



# BETTER MARKETS

June 19, 2017

Jennifer Piorko Mitchell  
Office of Corporate Secretary  
FINRA  
1735 K Street, NW  
Washington, DC 20006

Re: Potential Enhancements to Certain Engagement Programs

Dear Ms. Mitchell:

Better Markets<sup>1</sup> appreciates the opportunity to review and comment on the above-captioned Special Notice (“Notice”) released for public comment by the Financial Industry Regulatory Authority (“FINRA”). As part of a newly announced initiative to “evaluate various aspects of [FINRA’s] operations and programs to identify opportunities to more effectively further its mission,”<sup>2</sup> the Notice invites comment on FINRA’s proposal to enhance its engagement programs with the industry and other stakeholders.

As the Notice comprehensively makes clear, today, FINRA is already deeply engaged with the industry it is statutorily required to regulate. Our letter will focus on ways FINRA could enhance its engagement programs through the act of re-balancing and increasing transparency. FINRA could better fulfill its mission of investor protection and promotion of market integrity<sup>3</sup> by increasing investors’ voices, and at times, reducing industry’s undue influence over regulatory and policy matters pertaining to this important mission.

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<sup>1</sup> Better Markets is a non-profit, non-partisan, and independent organization founded in the wake of the 2008 financial crisis to promote the public interest in the financial markets, support the financial reform of Wall Street, and make our financial system work for all Americans again. Better Markets works with allies—including many in finance—to promote pro-market, pro-business, and pro-growth policies that help build a stronger, safer financial system that protects and promotes Americans’ jobs, savings, retirements, and more.

<sup>2</sup> Notice at p. 1.

<sup>3</sup> See 15 U.S.C. § 78o-3(b)(6) (2012) (requiring the rules of registered securities associations to 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”); Fair Administration and Governance of Self-Regulatory Organizations, 69 Fed. Reg. 71129 (Dec. 8, 2004) (“SROs are charged with an important public trust to carry out their self-regulatory responsibilities

FINRA is to be commended for comprehensively taking stock of its engagement programs, and announcing its commitment to enhance these programs as appropriate to better fulfill its mission of protecting investors and enhancing market integrity. Self-regulatory organizations (“SROs”) are uniquely positioned to utilize market practitioners’ knowledge and experience as appropriate inputs when crafting strong, workable, and enforceable rules for the securities markets. FINRA (and its predecessors) have had the advantage of this input for nearly a hundred years. We agree that “FINRA must understand what it regulates.”<sup>4</sup> These engagement programs, particularly the Advisory Committees, can allow FINRA to better understand the practices and products offered in the securities markets.

But we also are concerned that deep and constant “engagement” with the industry may expose FINRA to undue influence, inappropriate meddling, or much worse, regulatory capture by the very entities it is Congressionally-charged to regulate and oversee.

As shown by the 1996 Securities and Exchange Commission (“SEC”) enforcement action against NASD and NYSE Member Regulation (the two entities that joined together in 2007 to become FINRA), self-regulatory organizations have a troubling history of regulatory-capture.<sup>5</sup> Therefore, FINRA must always vigilantly strive for independence, impartiality, objectivity, and public-interest orientation as it aims to fulfill its mission of investor protection and promotion of market integrity. Indeed, that is statutorily required of FINRA. Our comment letter will offer ways for FINRA to better adhere to these bedrock principles while remaining true to its nature as a non-governmental self-regulatory organization.

## **SUMMARY**

If the Advisory Committees and other engagement programs play as important a role as the Notice suggests, then FINRA must fundamentally reform and significantly increase the transparency of, and the availability of information from, its Advisory Committees and engagement programs. Today, other than the briefest of descriptions, almost no information is available publicly about these Committees.

FINRA must re-constitute several Committees to increase investor and other non-industry representation. There are more than a dozen Committees that are industry **only**, whereas, other seemingly investor-oriented Committees have industry representatives. These representational deficiencies must be fixed through re-balancing.

Finally, all Advisory Committee charters must expressly state that all advice and recommendations emanating out of these Committees must specifically be aimed at investor protection and promotion of market integrity. These Advisory Committees must not serve

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effectively and fairly, while fostering free and open markets, protecting investors, and promoting the public trust”).

<sup>4</sup> Notice at p. 2.

<sup>5</sup> See the SEC Investigative report at <https://www.sec.gov/litigation/investreport/nd21a-report.txt>.

any other goals outside of FINRA's statutorily charged mission of investor protection and promotion of market integrity. Intra-industry squabbles should be resolved in the halls and Committee rooms of industry trade associations, not at FINRA.

## **COMMENTS**

### **FINRA Must Radically Improve the Transparency of Its Advisory Committees by Providing More Public Access to Information**

As described in the Notice, and based on our own research using FINRA's website, [finra.org](http://finra.org), we can find very little information about the Advisory Committees or the various other engagement programs listed in the Notice. Were it not for this Notice, the public could not have learned about the profound impact the various advisory committees have on FINRA's regulatory functions.

Today, the public does not have access to the charter, membership, meeting dates, minutes, reports, memoranda, decisions, or other work products and news items about these Committees or engagement programs. Without such basic information, it is difficult for the public to assess whether these engagement programs are appropriately supporting FINRA's investor protection and market integrity missions. Or whether they are inappropriately delaying or diluting necessary regulatory actions by providing self-interested and one-sided advice to the Board of Directors and senior management of FINRA. For example, the public cannot determine the membership of important Advisory Committees such as the Compliance Advisory Committee, Regulatory Advisory Committee, Economic Advisory Committee, Uniform Practice Code Committee, Operations Advisory Committee, Technology Advisory Committee, Fixed Income Committee, and others. As a result, the public cannot assess the nature of the input being provided by these members, the level of expertise they offer, or even whether they include members of the industry who have violated either FINRA's rules or other securities laws and regulations in the past, making them unfit to serve.<sup>6</sup>

The Notice requests comment as to whether FINRA "should make publicly available all advisory and *ad hoc* committee rosters" but it cautions whether "the usefulness of this information [may] outweigh concerns regarding inappropriate communication with or public disparagement of committee members."<sup>7</sup> We are at loss regarding what possible public disparagement may be directed either at FINRA or the committee members

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<sup>6</sup> Unfortunately, this concern is not hypothetical. There is a sad history of securities law violators—some flagrant—serving on regulatory advisory boards. In 2015, Better Markets brought attention to one such instance. The SEC's Equity Market Structure Advisory Committee included at least three members whose firms had been implicated in serious securities wrongdoing. See "Special Interests Dominate SEC Trading Advisory Panel." Dennis Kelleher, *American Banker*. November, 13 2015, <https://www.americanbanker.com/opinion/special-interests-dominate-sec-trading-advisory-panel>; see also Better Markets letter to SEC Chair Mary Jo White, October 22, 2015, [http://www.bettermarkets.com/sites/default/files/Illegal%20Conduct%20by%20Firms%20on%20SEC%27s%20EMSAC\\_0.pdf](http://www.bettermarkets.com/sites/default/files/Illegal%20Conduct%20by%20Firms%20on%20SEC%27s%20EMSAC_0.pdf).

<sup>7</sup> Notice at p. 10.

themselves, if these members are fairly appointed and appropriately serve FINRA's mission of investor protection and promotion of market integrity. But, on the other hand, if these Advisory Committees are filled with representatives from firms with a checkered history of violating the very rules they are in a position to influence, then the public and the journalistic profession should know. And, with that knowledge, they can help call attention to the problem, precipitate positive change at FINRA in the selection of committee members, and hold FINRA accountable when it fails to do so.

Additionally, almost no information is publicly available about the work products and recommendations these Committees presumably create. Today, of the 16 standing and several *ad hoc* Committees, FINRA's website is hosting exactly two reports: a 2009 report by a FINRA Special Committee on FINRA's examination programs related to the Bernard Madoff and R. Allen Stanford Ponzi schemes, and a 2010 report on whether FINRA's Board should claw back senior management's compensation. While both these reports are useful for the public, since they address important substantive questions and allow a glance into the inner workings of FINRA, they fall far short of showing the totality of the influence Advisory Committees exert on FINRA's Board of Directors, its senior management, and the staff conducting the examination, enforcement, and other regulatory functions within FINRA. FINRA's advisory committees must have produced many other reports and recommendations over the years but they remain shrouded in secrecy. That is wrong and ought to be remedied.

More transparency would confer several advantages by allowing the public and market watchers to gain the benefit of the recommendations, to understand the nature of the influence that the Committees wield over FINRA, to discover any inappropriate decisions or recommendations these Committees offer to FINRA, and ultimately to increase the credibility of FINRA. In the process, the Advisory Committee institution itself, FINRA's objectivity and independence, and the public's trust in the regulators who rely on these Committees will all be strengthened.

### **FINRA Must Reform and Re-Constitute Advisory Committees to Include More Investor and Non-Industry Perspectives**

Today, as described in the Notice, FINRA's Advisory Committees are heavily dominated by industry representatives. FINRA's Advisory Committees include a combination of 160 industry and only 35 non-industry representatives.<sup>8</sup> Most of the Committees are industry-**only**. For example, the Regulatory Advisory Committee, whose "primary purpose is to review and provide comment on all major regulatory initiatives and rule proposals **before** they are brought before FINRA's Board of Directors," is composed of one representative from each of FINRA's 11 District Committees.<sup>9</sup> FINRA's District Committees that feed the Regulatory Advisory Committee are entirely composed of FINRA Members who are representatives of industry. The District Committees thus are clearly

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<sup>8</sup> Notice at p. 5.

<sup>9</sup> Notice at p. 5 and p. 9 (emphasis added).

meant to provide only “demographic and geographic diversity of input”<sup>10</sup> to FINRA, not diversity in substance or point of view. FINRA, and the public, would benefit from the substantive diversity of views that non-industry representatives could bring from the same demographic and geographic districts.

Presumably, wherever these FINRA members conduct business, there are investors who are clients of these members who are directly impacted by the products and practices offered by these members, and by the protections afforded by FINRA’s rules and regulatory actions. For example, FINRA District 2 encompasses Southern California, and four of its seven members are from the San Diego area—home to thousands of active and retired military families. Of the four industry representatives from San Diego, two are from the same firm—WBB Securities, LLC. If there is room for two representatives from one firm to serve on a District Committee, then surely FINRA could appoint a current or former investor served by these firms, and receive the benefit of their experience in dealing with the products and practices offered by these financial firms. In particular, FINRA—as FINRA’s predecessor NASD did back in 2006—could benefit by hearing from military families, as “for generations, young members of the military have been targeted for investment products that, while not illegal, are inappropriate for their position in life or, even worse, gouged them with fees and expenses.”<sup>11</sup>

In addition to the Regulatory Advisory Committee, the Notice lists the following Committees that actively impact FINRA’s regulatory and policymaking functions and are comprised exclusively of industry representatives:

- Compliance Advisory Committee – 10 to 15 industry, 0 non-industry;
- Small Firm Advisory Board – 10 small firm industry representatives, 0 non-industry;
- Economic Advisory Committee – 10 “economic and finance experts,” unclear if any of them are non-industry;<sup>12</sup>
- Financial Responsibility Committee – 14 industry representatives, 0 non-industry;
- Fixed Income Committee – 13 industry representatives, 0 non-industry;
- Independent Dealer/Insurance Affiliate Committee – 10 industry, 0 non-industry;
- Membership Committee – 14 to 16 industry “who provide feedback on the impact of proposed regulatory requirements,”<sup>13</sup> and 0 non-industry;
- Operations Advisory Committee – 15 industry representatives who, among other issues, advise FINRA on “global clearance, settlement, and data standards,”<sup>14</sup> 0 non-industry;

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<sup>10</sup> Notice at p. 9.

<sup>11</sup> See “Military Often Targeted by Companies,” <http://www.sandiegouniontribune.com/sdut-military-often-targeted-by-companies-2007may13-story.html>.

<sup>12</sup> Notice at p. 6.

<sup>13</sup> Notice at p. 6.

<sup>14</sup> Notice at p. 7.

- Public Communications Committee – 12 industry representatives who advise FINRA on how member firms communicate with investors, including, ostensibly, how firms market products to investors. This Committee also has 0 non-industry representatives;
- Technology Advisory Committee – 17 industry representatives, 0 non-industry; and
- Uniform Practice Code Committee – 8 industry representatives, 0 non-industry.

Not one of the above 11 Advisory Committees (and at least four *ad hoc* committees not listed above<sup>15</sup>) include investors or non-industry representatives with the appropriate expertise or experience to help ensure that FINRA drafts rules that safeguard investor interests in their quest for financial stability and prosperity. While it is true that investors and non-industry stakeholders have an opportunity to comment on regulatory proposals when FINRA releases them publicly (as described in the Notice),<sup>16</sup> and also when the SEC issues a rulemaking proposal based on the submission the Commission receives from FINRA for public comment, the non-industry stakeholders have had no formal role in identifying, conceptualizing, drafting, revising, and vetting these policies in their formative stages, and they certainly have not had the chance to help shape the proposals before FINRA's Board of Directors considers them. That's when the input matters the most.

The industry and their lobbyists often complain that by the time rulemaking proposals are released for public comment, they are fully “baked” and not subject to significant revision. What the industry fails to say is that they are the ones—as shown in the compositions of the above-noted Advisory Committees—providing the ingredients and the recipes to FINRA, as it aims to “bake” the rules. It is the non-industry and investing public that is afforded but one chance to have an impact on the rules, and that only comes at the end of the process.

FINRA must fix this inequity by including non-industry views on its Advisory Committees. If FINRA needs to expend resources to make it possible for more non-industry participation in the Advisory Committees, then so be it. There is no better use of FINRA's resources than enabling and empowering investors and non-industry representatives to help FINRA craft modern and strong rules that would protect investors and promote market integrity.

### **FINRA Must Amend All Advisory Committee Charters to Expressly State that All Recommendations Must Exclusively Address FINRA's Mission of Investor Protection and Market Integrity**

Because the charters of the Advisory Committees are not public, nor are they, unfortunately, reproduced in the Notice, the governing mandates for these various Committees are unclear. From the descriptions listed in the Notice, it could be reasonably surmised that at least several of these Committees are more interested in catering to the

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<sup>15</sup> For more on FINRA's *ad hoc* advisory committees, see Notice at p. 8.

<sup>16</sup> See Notice pp. 13-15.

parochial needs of their particular segment of the industry than in supporting FINRA in fulfilling its investor protection and market integrity mandate. For example, take the Small Firm Advisory Board: It is unclear exactly what “issues of particular interest and concern” to small firms need to be “more effectively communicated to and considered by the [FINRA] Board.”<sup>17</sup> While we can appreciate that there may be times for FINRA to appropriately tailor its rules and regulatory compliance requirements for small firms, any such request from an Advisory Committee should be filtered through a charter that is focused on investor protection and market integrity.

FINRA, as a regulator Congressionally-charged with protecting investors and promoting market integrity, must be more interested in fulfilling its mission than playing the role of King Solomon for the industry. Every segment of the industry has its own trade associations, and there are multiple umbrella organizations that represent the interests of the industry as a whole. Those venues would be more appropriate for settling industry squabbles than FINRA’s Advisory Committees. Therefore, FINRA must amend the charters of all of its Advisory Committees to expressly state that all recommendations of such committees must support FINRA’s mission of investor protection and market integrity.

## **CONCLUSION**

We hope our comment letter will help FINRA’s staff and its Board of Directors as it considers enhancing its engagement programs. FINRA, today, has no lack of input from the industry; indeed, it has too much. What FINRA lacks in its Advisory Committees—as shown above—is fair representation by investors and non-industry representatives. FINRA also needs to fundamentally change the amount of information and transparency it provides with regards to these engagement programs, and specifically, about the composition, activities, and recommendations of the Advisory Committees. And, finally, FINRA needs to amend the charters of its Advisory Committees so that recommendations emanating from these Committees will be ultimately focused on enhancing investor protection and market integrity. Without these reforms, FINRA will continue to suffer from an erosion in its independence, impartiality, objectivity, and public-interest orientation as it aims to fulfill its mission of investor protection and promotion of market integrity.

Sincerely,



Dennis M. Kelleher  
President & CEO

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<sup>17</sup> Notice at p. 5.

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