

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-90324; File No. SR-FINRA-2020-037)

November 3, 2020

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of a 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

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² notice is hereby given that on October 22, 2020, the Financial Industry Regulatory Authority, Inc. (“FINRA”) 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 Regulation, Inc. (“FINRA Regulation”), FINRA’s regulatory subsidiary, to further align the grounds for member removal from the National Adjudicatory Council (“NAC”) with an existing provision in the FINRA By-Laws related to the removal of a FINRA Governor from the FINRA Board of Governors (“FINRA Board”).³

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ In 2008, the FINRA Regulation By-Laws were amended to, among other things, designate the FINRA Board as the body authorized to oversee the NAC and empowered to remove NAC members for refusal, failure, neglect, or inability to discharge duties. See Securities Exchange Act Release No. 58909 (November 6, 2008), 73 FR 68467 (November 18, 2008) (Order Approving File No. SR-FINRA-2008-046). Under the FINRA By-Laws, members of the FINRA Board can be removed under the same grounds, plus an additional ground. See infra note 8.

Below is the text of the proposed rule change. Proposed new language is italicized.

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BY-LAWS OF FINRA REGULATION, INC.

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ARTICLE V NATIONAL ADJUDICATORY COUNCIL

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Removal

Sec. 5.8 Any or all of the members of the National Adjudicatory Council may be removed from office at any time for refusal, failure, neglect, or inability to discharge the duties of such office, *or for any cause affecting the best interests of the National Adjudicatory Council the sufficiency of which the FINRA Board shall be the sole judge*, by majority vote of the FINRA Board.

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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

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”).⁴ The FINRA Regulation By-Laws authorize the NAC to function on behalf of the FINRA Board in several capacities.⁵ For example, the NAC presides over disciplinary matters appealed to or called for review by the NAC; acts on applications in statutory disqualification and membership proceedings; exercises exemptive 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.⁶ For most matters that the NAC considers, the NAC prepares proposed written decisions that become final FINRA action if the FINRA Board does not call them for review.

FINRA periodically reviews its and FINRA Regulation’s By-Laws to ensure adherence to effective governance practices. The FINRA Regulation By-Laws currently permit the FINRA Board to remove “any or all members” of the NAC from office at any time for refusal, failure, neglect, or inability to discharge the duties of the office.⁷ By comparison, the FINRA By-Laws include those grounds for removal of a Governor from the FINRA Board plus an additional ground allowing for removal for any cause affecting the best interests of FINRA the sufficiency

⁴ See Plan, II. FINRA Regulation, Inc., <https://www.finra.org/rules-guidance/rulebooks/corporate-organization/ii-finra-regulation-inc>.

⁵ See Article V, Sec. 5.1 of the FINRA Regulation By-Laws.

⁶ See supra note 5.

⁷ See Article V, Section 5.8 of the FINRA Regulation By-Laws.

of which the FINRA Board shall be the sole judge.⁸ The proposed rule change would amend Article V, Section 5.8 of the FINRA Regulation By-Laws to align the bases for removal of a member of the NAC in the FINRA Regulation By-Laws with those of the FINRA By-Laws for removal of a Governor. Specifically, the proposed rule change would provide that a NAC member could 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.

FINRA notes that the voting threshold for removal of a NAC member differs from that of a Governor. The former requires a majority vote of the FINRA Board, while the latter requires a two-thirds vote.⁹ The higher voting threshold for removal of a Governor reflects the historical standard that existed at the National Association of Securities Dealers (“NASD”) prior to its 2007 merger with the member regulation, enforcement and arbitration operations of the New York Stock Exchange (“NYSE”) that formed FINRA, and 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.¹⁰

⁸ See Article VII, Section 1(b) of the FINRA By-Laws.

⁹ 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). While the standard for removal of NAC members is not directly subject to the Delaware General Corporation Law, FINRA has adopted a removal threshold for NAC members that is consistent with the removal threshold for directors under the Delaware Corporation Law.

¹⁰ The FINRA Regulation By-Laws addressing the composition of the NAC also provide for a diverse, majority non-industry composition, and for the fair representation of industry. See Article V, Section 5.2(a) of the FINRA Regulation By-Laws; See also Securities Exchange Act Release No. 78094 (June 17, 2016), 81 FR 40932, 40934-35 (June 23, 2016).

Given the NAC’s adjudicatory role, the best interests of the NAC are more targeted than the best interests of FINRA. 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. In considering whether to remove a NAC member for a cause affecting the best interests of the NAC, the FINRA Board may consider, among other things, a NAC member’s adherence to general standards concerning actual and apparent adjudicator conflicts of interest and bias,¹¹ and to the NAC’s Conflict of Interest and Bias Policy (“Policy”). The Policy sets forth broad-based principles of behavior that are expected from NAC members.¹² Removal of a NAC member from office is a facts and circumstances determination. The additional removal authority provided in the proposed rule change may, depending on the facts and circumstances, overlap in part with the FINRA Board’s existing authority to remove a NAC member. However, depending on the facts and circumstances, it may also provide an additional basis for removal for a cause affecting the best interests of the NAC that does not fall within the scope of the FINRA Board’s current removal authority.

In order to balance the NAC’s ability to perform certain actions on behalf of FINRA¹³ with the FINRA Board’s authority to review such actions,¹⁴ FINRA believes that it is reasonable

¹¹ See, e.g., Article IV, Section 4.14(a) of the FINRA Regulation By-Laws.

¹² The principles outlined in the Policy are Independence, Impartiality, Integrity, Accountability and Transparency; and place upon NAC adjudicators the responsibility for recognizing and reporting actual and apparent conflicts of interest and bias.

¹³ See supra note 5.

¹⁴ See Plan, I(B). FINRA, Inc., <https://www.finra.org/rules-guidance/rulebooks/corporate-organization/i-finra-inc>.

and appropriate to amend the FINRA Regulation By-Laws to align the grounds under which members of the NAC and FINRA Board can be removed. In doing so, the proposed rule change will strengthen the FINRA Board's oversight of the NAC and benefit the appellate portion of FINRA's disciplinary process, in which the NAC prepares the decision that becomes FINRA's final action in the vast majority of cases.

If the Commission approves the proposed rule change, the effective date of the proposed rule change will be the date of 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,¹⁵ 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, which requires, among other things, that FINRA rules be designed to assure a fair representation of FINRA's members in the administration of its affairs.¹⁶ FINRA believes that the proposed By-Laws change will strengthen its governance practices by aligning grounds for removal of NAC members with those of the FINRA Governors. The FINRA By-Law provision that allows for the Board's direct ability to remove a Governor for any cause affecting the best interests of FINRA existed in the By-Laws of the NASD prior to its 2007 merger with the NYSE, and was also a part of the By-Laws that were previously found to meet the statutory requirement when the NASD merged with the member regulation, enforcement and

¹⁵ 15 U.S.C. 78o-3(b)(6).

¹⁶ 15 U.S.C. 78o-3(b)(4).

arbitration operations of the NYSE to form FINRA.¹⁷ FINRA also believes applying the same standard to removal of NAC members will support a fair and impartial disciplinary process for members and their associated persons. FINRA further believes that the proposed rule change will strengthen investor protection and further the public interest by bolstering the integrity of the NAC and strengthening existing FINRA Regulation By-Laws that foster a framework in which NAC members may perform their duties free from bias or conflicts of interest. In addition, FINRA believes that the proposed rule change furthers FINRA's ability to assure a fair representation of FINRA members on the NAC by enhancing the FINRA Board's ability to remove NAC members for conduct that might hamper the NAC's adjudicatory function.

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

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. FINRA has evaluated the potential for economic impacts associated with the proposed rule change and determined that no material costs or benefits were likely to arise. The proposed rule change would not require member firms or other persons appearing before the NAC to incur any direct costs or change their behaviors in any way. All potential actions taken pursuant to the proposed rule change would be taken by the FINRA Board. Further, FINRA's other By-Law provisions remain unchanged, so the proposed rule change will have no material impact on fair process to litigants.

¹⁷ 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) (Order Approving File No. SR-NASD-2007-023).

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 45 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 or disapprove 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. Please include File Number SR-FINRA-2020-037 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-FINRA-2020-037. 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 website (<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 website viewing and printing 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 such filing also will be available for inspection and copying at the principal office of FINRA. All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-FINRA-2020-037 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.¹⁸

J. Matthew DeLesDernier
Assistant Secretary

¹⁸ 17 CFR 200.30-3(a)(12).