The “What to Expect” Webcast Series

Rulemaking Process

This is another installment in our “What to Expect” webcast series on FINRA’s regulatory processes. In this one, our focus is on the rulemaking process.

While we believe that regulation can always be improved, improvements do not always mean more rules or requirements. We have a range of options to choose from, including best practices, guidance, education and task forces. But, whether a change involves a rule or guidance, your participation is crucial to the process. That’s why we listen closely to firms and strongly encourage industry input on nearly every potential rule proposal.

In this webcast, we will explain what you should expect from us, what we expect from you and how you can get involved.

We hope you find this webcast helpful and that it takes some of the mystery out of FINRA’s rulemaking process.

FINRA™
Financial Industry Regulatory Authority

Overview

The rulemaking process follows some standard procedures with opportunities for firm involvement.

Generally, unless a legal exception exists, there is a public comment period after the SEC publishes a rule proposal in the *Federal Register*. There may also be subsequent comment periods if there are material amendments in response to comments which would need to be republished.

FINRA’s general process is to publish a proposed rule for comment in a *Regulatory Notice* before filing it with the SEC. Sometimes, however, FINRA does not do this first round of publication. This is because a proposed rule change may be technical or not material, or because FINRA determines that time is of the essence for the proposed rule change.

FINRA is responsible for developing rules that govern the conduct of the US securities industry in areas as diverse as sales practices, advertising, transactions with customers, marketplace rules and corporate finance.

The process for rule development is a participatory one with broad input from industry members, trade associations, other regulators and the public. This happens through the comment process, other informal consultations and through FINRA’s standing industry committees.

As a start, it is helpful to understand FINRA itself. FINRA’s history began in the 1930s, when the securities industry tried different approaches to self-regulation. In 1938, the Maloney Act added section 15A to the Securities Exchange Act of 1934 to allow for regulation of over-the-counter markets through self-regulated organizations. As a result, the National Association of Securities Dealers (NASD) was established in 1939. In the summer of 2007, NASD and NYSE member regulation combined to become FINRA. In general, all of FINRA’s new rules require SEC approval before they become final under the Exchange Act.

The Rulemaking Process

New rule proposals come from a number of sources. Some are ideas that member firms, investors and other interested parties suggest. Others are FINRA-initiated rule proposals based on proactive analysis of data and trends. Rule proposals may also be based on recommendations from the SEC or other regulators. They can also come from FINRA advisory and standing committees, which are comprised of industry representatives. These include our Advisory Council, the Small Firm Advisory Board, subject-matter expert committees like the Independent Dealer/Insurance Affiliate Committee and the Variable Insurance Product Committee, and geographically-based district committees. FINRA maintains these committees to provide feedback in a variety of areas including rulemaking.

Once an idea for a possible rule proposal is identified, the FINRA subject-matter experts research and develop it. A working draft or overview is then presented to FINRA management for review. The proposal is then typically presented at FINRA’s standing and District committee meetings that are conducted while a proposal is being considered. Following review by various FINRA committees, all rule proposals are presented to the Small Firm Advisory Board. That group exists to ensure that issues of particular interest and concern to small firms are effectively communicated to and considered by the FINRA Board of Governors.

Once this review is complete, FINRA staff considers any comments and prepares a presentation to the FINRA Board of Governors. That document describes the rule proposal along with its purpose and background, as well as the views of the Small Firm Advisory Board and the standing committees that considered the matter.

The Board of Governors consists of a mix of elected industry representatives, appointed members representing both the industry and the public, and includes both FINRA’s Chief Executive Officer and non-executive Chairman. Depending on the details of the rule proposal, the Board of Governors may authorize the publication of a *Regulatory Notice* to solicit comment on the proposal from firms and the public. The Board may also authorize direct filing of the proposal with the SEC.

If comments are requested, FINRA will notify firms through FINRA’s Weekly Update email and on finra.org. FINRA often asks firms to comment to help shape rules with greater precision and to ensure consideration of the operational impact of implementing the proposal.

Some believe that once FINRA publishes a rule proposal for comment in a *Regulatory Notice*, the rule is essential final. This is not the case. Whether FINRA issues the *Regulatory Notices*, or if comment is sought for the first time in the *Federal Register* after filing with the SEC, FINRA asks for comments that help identify or improve any problems that might exist in the proposal. This is a firm’s opportunity to get involved in the rulemaking process and make their voice heard. And, there is a long history that shows rule proposals do, in fact, change as a result of such comments.

When FINRA issues a *Regulatory Notice* soliciting comment on a rule proposal, the comment period typically is open for one to two months. FINRA accepts comments by hard copy or electronically. All comments become part of the rule proposal’s “official record” and are posted on FINRA’s Web site.

Depending on the comments, and whether any significant changes are being made, FINRA staff will either return to the Board with a revised proposal or file the proposal with the SEC. In certain cases, the comment process has persuaded FINRA to conclude that the proposed rule was not the best course of action and decide not to pursue the proposal.

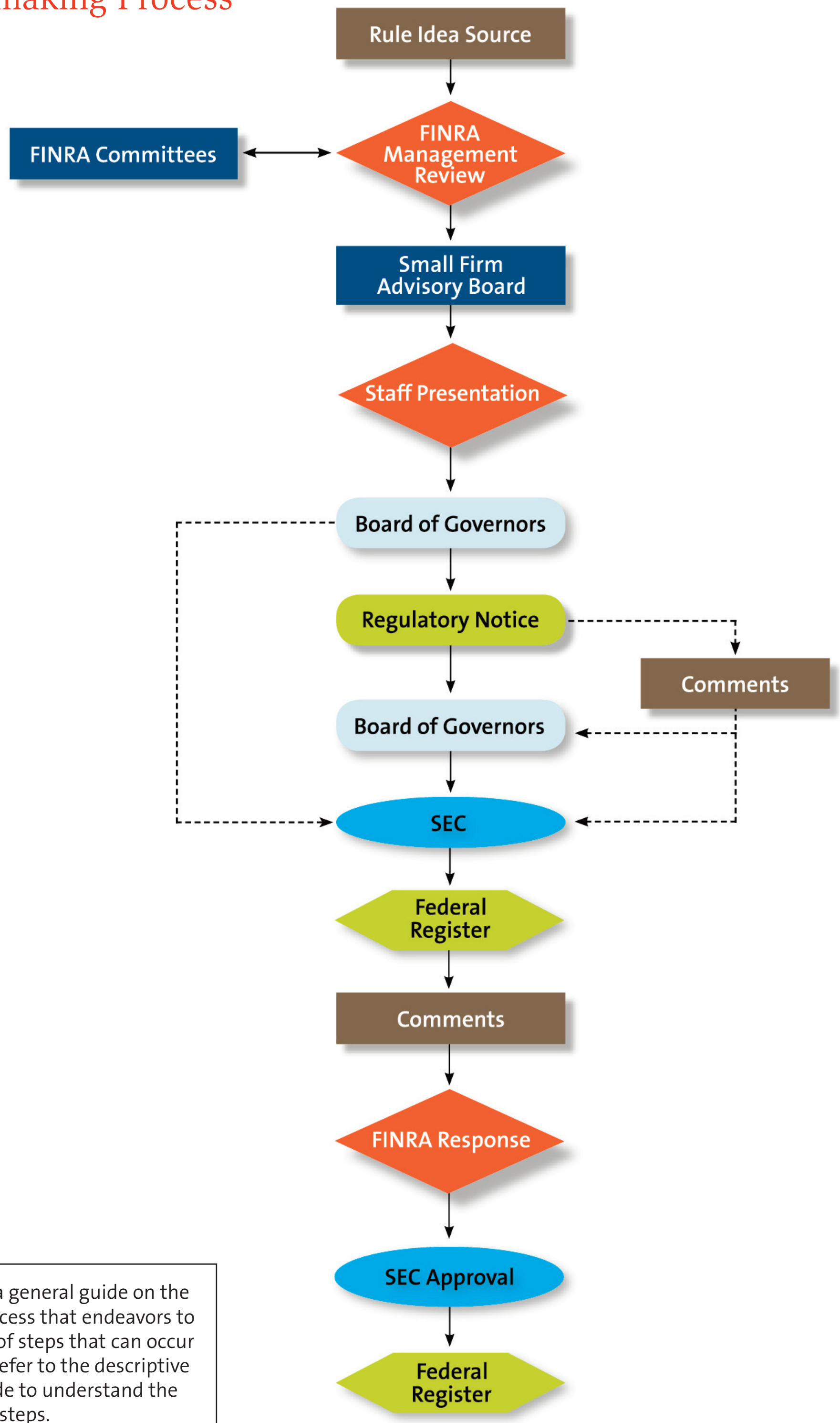
When FINRA pursues a rule proposal, it is filed with the SEC and posted on FINRA’s Web site within two business days after filing. Once filed, SEC staff reviews the rule proposal to determine whether it is consistent with the requirements of the Securities Exchange Act of 1934. During this process, SEC staff will often confer with FINRA. As a result, FINRA staff may determine to make subsequent modifications to the rule proposal.

After the SEC receives the rule proposal, the next step in the rule process is to publish the proposal for comment in the *Federal Register*. Generally, the comment period is open for 21 days following the publication date. In certain limited instances, the SEC may grant accelerated approval to a proposal. Also, in some limited situations specified in the Exchange Act, FINRA may file the rule for immediate effectiveness. The SEC has 60 days to consider whether a rule change filed for immediate effectiveness should be canceled or allowed to remain in effect.

Depending on the types of comments received, SEC staff typically requests a FINRA response. As a result, FINRA may decide to propose amendments to the rule proposal. Depending on the changes, the SEC may also choose to republish the revised rule proposal for comment in the *Federal Register*. If the SEC approves the final rule, it places an official announcement in the *Federal Register*. After that, FINRA issues a *Regulatory Notice* announcing SEC approval of the rule, which also summarizes the new rule or rule amendments, includes the rule text and announces the effective date. In many cases, the effective date will be a set number of days following publication of the *Notice*.

FINRA monitors the implementation of significant new rules to determine if they are working as anticipated. This rule review is a proactive way of determining if the research and industry collaboration on a rule’s development is producing the desired results. If it is not, then FINRA revisits the rule. If it is producing the desired results, it will stay in effect until a regulatory need arises to change or rescind it.

The Rulemaking Process



This graphic is a general guide on the rulemaking process that endeavors to show a variety of steps that can occur with it. Please refer to the descriptive text of this guide to understand the nuances of the steps.

Remember that firms have opportunities to share their views during the rulemaking process. Please know that comments are both welcomed and encouraged. To submit comments during the FINRA comment period, please send them by mail or email to FINRA’s Office of the Corporate Secretary. All comments are then posted to FINRA’s public web site.

For more information on rulemaking, take advantage of the following resources.

RESOURCES:

FINRA Rulemaking Process

http://www.finra.org/RulesRegulation/RuleFilings/p012774

FINRA Rule Filing Information

http://www.finra.org/RulesRegulation/RuleFilings/index.htm

15 USC 78s(b)(1)

http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=browse_usc&docid=Cite:+15USC78s

SEC Rule 19b-4

http://a257.g.akamaitech.net/7/257/2422/03jul20071500/edocket.access.gpo.gov/cfr_2007/aprqtr/pdf/17cfr240.19b-4.pdf