules of the Association” would be replaced with “the Rules of the Corporation;”

³¹ The proposal would delete as imprecise the words “certificates for” in the discussion of potential registration of shares of capital stock. See proposed NASD Dispute Resolution By-Laws, Article VIII, section 8.4(b) (Stock Ledger), 8.5 (Transfers of Stock), 8.6 (Cancellation), and 8.7 (Lost, Stolen, Destroyed, and Mutilated Certificates).

³² See *supra* note 26, and the explanation of the term “electronic transmission” under “Amendments to Article I - Definitions.”

- “National Nominating Committee” would be replaced with “Nominating Committee;”
- a reference to “FINRA Regulation” would be added; and
- “Association” would be replaced with “Corporation.”

FINRA also proposed to amend Article II, section 2.1 to change the name and address of the registered agent from The Corporation Trust Company, 1209 Orange Street, Wilmington, DE, 19801 to Corporation Creations Network Inc., 1308 Delaware Avenue, Wilmington, DE, 19806.

II. Comments

The Commission received one comment on the proposed rule change,³³ as well as FINRA’s response to the comment³⁴. The commenter opposed the rule filing arguing that the proposed rule change would not “redound to the benefit of investors” because: (1) the Chair of the FINRA Dispute Resolution Board would be selected by FINRA; (2) FINRA, by selecting the Chair of the FINRA Dispute Resolution Board, may prevent a director of FINRA Dispute Resolution from “suggesting a measure that might bring some element of fairness to the dispute resolution process”; and (3) FINRA would have the power to remove directors of FINRA Dispute Resolution.³⁵

FINRA responded to the commenter’s concern regarding the selection of the Chair of the FINRA Dispute Resolution Board by stating that since the FINRA Board is comprised of a majority of public governors, “the majority will be able to represent

³³ See supra, note 4.

³⁴ See letter from Mignon McLemore, Assistant Chief Counsel, FINRA Dispute Resolution, dated May 5, 2010 (“FINRA Letter”).

³⁵ See Estell Letter.

the interests of the investing public regarding the selection of the [Chair of the FINRA Dispute Resolution Board]”³⁶. FINRA also noted that, “as the proposed FINRA Dispute Resolution By-Laws require that the number of Public Directors exceeds the number of Industry Directors, matters affecting the dispute resolution process also would be controlled by a majority of Public Directors”.³⁷

With respect to the commenter’s concern that the proposed rule change would provide the Chair with the authority to prevent matters from being raised at a meeting, FINRA stated that the Chair cannot prevent an item from being raised at a meeting. FINRA also noted that any member of the Board may raise a matter for consideration and that the Chair may influence when the matter is heard, but cannot prevent it from being heard.³⁸

In response to the commenter’s concern regarding FINRA’s power to remove directors of FINRA Dispute Resolution with or without cause, FINRA reiterated that Delaware law requires that the stockholder have the power to remove directors. Since FINRA is the stockholder of FINRA Dispute Resolution, the removal of a Director from FINRA Dispute Resolution’s Board is also a function that is controlled by FINRA’s Board. FINRA also stated that since the FINRA Board is comprised of a majority of public governors, that majority would consider the public interests and market implications in determining whether to remove a Director from FINRA Dispute Resolution’s Board.³⁹

³⁶ See FINRA Letter at page 1.

³⁷ Id.

³⁸ See FINRA Letter at page 2.

³⁹ Id.

III. Discussion and Findings

After careful review of the proposed rule change, the comment received, and FINRA's response to the comment, the Commission finds the proposed rule change to be consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities association⁴⁰. In particular, the Commission finds that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act⁴¹, 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; to remove impediments to and perfect the mechanism of a free and open market and a national market system; and, in general, to protect investors and the public interest.

The Commission believes that the proposed rule change is consistent with FINRA's obligations under the Act. In particular, the proposed rule change will conform definitions in the By-Laws with definitions in the Act, as well as to the By-Laws of FINRA and FINRA Regulation. The proposed rule change will also conform other provisions of the By-Laws with the FINRA and FINRA Regulation By-Laws and be consistent with Delaware law, under which all the entities are organized. In addition, the proposed rule change would clarify that FINRA members remain subject to the requirements of the Codes after their membership has been terminated or cancelled.

⁴⁰ In approving this 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).

⁴¹ 15 U.S.C. 78o-3(b)(6).

IV. Conclusion

For the foregoing reasons, the Commission finds that the proposed rule change is consistent with the Act and the rules and regulations thereunder applicable to a national securities association.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act⁴², that the proposed rule change (SR-FINRA-2010-007) be and hereby is approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.⁴³

Florence E. Harmon
Deputy Secretary

⁴² 15 U.S.C. 78s(b)(2).

⁴³ 17 CFR 200.30-3(a)(12).