

REGULATION INTEGRATION

NYSE Member-Firm Regulation and the NASD combine to form the Financial Industry Regulatory Authority.

BY JEANNE COTRONEO DARROW

SELF-REGULATION OF THE U.S. FINANCIAL MARKETS took a significant step forward this summer when the NASD combined with the member-firm-regulation operations of NYSE Regulation, the not-for-profit regulatory subsidiary of **NYSE Euronext** (NYSE). The merger formed the Financial Industry Regulatory Authority (FINRA), now the largest non-governmental regulatory organization for brokers and dealers doing business in the U.S.

“With investor protection and market integrity our overarching objectives, FINRA is a streamlined regulator better suited to the complexity and competitiveness of today’s global capital markets,” says FINRA CEO Mary Schapiro. Adds FINRA Non-Executive Chairman Richard Ketchum: “Our goal with this consolidation is to ensure that everyone is subject to the same rules, requirements and interpretations, and that by eliminating duplication, we’re able to expand our reach and more efficiently use resources to protect investors.”

FINRA touches virtually every aspect of the securities business — from registering and educating industry participants to informing and educating the investing public to providing trade reporting and other industry utilities. It is responsible not only for adopting and interpreting rules that govern the participation of broker-dealers in the equity and corporate debt markets but also for ensuring that broker-dealer firms meet the financial, operational and sales-practice rules set forth by the SEC and FINRA. It also provides enforcement and discipline when those rules are violated, administers the largest dispute resolution forum for investors and registered firms and handles all of NASD’s previous functions, including market regulation under contract for the Nasdaq, the American Stock Exchange and the International Securities Exchange. The merger brought 470 staffers onboard from NYSE Regulation, bringing FINRA’s total employee count to 3,000.

To uphold its independence, the majority of FINRA’s board of governors are not affiliated with the securities industry or any one market. FINRA and NYSE Regulation participate equally in nominating governors. “With its proper balance of public and industry representatives, the board will represent the wide-ranging interests of investors everywhere,” says Ketchum. Another factor to ensure FINRA’s independence is that the SEC’s oversight “is still every bit as intense as it was before the merger,” adds Schapiro.

Although the NASD and NYSE Regulation historically have coordinated and cooperated with each other, the time for the union had come, explains Schapiro, who previously was NASD’s chairman and CEO. “The idea of combining our regulation functions, a topic of conversation for many years, became particularly compelling recently as we focused more on competitiveness and efficiency during a time of greater trading fragmentation,” she says. “The ability to leverage our respective strengths and expertise with a more coherent and cohesive approach just makes so much sense.”

WHO BENEFITS

The integration immediately benefits the large brokerage firms that faced dual oversight by the NASD and NYSE Regulation. By fielding a single coordinated exam team, combining technology and unifying rules, FINRA hopes to lower the cost of broker examinations. “It didn’t make sense for the world’s largest brokerage firms to be subject to two rule books that sometimes conflicted, two teams of examiners and two potential enforcement referrals,” says Schapiro.

FINRA has committed to substantially consolidating the two rule books within a year. In fact, the SEC is already considering a plan submitted by the two regulatory groups in February to eliminate rule differences.

BY THE NUMBERS

» FINRA oversees...

5,100 BROKERAGE FIRMS

173,000 BRANCH OFFICES

665,000 REGISTERED REPS

» FINRA each year handles...

7,500 COMPLIANCE EXAMINATIONS

7,000 ARBITRATION DISPUTES

1,400 DISCIPLINARY ACTIONS

But the ultimate beneficiaries of the merger are investors. “Having one regulator with a consolidated view of what’s happening in each and every broker dealer works very much to the benefit of investors,” says Schapiro, who notes

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— MARY SCHAPIRO, FINRA CEO

that she is delighted to again be working with Ketchum. (The two were colleagues at the SEC in the late 1980s and later at the NASD in the 1990s.) Ketchum elaborates: “An environment that’s clearer and that uses regulatory resources most efficiently to protect investors should give them confidence about their dealings with their brokerage firms.”

Meanwhile, issuers likely won’t notice much difference, because the listings-compliance function remains at the NYSE. NYSE Regulation — which remains separate from the New York Stock Exchange through its own majority independent board of directors — continues to oversee trading at NYSE and NYSE Arca as well as to ensure that listed companies continue to comply with those markets’ financial and corporate-governance standards. “By retaining market surveillance we ensure that both on-floor and off-floor participants operate in a way that absolutely provides for marketplace integrity,” says Ketchum, who remains CEO of NYSE Regulation. Still, he adds, issuers benefit from the increased investor confidence that results from the more coordinated, efficient and effective regulatory oversight.

GLOBAL IMPACT

Beyond that, Schapiro and Ketchum agree that the combination boosts the competitiveness of the U.S. capital markets. For one, it improves the U.S. marketplace’s ability to coordinate with non-U.S. regulators. “Foreign

regulators now have to deal with only one U.S. member-firm self-regulator,” says Schapiro. Adds Ketchum: “Eliminating duplication reduces compliance costs and therefore provides an additional ounce of competitiveness.”

Given the global amalgamation among market operators and growing investor interest in foreign stocks, Schapiro and Ketchum anticipate further regulatory cooperation worldwide. “Our financial industry is global, and our valued corporate issuers are global, so it is only logical that in a short period steps will be

benefiting from their good relations with regulators of each country in which NYSE Euronext operates. It’s important over time to have that communication with other major exchanges and regulators in Europe and Asia.”

Schapiro refers to three recent reports that examine U.S. capital-market and financial-industry competitiveness: the Schumert-Bloomberg report, the “Paulson Committee Report” and one by a commission established by the U.S. Chamber of Commerce. “Fairly or unfairly, they all point to this spaghetti bowl



CEO MARY SCHAPIRO AND CHAIRMAN RICHARD KETCHUM SIGN THE MERGER AGREEMENT ON JULY 30, CREATING FINRA.

taken to enable more fluid international markets with integrated regulatory oversight,” notes Ketchum, who also chairs the World Federation of Exchanges’ regulatory committee, which aims to enhance communication and cooperation between markets and regulators. “Markets will have to move to a regulatory environment in which we’re not only cooperating with enforcement investigations but exchanging alerts and indications of potential cross-border manipulative activity and insider trading.”

Ketchum points out that progress is already under way: “We’re working closely with our regulatory colleagues at Euronext and are

of regulatory agencies overseeing U.S. financial services,” she says. “I’m not saying all that regulation isn’t necessary, but that it does come with a cost. And where it can be streamlined, it will certainly contribute to U.S. competitiveness and the attractiveness of our capital markets. With this merger, we’ve taken one small step toward a more efficient capital market regulatory structure.”

This article includes information that may constitute “forward-looking statements,” as it is based on current expectations and assumptions that are subject to risks and uncertainties. Please refer to the complete text of the Cautionary Note on page 3 for further information on factors that could cause actual results to differ materially from forward-looking statements.