

Alerts

## SIFMA Chief Legal Counsel Provides Insight into new FINRA Procedures

Related Attorneys

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Robert Colby, the chief legal counsel for SIFMA, provided insight into several new FINRA approaches in addressing its self regulatory responsibility during the monthly SIFMA luncheon meeting in New York City on September 25. FINRA's designation as a self regulatory organization (SRO) may be somewhat of a misnomer, as Mr. Colby pointed out, since the majority of the members of FINRA's Board of Directors are public members as opposed to industry members.

Four areas in which FINRA is developing new approaches to its regulatory responsibility are:

1. Examining the motivation of business conduct and developing rules to either encourage or discourage particular conduct;
2. Examining the economic impact of its rules;
3. Finding narrow regulatory schemes to particular entities;
4. Cooperative planning with other SROs regarding markets.

An example of the process that FINRA is using to examine the motivation of business conduct can be found by looking at how firms handle conflicts. FINRA issued a targeted examination letter to 12 selected member firms requesting information about how they identify and manage conflicts. The letter requested a summary of the most significant conflicts the firms are currently managing. Mr. Colby suggested that incentives may contribute to conflicts, as people are motivated by monetary rewards. FINRA Regulatory Notice 12-09 proposed that members establish, maintain and enforce policies and procedures reasonably designed to identify and manage conflicts of interest related to the preparation and distribution of debt research reports.

Mr. Colby noted that some guidance may be found in examining how other countries treat conflicts. Written conflict procedures are employed in a number of other countries. Often the procedures address how conflicts are identified, managed, avoided, and disclosed, as well as the timing of the disclosure. However, some conflicts cannot be resolved, and accordingly the conduct is banned. An example of banned conduct is receiving payment from third parties.

FINRA is also attempting to understand the economic impact of its rules. The SEC is required to evaluate the economic impact of each rule it adopts. The SEC wants SROs to better support their proposed rules so that they do not have to start from scratch when conducting an economic impact review. However, Mr. Colby noted that trying to appreciate the benefits of a proposed rule may be more difficult than the actual analysis of costs associated with the proposed rule. He also noted that the debt research proposal, Regulatory Notice 12-09, requested comments on a revised debt research conflicts-of-interest proposal. A number of the comments provided suggested that the proposal does not treat institutions appropriately, and that institutions are not providing their sophisticated members with certifications for the purpose of opting out of retail customer treatment. FINRA intends to issue another notice dealing with the debt research proposal.

One example of FINRA developing narrow regulations of specific entities is crowd funding portals, which are required to be members of an SRO, but do not need to be registered as broker-dealers. FINRA is reviewing its current rules to determine if any are applicable to portals.

Finally, SROs are working together to develop a consolidated audit trail (CAT). Initially, the CAT will affect equities and options. It will then be expanded to cover other products such as debt and IPOs. A CAT can include requirements for time entry and unique customer ID numbers (including retail customers) for every order.