

Regulatory Notice

16-27

NAC Composition

FINRA Announces Changes Relating to Composition, Terms of Members and Election Procedures for the National Adjudicatory Council

Effective Date: August 11, 2016

Executive Summary

The SEC has approved FINRA's proposed rule change to amend the By-Laws of FINRA Regulation, Inc. (FINRA Regulation By-Laws) to expand the size of the National Adjudicatory Council (NAC) by one member and apply the requirement that the NAC have more Non-Industry Members than Industry Members, lengthen the terms of future NAC members by one year, and update the process used for sending and counting ballots in the event of a contested election to fill vacancies for certain Industry Members.

The revised FINRA Regulation By-Laws are available on FINRA's website. They take effect on August 11, 2016.

Questions concerning this *Notice* should be directed to:

- ▶ Alan Lawhead, Vice President and Director – Appellate Group, Office of General Counsel (OGC) at (202) 728-8853 or Alan.Lawhead@finra.org; or
- ▶ Gary Dernelle, Associate General Counsel, OGC, at (202) 728-8255 or Gary.Dernelle@finra.org.

Background & Discussion

The NAC acts on behalf of FINRA in several capacities. The NAC presides over disciplinary matters appealed to or called for review by the NAC. The NAC also acts, when requested, in statutory disqualification and membership proceedings; considers the appeals of members seeking exemptive relief; and retains the authority to review decisions proposed in other proceedings as set forth in the Code of Procedure. For most matters, the NAC prepares a proposed written decision, which becomes final FINRA action if the Board of Governors of FINRA (FINRA Board) does not call the matter for review.

August 2016

Notice Type

- ▶ Rule Amendment

Suggested Routing

- ▶ Compliance
- ▶ Executive Representatives
- ▶ Legal
- ▶ Registered Representatives
- ▶ Senior Management

Key Topics

- ▶ National Adjudicatory Council

Referenced Rules & Notices

- ▶ FINRA Regulation By-Laws

The NAC is currently composed of 14 members, with the number of Non-Industry Members equaling the number of Industry Members. The seven Industry Members include two Small Firm NAC Members, one Mid-Size Firm NAC Member, two Large Firm NAC Members and two at-large Industry Members.

The FINRA Board currently appoints NAC members to serve staggered three-year terms. The FINRA Board appoints Non-Industry Members and at-large Industry Members from candidates recommended by the Nominating Committee. The FINRA Board also appoints Small Firm, Mid-Size Firm and Large Firm NAC Members, either from candidates recommended by the Nominating Committee, or in the event of a contested election for a Small Firm, Mid-Size Firm or Large Firm NAC Member vacancy, the candidate who wins an election in which FINRA members have an opportunity to vote directly for a candidate based on firm size.

Changes to NAC Composition, Member Terms and Election Process

On June 17, 2016, the Securities and Exchange Commission approved a proposed rule change to amend the FINRA Regulation By-Laws in three principal ways.¹ First, the rule change amends Section 5.2 of the FINRA Regulation By-Laws to expand the size of the NAC to 15 members and apply the requirement that the NAC have more Non-Industry Members than Industry Members. Accordingly, FINRA will add one Non-Industry Member to the current 14-member committee and align its composition more closely with that of the FINRA Board, which must have more Public Governors than Industry Governors.

Second, the rule change amends Section 5.6 of the FINRA Regulation By-Laws to extend by one year, to four total years, the terms of new NAC members.² The result is a NAC that is divided into four classes, rather than the current three, which allows FINRA to utilize the skills, expertise and institutional knowledge of each NAC member for an additional year.³

Finally, the rule change amends Section 6.7 of the FINRA Regulation By-Laws to allow FINRA members to vote in NAC elections by using online and telephonic methods in addition to paper ballots. The rule change also amends Section 6.10 of the FINRA Regulation By-Laws by eliminating the provision that permits NAC candidates to observe the Independent Agent's accounting of ballots in contested NAC elections, thus expediting the accounting process and permitting the Secretary of FINRA to notify the candidates more quickly of NAC election results. The changes streamline the NAC election process and align it with the current process for elections involving the FINRA District Committees.

Endnotes

1. See Securities Exchange Act Release No. 78094 (June 17, 2016), 81 FR 40932 (June 23, 2016) (Order Approving Proposed Rule Change Relating to Composition, Terms of Members and Election Procedures for the National Adjudicatory Council; File No. SR-FINRA-2016-14).
2. The rule change does not alter or extend the term of any NAC member serving currently; the rule change is applied prospectively.
3. The rule change provides a three-year transitional period during which the FINRA Board may appoint new NAC members to terms of office less than four years to achieve the staggering necessary to divide the NAC into four classes. FINRA anticipates that, beginning in January 2017, and ending in December 2019, new NAC members shall be appointed to terms of either three years or four years to achieve the result of a NAC that is divided into four classes, with each NAC member serving a term of four years.