

*FINRA Governance Review:
Public Governors Should Protect the Public Interest*

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Acknowledgements²

Introduction

The Financial Industry Regulatory Authority (FINRA) plays a vital role in regulating the securities industry. In public materials, FINRA describes itself as “an independent, not-for-profit organization authorized by Congress to protect America’s investors by making sure the securities industry operates fairly and honestly.”³ It also claims to be “dedicated to investor protection and market integrity through effective and efficient regulation of broker-dealers.”⁴ Its stated mission is “to provide investor protection and promote market integrity.”⁵

Although it characterizes itself as “independent,” FINRA’s current governance structure allows the securities industry to exert substantial control over FINRA’s operations. FINRA’s governing board contains 13 Public Governors, 10 Industry Governors, and one seat for its Chief Executive Officer.⁶ FINRA’s by-laws state that its Public Governors may

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³ About FINRA, FINRA, <http://www.finra.org/about> (last visited Oct. 9, 2017).

⁴ *Id.*

⁵ FINRA, Our Mission, <https://www.finra.org/about/our-mission> (last visited Oct. 30, 2017).

⁶ See FINRA, FINRA Board of Governors, <http://www.finra.org/about/finra-board-governors>, (last visited Oct. 24, 2017) (“FINRA’s Board is currently composed of 24 industry and public members, with 10 seats designated for industry members, 13 seats designated for public members and one seat reserved for FINRA’s Chief Executive Officer”).

have no “material business relationship with a broker or dealer or [other] self-regulatory organization.”⁷

The inclusion of Public Governors on the governing board is intended to give the investing public representation and influence in FINRA’s governance.⁸ With 10 governing board seats given to the industry, specifically, FINRA member-firms, the securities industry is more than adequately represented on FINRA’s board. FINRA’s efficacy and legitimacy as an investor protection organization requires the inclusion of Public Governors with a demonstrated commitment to investor protection.

Our review of FINRA’s current and recently departed Public Governors reveal significant conflicts and concerns. Rather than having a “public” (*i.e.*, customer-oriented) bent, FINRA’s Public Governors often provide additional representation for securities industry constituencies. In many instances, FINRA’s Public Governors join the board after long careers in the securities industry. Although some academics and former regulators do serve on FINRA’s board as Public Governors, the Board only infrequently includes persons primarily identified as investor protection advocates. This absence is troubling for an organization that publicly characterizes itself as dedicated to investor protection.

The composition of FINRA’s Board of Governors matters because it makes significant policy decisions that shape the industry and influences the costs the public pays for financial services as well as the protections investors enjoy. Although the public pays transaction costs, these costs create revenues for FINRA’s member firms. This financial dynamic creates the perception, if not the reality, that FINRA is slow to support changes that reduce costs for public investors or increase protections for investors at the expense of industry profits.⁹

This Report examines the extent to which FINRA’s governance structure and selected “public” representatives embody its stated commitment to investor protection. This Report focuses on FINRA’s Board of Governors because FINRA’s governance rarely receives attention and its Board of Governors wields substantial power.¹⁰ Given the

⁷ FINRA, BY-LAWS OF THE CORPORATION ART. I, § tt.

⁸ See CSPAN, Senator Cortez Masto on FINRA Conflicts, July 27, 2017, <https://www.c-span.org/video/?c4678228/senator-cortez-masto-finra-conflicts> (discussing how Public Governor seats are intended to represent the investing public).

⁹ See Susan Antilla, Finance Execs Fill 'Public' Board Seats at Finra, the Regulator that Promises Investor Protection, THE STREET, Aug. 26, 2016, <https://www.thestreet.com/story/13684706/1/finance-execs-fill-public-board-seats-at-finra-the-regulator-that-promises-investor-protection.html> (“if you’re wondering why things don’t always turn out so well for Mom and Pop when they entrust money to a broker, you might ponder the balance of power on Finra’s board”); see also Mark Schoeff Jr. & Bruce Kelly, Finra: Who’s watching the watchdog?, InvestmentNews, Sept. 2, 2017, <http://www.investmentnews.com/article/20170902/FEATURE/170909996> (quoting Barbara Roper as explaining that “They operate in a difficult environment . . . Their incentives for doing anything groundbreaking to advance a pro-investor agenda are non-existent.”).

¹⁰ See Jonathan Macey & Caroline Novogrod, *Enforcing Self-Regulatory Organization's Penalties and the Nature of Self-Regulation*, 40 HOFSTRA L. REV. 963 (2012) (“Few issues are as poorly understood and under-theorized as the concept of ‘industry self-regulation.’”); Andrew F. Tuch, *The Self-Regulation of*

concerns we identified with FINRA’s existing (or recently departed) Public Governors, this Report proposes governance changes as well as an alternative slate of Public Governors that FINRA should draw upon to increase board independence and advance its stated investor protection goals. We also believe that FINRA would earn substantial goodwill and increase its credibility by continuing to increase transparency into its governance processes.¹¹

The Governance Constraint on Industry Self-Regulation

The Securities and Exchange Commission (SEC) has long recognized “the inherent potential for self-regulation to favor the interests of the securities industry over those of the investing public.”¹² Financial self-regulatory organizations, such as FINRA, pose unique risks because they wield delegated governmental authority without all of the restraints that normally accompany the exercise of state power. To check the risk that the securities industry’s self-regulator will behave like a cartel and prioritize industry over public interests, FINRA’s governance documents require the appointment of a majority of Public Governors.¹³ If FINRA appoints insufficiently independent Public Governors, FINRA’s key investor protection mission suffers.

Background: FINRA Emerges as a Quasi-Governmental Regulator

In 2007, the regulatory arm of the New York Stock Exchange (NYSE) and the National Association of Securities Dealers (NASD) merged to create FINRA.¹⁴ FINRA is the nation’s largest securities regulator and has responsibility for overseeing the nation’s brokerage firms. FINRA also plays a critical investor protection role for retail investors.¹⁵

Investment Bankers, 83 GEO. WASH. L. REV. 101, 105 (2014) (explaining that FINRA’s “self-regulation of investment bankers has thus far attracted scant scholarly attention”); Saule T. Omarova, *Wall Street As Community of Fate: Toward Financial Industry Self-Regulation*, 159 U. PA. L. REV. 411, 414-15 (2011) (“what is conspicuously absent from the . . . broader debate among academics and policy-makers, is a meaningful discussion of the role and shape of industry self-regulation in the emerging postcrisis regulatory order”).

¹¹*C.f.* Thayla Knight, Transparency and Accountability at the SEC and at FINRA, Heritage Foundation (Feb. 28, 2017), <http://www.heritage.org/markets-and-finance/report/transparency-and-accountability-the-sec-and-finra> (“Neither fish nor fowl, it straddles the line between government and private entity, in many instances taking the worst from both worlds and offering a considerable lack of transparency and accountability overall”).

¹² See SEC, Report Pursuant to Section 21(a) of the Securities Exchange Act of 1934 7 (1996), <https://www.sec.gov/litigation/investreport/nd21a-report.txt> [hereinafter SEC, 21A Report].

¹³ See JOHN C. COFFEE ET AL., SECURITIES REGULATION: CASES AND MATERIALS 692 (13th ed. 2015) (“A special study conducted under William Cary, President Kennedy’s chair of the SEC, found that industry self-regulation consistently had been self-interested and self-protective, often failing to produce standards of conduct superior to those that existed before the enactment of the securities laws”).

¹⁴ The consolidation was intended to “streamline the broker-dealer regulatory system, combine technologies, and permit the establishment of a single set of rules and [a single set of] examiners with complementary areas of expertise [within] a single [SRO].” Self-Regulatory Organizations, Exchange Act Release No. 55,495, 2007 WL 1260858, at *9 (Mar. 20, 2007).

¹⁵ See Barbara Black, *Punishing Bad Brokers: Self-Regulation and Finra Sanctions*, 8 BROOK. J. CORP. FIN. & COM. L. 23 (2013) (explaining that FINRA “plays an important role in protecting investors,

FINRA straddles the line between a public and private entity. Although FINRA officially remains a private, not-for-profit corporation, it exercises governmental power that has been delegated to it in securities regulation.¹⁶ Because of its use of government power and unique role, debates have emerged over whether it should be classified as a state actor.¹⁷ It plays such an essential role that courts have referred to it as a “quasi-governmental agency.”¹⁸

The Inclusion of Public Governors

After past crises, scandals, and governance failures, financial self-regulatory organizations agreed to include public representatives on their boards. The inclusion of public members on the governing board of financial self-regulatory organizations began during the Great Depression. At that time, the NYSE voted to add three “public” members to its thirty-person board, putting the first purportedly public representatives in place.¹⁹ The Maloney Act later authorized broker-dealer firms to create their own self-regulatory organization modeled on the NYSE. The NASD similarly agreed to appoint a majority of “non-industry” representatives in response to the odd-eights scandal.²⁰ In the odd-eights affair, academics pieced together that FINRA members had colluded to increase trading spreads and industry-wide profits.²¹ Afterward, it emerged that FINRA’s precursor, the NASD, had done nothing to protect the public despite knowing about the “facts and circumstances” of the behavior for a substantial time.²² At the time, the SEC acknowledged that “[w]hile self-regulation benefits from the knowledge, insight, and expertise brought by industry participants, it must give primacy to the

especially retail investors, and bolstering investor confidence in the securities industry and capital markets”).

¹⁶ See S. REP. 94-75, 23, 1975 U.S.C.C.A.N. 179, 201 (“Industry organizations, i.e., the exchanges and the NASD, are delegated governmental power in order to enforce, at their own initiative, compliance by members of the industry with both the legal requirements laid down in the Exchange Act and ethical standards going beyond those requirements.”); Jennifer M. Pacella, *If the Shoe of the SEC Doesn't Fit: Self-Regulatory Organizations and Absolute Immunity*, 58 WAYNE L. REV. 201, 202 (2012) (“SROs carry out quasi-governmental functions as delegates of the SEC”).

¹⁷ See William A. Birdthistle & M. Todd Henderson, *Becoming A Fifth Branch*, 99 CORNELL L. REV. 1, 13 (2013) (pointing out that a debate has emerged over whether self-regulatory organizations have become “quasi-governmental organizations”).

¹⁸ See, e.g., *Nat'l Ass'n of Sec. Dealers, Inc. v. S.E.C.*, 431 F.3d 803, 804 (D.C. Cir. 2005) (explaining that FINRA’s precursor “serve[d] as a quasi-governmental agency, with express statutory authority to adjudicate actions against members who are accused of illegal securities practices and to sanction members found to have violated the Exchange Act or [SEC] regulations issued pursuant thereto”).

¹⁹ See WILLIAM O. DOUGLAS, *GO EAST, YOUNG MAN: THE EARLY YEARS: THE AUTOBIOGRAPHY OF WILLIAM O. DOUGLAS* 291 (1974) (claiming that the self-regulating exchanges had become “modern Augean stables . . . fighting for opportunities to exploit the unsuspecting public”).

²⁰ SEC, 21A Report (After the odd-eights scandal, it emerged that industry members had “engaged in a variety of abusive practices to suppress competition and mislead customers” and that the NASD had done nothing about it despite knowing the “facts and circumstances” for a substantial time”).

²¹ See generally William G. Christie & Paul H. Schultz, *Why Do NASDAQ Market Makers Avoid Odd-Eighth Quotes?*, 49 J. Fin. 1813 (1994).

²² SEC, 21A Report, *supra* note 12, at 1 (“The NASD failed over a period of time to conduct an appropriate inquiry into an anticompetitive pricing convention among Nasdaq market makers, even though the NASD knew of facts and circumstances evidencing such matters by 1990”).

fundamental purpose of regulation of the securities markets: the protection of investors and the public interest.”²³ The stated commitment to including public governors continued when the NYSE and NASD merged to create FINRA.²⁴

If they are not conflicted and are truly looking to protect investors, Public Governors would play a key role on FINRA’s board and provide a check against the ever-present danger of industry domination. But, to achieve this goal, a public representative must have actual independence and a true public-interest orientation. If, however, public representatives share the same perspectives, beliefs, and biases as industry members, they may represent the public’s interest with less vigor.²⁵ At worst, industry-aligned public representatives provide only a veneer of investor protection, cloaking industry control over a purportedly independent board.

The Appointment Process and Requirements for Public Governors

The FINRA Board of Governors selects Public Governors “from candidates recommended to the Board by the Nominating Committee.”²⁶ Under the by-laws, the “number of Public Governors on the Nominating Committee shall equal or exceed the number of Industry Governors on the Nominating Committee.”²⁷ Because of this structure, a single industry-aligned Public Governor on the Nominating Committee may amplify the industry’s influence over the Public Governor nominating process.²⁸

FINRA’s by-laws provide few limitations on who may serve as a Public Governor. Its by-laws define Public Governors as:

any Governor or committee member who is not the Chief Executive Officer of the Corporation . . . who is not an Industry Governor and who otherwise has no material business relationship with a broker or dealer or a self regulatory organization registered under the Act (other than serving as a public director of such a self regulatory organization).²⁹

FINRA’s limited “no material business relationship” test for public governors may fail to capture other significant bias-producing conflicts of interest for its Public Governors.

²³ *Id.* at 51.

²⁴ See Self-Regulatory Organizations; Nat’l Ass’n of Sec. Dealers, Inc.; Order Approving Proposed Rule Change to Amend the by-Laws of Nasd to Implement Governance & Related Changes to Accommodate the Consolidation of the Member Firm Regulatory Functions of Nasd & Nyse Regulation, Inc., Release No. 56145, 2007 WL 5185330, *2 n 13 (July 26, 2007) (“A “Public Governor” means any Governor who is not the Chief Executive Officer of the New SRO or, during the Transitional Period, the CEO of NYSE Regulation, who is not an Industry Governor (as defined below) and who otherwise has no material business relationship with a broker or dealer or an SRO registered under the Exchange Act, other than as a public director of such an SRO.”).

²⁵ See Steven Davidoff Solomon, *The Government's Elite and Regulatory Capture*, N.Y. TIMES (June 11, 2010), <http://dealbook.nytimes.com/2010/06/11/the-governments-elite-and-regulatory-capture> (explaining that ideological capture occurs when regulators “share the same beliefs and ideas as their industry”).

²⁶ FINRA, BY-LAWS OF THE CORPORATION ART. VII, § 5.

²⁷ FINRA, BY-LAWS OF THE CORPORATION ART. VII, § 9(b).

²⁸ As explained below, the chair of FINRA’s nominating committee has substantial industry connections.

²⁹ FINRA, BY-LAWS OF THE CORPORATION ART. I, § tt.

Notably, its by-laws do not define what constitutes a material business relationship. For example, it appears that FINRA's Public Governors affiliated (through board service or otherwise) with entities that rely on FINRA-member firms to distribute financial products are not deemed to have a "material business relationship" with FINRA firms. Other financial services firms have significant interests in FINRA's regulation because FINRA's member-firms play an integral role in the financial system. FINRA itself recognized this when it expanded its definition of non-public arbitrators in its Code of Arbitration Procedure to include persons associated with mutual funds, hedge funds, and investment advisers.³⁰

FINRA's by-laws also impose a term limit on Public Governors, limiting their ability to serve indefinitely.³¹ FINRA's website explains that "Governors are appointed or elected for three-year terms and may not serve more than two consecutive terms."³²

The SEC's Past Understanding of "No Material Business Relationship"

When the NASD instituted its requirement that Public Governors have "no material business relationship" with a broker or a dealer, the SEC understood that Public Governors differed from Industry Governors.³³ It recognized that Industry representatives included "all brokers and dealers, their officers, directors, and holding companies, large shareholders of brokers and dealers, as well as many of the people (including professionals) that work for them."³⁴ The NASD also previously categorized some board members as "non-industry" if they were connected in some way to NASDAQ.³⁵

FINRA's Current Conflict of Interest Materials

In addition to its by-laws prohibiting a material business relationship with broker-dealers, FINRA has also created policies and guidelines to address conflicts of interests

³⁰ See FINRA, FINRA Rule 12100 (y), http://finra.complanet.com/en/display/display_main.html?rbid=2403&element_id=4099, (last visited Oct. 24, 2017).

³¹ See FINRA, By-Laws of the Corporation Art. VII, § 5 ("No Appointed Governor may serve more than two consecutive terms. . . . Appointed Governors shall be appointed by the Board for a term of three years to replace those whose terms expire.")

³² FINRA, FINRA Board of Governors, (visited Oct. 11, 2017), <http://www.finra.org/about/finra-board-governors>.

³³ See SEC, *Self-Regulatory Organizations; Nat'l Ass'n of Sec. Dealers, Inc.; Order Approving Proposed Rule Change & Amendment No. 1 to the Proposed Rule Change, Notice of Filing & Order Granting Accelerated Approval of Amendment No. 2 to the Proposed Rule Change, & Order Extending Temp. Approval of Sr-Nasd-96-20 & Sr-Nasd-96-29, Regarding Proposed Changes in the by-Laws & Restated Certificates of Incorporation of the Nasd*, Release No. 39326 (S.E.C. Release No.), Release No. 34-39326, 65 S.E.C. Docket 1957, 1997 WL 714065, at *4 (Nov. 14, 1997) ("A Public participant on a board or committee is someone who has no material business relationship with the Association, or with any broker or dealer") [hereinafter NASD Governance Order].

³⁴ *Id.* The NASD Governance order excluded outside directors from its definition of "Industry" participants. *Id.* at n 29. The NASD had a separate category for persons with connections to NASDAQ that were not members of the industry, labeling them as "non-industry" representatives. *Id.* at n 27.

³⁵ *Id.*

for its Board of Governors. Its Code of Ethics and Business Conduct for the Board of Governors of FINRA and the Board of Directors of its Subsidiaries (Code of Ethics) explains that a “conflict of interest exists when our private interests interfere, could interfere, or even *appear* to interfere with the interests of FINRA.³⁶ The Code of Ethics states that Governors should not have “direct or indirect interests in, or relationships with, any organization where these interests or relationships could conceivably: (a) hinder our objectivity, independence of judgment or conduct in carrying out our responsibilities as FINRA Governors and Directors, or (b) embarrass FINRA because of the *appearance* of a conflict of interest.”³⁷

Implicitly recognizing that it plays a critical role in protecting investor confidence, FINRA’s Code of Ethics makes clear that “the appearance of a conflict can be as harmful as an actual conflict.” FINRA’s stated Code of Ethics explains that it is intended “to avoid the appearance of impropriety, as well as situations where independence is actually impaired.”³⁸ To the extent that a business relationship is not explicitly recognized by the by-laws, the Code of Ethics should ensure that Public Governors do not have affiliations with the industry that may create the appearance of conflicts.

Additionally, FINRA’s Code of Ethics recognizes that Governors with multiple board memberships may face potential conflicts. Its Code of Ethics states that Governors should “be sensitive to other commitments or activities (i.e., your duties to another Board) that may interfere with your ability to act in the best interest of FINRA.”³⁹

FINRA also has Corporate Governance Guidelines (Guidelines) that give direction to its Board of Governors.⁴⁰ Those Guidelines make clear that because FINRA serves as “a protector of investors and a guardian of market integrity, FINRA’s Governors have a heightened duty to make certain that they act in the best interest of the company and that their conduct is beyond reproach.”⁴¹ The Guidelines make clear that “actions by a Governor in his or her individual capacity that may cast doubt upon his or her honesty, integrity, fairness and excellence and/or attract adverse publicity may undermine FINRA’s stakeholders’ confidence in the organization.”⁴²

The Securities & Exchange Commission’s Conflicts Guidance for SEC Commissioners

The SEC more closely polices conflicts of interest in its own governance and would prohibit Commissioners from serving in the same types of simultaneous governance positions that FINRA’s Public Governors now occupy. The SEC defines employment as “any form of non–Federal employment or business relationship, involving the provision

³⁶ FINRA, Code of Ethics and Business Conduct for the Board of Governors of FINRA and the Board of Directors of its Subsidiaries (adopted Dec. 3, 2008; amended Sept. 19, 2013) (emphasis in original).

³⁷ *Id.* (emphasis in original).

³⁸ *Id.*

³⁹ *Id.* at 3.

⁴⁰ FINRA, Corporate Governance Guidelines (Updated Aug. 22, 2016).

⁴¹ *Id.* at 3.

⁴² *Id.* at 4.

of personal services by the employee.”⁴³ Notably, the SEC’s definition of employment specifically includes service as an “officer” or as a “director” of another organization.⁴⁴ The SEC prohibits its employees from accepting employment with “any entity regulated by the Commission.”⁴⁵ It also sweeps broadly and bars employment that is “otherwise involved with the securities industry.”⁴⁶

Limited Public Accountability and Oversight

Hester Peirce of the Mercatus Center at George Mason University, and a nominee to the SEC, has observed that “FINRA is not subject to mechanisms comparable to those that hold government regulators accountable to Congress, the president, and the public.”⁴⁷ She found that “FINRA’s version of self-regulation embodies a troubling independence from government, industry, and the public.”⁴⁸

Historically, the SEC has only barely supervised FINRA’s governance. A 2012 Government Accountability Office Report found that the SEC had “conducted limited or no oversight of . . . FINRA’s . . . governance and executive compensation.”⁴⁹ More specifically, between 2005 and 2010, the SEC conducted no oversight of FINRA’s transparency of governance.⁵⁰ With respect to FINRA’s Board of Governors, the SEC told the Government Accountability Office that it “periodically reviewed the composition of FINRA’s board to determine compliance with [self-regulatory organization] board-composition requirements.”⁵¹ The SEC indicated that it had not “examined issues such as conflicts of interest or recusals related to FINRA’s governance.”⁵²

The SEC’s investor protection mission requires that it effectively supervise FINRA’s governance.⁵³ The SEC should devote additional resources to supervising FINRA’s governance.

Longstanding Concerns about FINRA’s Public Governors

Concerns about the public-interest orientation of FINRA’s Public Governors date back to FINRA’s creation in 2007. For example, the Massachusetts Securities Division, one of the most vigilant state securities divisions, argued in 2007 that FINRA would be “fundamentally flawed if the representatives of investors are chosen directly or

⁴³ 5 C.F.R. § 4401.103(a)(2).

⁴⁴ *Id.*

⁴⁵ *Id.*, at (c)(iii)(A).

⁴⁶ *Id.*, at (c)(iii)(C).

⁴⁷ Hester Peirce, *The Financial Industry Regulatory Authority: Not Self-Regulation after All 21*, Mercatus Working Paper, Jan. 2015, <https://www.mercatus.org/system/files/Peirce-FINRA.pdf>.

⁴⁸ *Id.* at 29.

⁴⁹ U.S. GOV’T ACCOUNTABILITY OFFICE, GAO-12-625, *SECURITIES REGULATION: OPPORTUNITIES EXIST TO IMPROVE SEC’S OVERSIGHT OF THE FINANCIAL INDUSTRY REGULATORY AUTHORITY* 7 (2012).

⁵⁰ *Id.*

⁵¹ *Id.* at 16.

⁵² *Id.*

⁵³ See SEC, *About the SEC*, <https://www.sec.gov/about.shtml> (last visited Nov. 13, 2017) (“The mission of the SEC is to protect investors; maintain fair, orderly, and efficient markets; and facilitate capital formation. The SEC strives to promote a market environment that is worthy of the public’s trust.”).

indirectly by the securities industry or the current” self-regulatory associations.⁵⁴ The Massachusetts Securities Division argued that FINRA’s Public Governors should be appointed by “members of the investing public and their representatives” instead of by existing boards.⁵⁵ This selection mechanism would provide “the best assurance that the views of investors will be heard and their interests will be protected.”⁵⁶ Massachusetts recommended that investor protection organizations like the “North American Securities Administrators Association, the American Association of Retired Persons, and the Consumer Federation of America be among the investor advocates who select the Public Governors.”⁵⁷

Public Representatives on FINRA Advisory Committees

FINRA has recognized the importance of including investor advocates at other levels of its governance. In the past, FINRA has appointed investor advocates to its lower-level Advisory Committees. For example, FINRA has appointed a majority of investor advocates as public representatives on its National Arbitration and Mediation Committee (NAMC).⁵⁸ The NAMC recommends changes to the rules governing the dispute resolution forum. The NAMC recommendations, however, are advisory, and are ultimately approved, amended or denied by the Board of Governors. Without adequate public representation at the Board level, the investor protections recommended by the NAMC may never see the light of day.

The FINRA360 Process

FINRA recently announced its FINRA360 organizational improvement initiative.⁵⁹ The initiative offers an opportunity for FINRA to build upon existing strengths and become a more effective force for investor protection. FINRA’s successes generate widespread public benefits by giving investors the confidence to invest for their futures. Investor protection also plays a vital role in business capital formation—keeping bad actors out of the market increases investor confidence and willingness to invest. Because FINRA’s

⁵⁴ Comment Letter from William F. Galvin, Secretary of the Commonwealth of Massachusetts, to Nancy M. Morris, Secretary, Securities and Exchange Commission (Apr. 18, 2007), <https://www.sec.gov/comments/sr-nasd-2007-023/nasd2007023-73.pdf> (“We specifically recommend that bodies like the North American Securities Administrators Association, the American Association of Retired Persons, and the Consumer Federation of America be among the investor advocates who select the Public Governors”).

⁵⁵ *Id.* at 3.

⁵⁶ *Id.*

⁵⁷ *Id.* at 3-4.

⁵⁸ See FINRA, National Arbitration and Mediation Committee (NAMC), <https://www.finra.org/arbitration-and-mediation/national-arbitration-and-mediation-committee-namc> (last visited Oct. 24, 2017). Like the Board of Governors, the NAMC consists of a majority of public members. “The NAMC members include investors, securities industry professionals and FINRA arbitrators and mediators. A majority of the NAMC members and its chair are non-industry representatives. This diverse composition ensures a neutral approach in the administration of Dispute Resolution’s forum, promoting fairness to all parties.” National Arbitration and Mediation Committee, <https://www.finra.org/about/committees>.

⁵⁹ FINRA CEO & President Robert W. Cook, Remarks at New Special Study Conference (Mar. 24, 2017), <https://www.finra.org/newsroom/speeches/032417-remarks-new-special-study-conference>.

policies and enforcement affect far more than its member firms, the public has a strong interest in its regulatory performance.

Transparency of FINRA's governance structure has received some attention as part of its 360 process.⁶⁰ In response to comments received through this process, FINRA disclosed additional information about its Board of Governors on its website for the first time. We encourage FINRA to maintain these disclosures and increase the availability of information about FINRA's governance. This increased transparency decreases the odds that material conflicts will go undetected and potentially taint FINRA's vital governance processes.

Concerns about FINRA's Public Governors

We reviewed publicly available information about FINRA's current Public Governors as well as Public Governors that served on FINRA's board within the last five years. We found that Public Governors often came to the posts after long industry careers at influential Wall Street firms. We detail particular concerns about some current and recent FINRA Public Governors below.

William H. Heyman

Mr. Heyman now serves as FINRA's Chairman and as one of FINRA's Public Governors.⁶¹ FINRA's biography for Heyman indicates that he served as a FINRA Governor from 2003 to 2016 before becoming FINRA's Chairman in 2017.⁶² Heyman now works as the Chief Investment Officer for The Travelers Companies, Inc. (Travelers).⁶³ PIABA has concerns about Heyman's ability to serve as an effective investor protection advocate. Heyman's presence on the Board in one of the Public Governor seats is problematic for a number of reasons including his past career in the securities industry, his present role at Travelers, exceeding his FINRA mandated term limit as a Public Governor, conflicted memberships on other financial services companies Boards, and overall service to roughly six different boards and committees. In addition, Heyman has a number of different connections to FINRA members, as does his wife. Heyman should not be classified as a Public Governor, taking a spot away from a truly public representative.

Lengthy Industry Career

Heyman has had a lengthy securities industry career. He was a partner in Mercury Securities from 1979 to 1988.⁶⁴ He spent two years at Smith Barney as its "Managing Director & Head of Arbitrage Department" from 1989 to 1991 before joining the SEC for two years as the Director of the Division of Market Regulation from 1991 to 1993.⁶⁵ Heyman rejoined the securities industry in 1993 as the Head of Private Investment at

⁶⁰ See FINRA, FINRA 360, <https://www.finra.org/about/finra360>, last visited Nov. 7, 2017.

⁶¹ FINRA, William H. Heyman, <http://www.finra.org/about/william-h-heyman> (last visited Oct. 11, 2017).

⁶² *Id.*

⁶³ *Id.*

⁶⁴ *Id.*

⁶⁵ *Id.*

Salomon Brothers.⁶⁶ He then joined Citigroup investments in 1995 where he remained until 2002.⁶⁷ Heyman left Citigroup in 2002 and later that year joined St. Paul Cos. which “acquired Travelers’ assets after Citi spun them off.”⁶⁸ Heyman has been “Vice Chairman and Chief Investment Officer” of Travelers since May 2005.⁶⁹ Heyman’s lengthy industry career and his past and present industry connections may lead him to sympathize more with industry over public investor concerns.

Election as an Industry Governor

FINRA’s predecessor, the NASD, did not consider Heyman to be a Public Governor. Heyman first joined the NASD’s Board of Governors as an Industry Governor.⁷⁰ Later, although Heyman remained employed by Travelers continuously, the NASD gradually reclassified him from “Industry” to “Public.” In 2005, the NASD designated Heyman as one of two “non-industry” Governors on its Board of Governors, presumably because Travelers traded on NASDAQ.⁷¹ For reasons which remain unclear, the NASD first designated Heyman as a “Public Governor” in 2006—even though the NASD had previously designated him as an “Industry” and “Non-Industry” Governor.⁷²

Term Limit Violation

FINRA’s by-laws provide that Public Governors may only serve for two consecutive three-year terms.⁷³ Despite this, Heyman has served on FINRA’s Board of Governors for roughly fourteen years, the last eleven as a “Public Governor.”⁷⁴ Heyman’s continued presence on FINRA’s Board of Governors despite the existence of its term limit by-laws raises questions about whether FINRA’s current Board of Governors complies with its own by-laws.

⁶⁶ *Id.*

⁶⁷ *Id.*

⁶⁸ Nathan Vardi, *Munificent Returns*, FORBES, Mar. 3, 2015, <https://www.forbes.com/sites/nathanvardi/2015/02/11/munificent-returns/2/#6bbe72aa1ad3> (profiling William H. Heyman’s long .

⁶⁹ The Travelers Companies, Inc., Form 10-K, 268 (Feb. 16, 2017), <https://www.sec.gov/Archives/edgar/data/86312/000104746917000695/a2230860z10-k.htm>.

⁷⁰ NASD, 2004 NASD Annual Financial Report 23, <http://www.finra.org/about/annual-reports-financials> (“WILLIAM H. HEYMAN (Industry), St. Paul Travelers, St. Paul, MN”).

⁷¹ NASD, 2005 NASD Annual Financial Report 98, <http://www.finra.org/about/annual-reports-financials> (“William H. Heyman (Non-Industry), The St. Paul Travelers Companies, Inc., St. Paul, MN”). At that time, the NASD Board of Governors contained seven industry governors, two non-industry governors, two staff governors, and seven public governors. *Id.*

⁷² NASD, 2006 NASD Annual Financial Report, 62, <http://www.finra.org/about/annual-reports-financials> (“William H. Heyman (Public), The Travelers Companies, Inc., St. Paul, MN”).

⁷³ FINRA, By-Laws of the Corporation Art. VII, § 5 (“No Appointed Governor may serve more than two consecutive terms. . . . Appointed Governors shall be appointed by the Board for a term of three years to replace those whose terms expire”).

⁷⁴ FINRA, William H. Heyman, <http://www.finra.org/about/william-h-heyman> (last visited Oct. 11, 2017).

Fiduciary Duties to Entities with FINRA Member Subsidiaries

As discussed above, FINRA's by-laws prohibit Public Governors from having "a material business relationship" with any broker or dealer.⁷⁵ Despite this restriction, Heyman also serves as a director for an entity with a FINRA member as a subsidiary. Heyman serves on the board of Bank Leumi USA (Leumi USA).⁷⁶ Leumi Investment Services, Inc. (Leumi Investment) is a FINRA member-firm.⁷⁷ The BrokerCheck report for Leumi Investment reveals that Leumi USA owns 75% or more of Leumi Investment and that Leumi USA directs the management and policies of Leumi Investments.⁷⁸

Marriage to Director of another Firm with FINRA-Member Subsidiaries

There are questions as to whether Heyman's close familial ties generate additional conflicts as well. Heyman's spouse also has had a long securities industry career.⁷⁹ She currently serves as the director of a firm with FINRA member subsidiaries.⁸⁰ This connection generates the appearance of a conflict of interest because of the close familial tie.

Overboarding

Heyman's board membership raises other concerns which should be addressed by FINRA's governance policies. Heyman serves in approximately six different governance and advisory roles simultaneously, raising concerns about his ability to effectively serve as a Director and Chair of FINRA's board. Institutional Shareholder Services (ISS) has expressed concern that Public Company Directors should not serve on excessive numbers of boards. In 2017, ISS advised institutional shareholders to vote against or withhold votes for "individual directors who . . . sit on more than five public company boards" as well as to vote against or withhold votes for directors that are "CEOs of public companies who sit on boards of more than two public companies besides their own."⁸¹

ISS recommends that institutional investors vote against overboarded directors because they may be too busy to serve as effective fiduciaries. Overboarded directors lack sufficient time to devote to their board duties because of other demands on their time

⁷⁵ FINRA, BY-LAWS OF THE CORPORATION ART. I, § tt.

⁷⁶ *Id.*

⁷⁷ See BrokerCheck Report for Leumi Investment Services.

⁷⁸ *Id.*

⁷⁹ Nathan Vardi, *Munificent Returns*, FORBES, Mar. 3, 2015, <https://www.forbes.com/sites/nathanvardi/2015/02/11/munificent-returns/2/#6bbe72aa1ad3> ("He is married to Katherine "Wendy" Dietze, the former chief operating officer of Credit Suisse First Boston's investment bank").

⁸⁰ Cowen Group, Inc., Form 10-K, Feb. 27, 2017, <https://www.sec.gov/Archives/edgar/data/1466538/000146653817000014/a10k12312016.htm#s1A426893AA565BCA8F11956533559A4F>.

⁸¹ INSTITUTIONAL SHAREHOLDER SERVICES, AMERICAS U.S., CANADA, AND LATIN AMERICA PROXY VOTING GUIDELINES UPDATES: 2017 BENCHMARK POLICY RECOMMENDATIONS 5, <https://www.issgovernance.com/file/policy/2017-america-iss-policy-updates.pdf>.

from other boards. Some research has found that large public company performance suffers when directors serve on many boards.⁸²

An overboarded Public Governor may lack the time and ability to adequately focus on vigilantly advocating for and protecting the interests of public investors on FINRA's Board of Governors. FINRA's Public Governors must balance competing demands on their time. Putting to the side conflicts of interest that may bias their behavior, overboarded directors may fail to vigorously protect public investors because they cannot devote sufficient time and attention to all of their responsibilities.

Heyman is an overboarded Public Governor. He faces demands on his time similar to those experienced by a CEO because he serves as the Chief Investment Officer for Travelers as well as the Vice Chairman of its board. Travelers 2016 Annual Report revealed that it has \$70,488,000 in total investments.⁸³ Managing this seventy-billion-dollar portfolio requires substantial time, attention, and effort, compromising Heyman's ability to focus on investor protection. Heyman also serves as a director at Bank Leumi USA, on the Senior Advisory Board of Atlas Merchant Capital, the Advisory Council of the Bendheim Center for Finance at Princeton University, the Economic Club of New York, and on the Investment Committee for the UJA-Federation of New York.⁸⁴ A position with the Investment Committee of the UJA-Federation of New York also entails significant responsibility because the UJA-Federation has \$1,280,118,000 in net assets.⁸⁵

Overboarded directors on FINRA's Board of Governors are also sources of systemic risk. Professor Jeremy Kress of the University of Michigan has argued that overboarded directors at financial institutions could cause the next financial crisis.⁸⁶ Professor Kress found that "overcommitted directors withdraw from corporate decision-making, tend not to challenge management, and experience attention shocks that distract them from company business."⁸⁷ An overboarded Public Governor on FINRA's Board of Governors cannot devote substantial time and attention to mitigating systemic risks or to ensuring that FINRA's management vigorously protects public investors. Although Heyman may have a long history of service with FINRA and its precursor, the NASD, he should not serve as a Public Governor because of his material business and other ties to the

⁸² See Ferris, Stephen P. and Jayaraman, Narayanan and Liao, Min-Yu (Stella), *Better Directors or Distracted Directors? An International Analysis of Busy Boards* (August 2, 2017). Georgia Tech Scheller College of Business Research Paper No. 17-30. Available at SSRN: <https://ssrn.com/abstract=3012820> (finding that "firms with busy boards exhibit lower market-to-book ratios and reduced profitability").

⁸³ THE TRAVELERS COMPANIES, INC., 2016 ANNUAL REPORT 6, <http://investor.travelers.com/interactive/newlookandfeel/4055530/AnnualReport2016.pdf>.

⁸⁴ FINRA, William H. Heyman, <http://www.finra.org/about/william-h-heyman> (last visited Oct. 11, 2017).

⁸⁵ UJA-Federation of New York, 2016 Annual Report, available <https://www.ujafedny.org/who-we-are/annual-reports/> (last visited Oct. 30, 2017).

⁸⁶ Kress, Jeremy C., *Board to Death: How Busy Directors Could Cause the Next Financial Crisis* (June 22, 2017). 59 B.C. L. Rev. ____ (2018 Forthcoming); Ross School of Business Paper No. 1370. Available at SSRN: <https://ssrn.com/abstract=2991142>.

⁸⁷ *Id.*

securities industry. These material relationships may reduce the confidence of many stakeholder communities in FINRA's ability to serve as a truly independent regulator.

Carol Anthony Davidson

Carol Anthony Davidson has served as a Public Governor since 2013.⁸⁸ PIABA has concerns about his ability to serve as an effective investor protection advocate. Like Heyman, Davidson has substantial connections to FINRA members which raise questions about the appropriateness of labeling him as a Public Governor. Additionally, like Heyman, Davidson serves on a number of corporate boards in addition to FINRA.

Fiduciary Duties to Entities with FINRA Member Subsidiaries

Davidson appears to have "a material business relationship" with a FINRA member firm.⁸⁹ Davidson joined the board of Legg Mason Inc. (Legg Mason) in 2014.⁹⁰ Legg Mason is a global asset management firm and has a FINRA member subsidiary, Legg Mason Investor Services, LLC.⁹¹ Davidson's fiduciary duties to Legg Mason may inhibit his ability to act in the public's interest and certainly inhibits the ability of other stakeholder communities to maintain confidence in his independence.⁹²

Conflicts of Interest from Asset Management Activities

Davidson's position as director at Legg Mason complicates his ability to protect public investors because Legg Mason relies on financial adviser commissions to distribute its mutual funds.⁹³ Davidson faces conflicted interests when considering rules that would require brokers to give advice in the best interests of their clients without regard to their

⁸⁸ FINRA, Carol Anthony (John) Davidson, <http://www.finra.org/about/carol-davidson> (last visited Oct. 12, 2017).

⁸⁹ FINRA, BY-LAWS OF THE CORPORATION ART. I, § tt.

⁹⁰ Legg Mason, Press Release: Legg Mason Appoints Carol A. "John" Davidson to its Board of Directors, April 30, 2014, <http://ir.leggmason.com/file/Index?KeyFile=23427561>.

⁹¹ See BrokerCheck Report for Legg Mason Investor Services, LLC.

⁹² Davidson's board position appears in tension with FINRA's own Code of Ethics for its board members. It provides that FINRA Governors should "not have direct or indirect interests in, or relationships with, any organization where these interests or relationships could conceivably: (a) hinder our objectivity, independence of judgment or conduct in carrying out our responsibilities as FINRA Governors and Directors, or (b) embarrass FINRA because of the *appearance* of a conflict of interest." FINRA, Code of Ethics and Business Conduct for the Board of Governors of FINRA and the Board of Directors of its Subsidiaries 2 (adopted Dec. 3, 2008; Amended Sept. 19, 2013) (emphasis in original).

⁹³ See Jacob Hale Russell, *The Separation of Intelligence and Control: Retirement Savings and the Limits of Soft Paternalism*, 6 WM. & MARY BUS. L. REV. 35, 64 (2015) ("Financial advisers, including brokers (who have no fiduciary duty to their clients), make the problem worse. Most of them are compensated based on (entirely legal) kickbacks."); Benjamin P. Edwards, *Conflicts & Capital Allocation*, 78 OHIO ST. L.J. 181, 198 (2017) ("Financial advisor incentives affect which institutional intermediaries receive capital. Before reaching the traditional securities markets, investor assets frequently pass through at least two layers of intermediation: (i) intermediation from a financial advisor selecting an institutional intermediary; and (ii) the institutional intermediary then investing the assets").

personal financial incentives to sell particular funds. Legg Mason relies on these conflicted payments to distribute many of its mutual funds.⁹⁴

Insider Trades & Substantial Stake in Financial Services Firm

Davidson has a financial incentive not to recommend regulatory changes in the interests of public investors because he purchased stock in Legg Mason while on the FINRA Board of Governors.⁹⁵ On July 6, 2016, Davidson purchased 3,000 shares of Legg Mason for \$101,760.00.⁹⁶ In total, as of June 14, 2017, Davidson beneficially owned 14,906 shares in Legg Mason.⁹⁷ At Legg Mason's current approximate stock price, Davidson's 14,906 shares give him a more than \$500,000 stake in Legg Mason. This substantial financial stake in Legg Mason may give him reason to prefer maintaining the profitability of industry firms over investor protection.

Overboarding Concern

Davidson serves on at least five corporate boards in addition to his position on FINRA's Board of Governors.⁹⁸ His FINRA biography reveals that he serves on the boards of Pentair Plc., DaVita Inc., Legg Mason Inc., TE Connectivity Ltd., and the University of Rochester.⁹⁹ As explained above, serving on a large number of boards significantly reduces the time and attention that a director may devote to investor protection.

Davidson's service on FINRA's board requires significant time and attention. The FINRA website explains that he serves on six different FINRA Board Committees including: Finance, Operations & Technology Committee (Chair), Investment Committee, Management Compensation Committee, Audit Committee, Executive Committee, and Regulatory Operations Oversight Committee.¹⁰⁰

Davidson may face too many conflicts of interest and outside commitments to serve as a vigorous and effective advocate for FINRA's core mission of investor protection.

Rochelle B. (Shelley) Lazarus

FINRA categorizes Shelley Lazarus as a Public Governor.¹⁰¹ Lazarus has served as one of FINRA's Public Governors since 2013. PIABA has concerns about Lazarus' ability to

⁹⁴ See Legg Mason, Legg Mason Funds Sales Charge and Breakpoint Information, <https://www.leggmason.com/en-us/site/disclosure/mutual-funds-breakpoints/breakpoint-equity.html> (last visited Oct. 12, 2017).

⁹⁵ See Dividend Channel, *Top Buys by Directors: Davidson's \$101.8K Bet on LM*, FORBES, July 28, 2016, <https://www.forbes.com/sites/dividendchannel/2016/07/28/top-buys-by-directors-davidsons-101-8k-bet-on-lm/#773248327a4b>.

⁹⁶ *Id.* ("directors of a company tend to have a unique inside view into the business, so when directors make major buys, investors are wise to take notice").

⁹⁷ Legg Mason, 2017 Proxy Statement 15, June 14, 2017, <http://ir.leggmason.com/Cache/1500100660.PDF?O=PDF&T=&Y=&D=&FID=1500100660&iid=102761>.

⁹⁸ FINRA, Carol Anthony (John) Davidson, <http://www.finra.org/about/carol-davidson> (last visited Oct. 12, 2017).

⁹⁹ *Id.*

¹⁰⁰ *Id.*

¹⁰¹ FINRA, Shelley Lazarus, <http://www.finra.org/about/shelley-lazarus> (last visited Oct. 12, 2017).

serve as an effective investor protection advocate due to her diffuse board service and her connections to FINRA members.

Overboarding Concern

In addition to her responsibilities to FINRA, Lazarus discloses ten different entities where she has board service commitments or affiliations, including Merck & Co., Inc. (Director), General Electric, Inc. (Director), Blackstone (Director), Business Board of the Department of Defense, The NYC Partnership (Board Member), The World Wildlife Fund (Board Member), Lincoln Center for the Performing Arts (Board Member), New York Presbyterian Hospital (Trustee), Columbia Business School Board of Overseers, and The Council on Foreign Relations (Member).

These extensive commitments make it difficult for her to devote substantial time, thought, and attention to investor protection as a member of FINRA's board. Her current board responsibilities at FINRA include four different committees, including the Executive Committee, Nominating & Governance Committee (Chair), Management Compensation Committee, and Finance, Operations & Technology Committee.¹⁰²

Lazarus faces so many conflicts of interest and other obligations that she may not serve as an effective chair for FINRA's Nominating & Governance Committee. Because the Nominating committee plays a significant role in selecting future Public Governors, the Chair of this committee should have the time and attention to devote the task.

Fiduciary Duties to Entities with FINRA-Member Subsidiaries

Lazarus serves on the Board of Directors of The Blackstone Group, "a leading global alternative asset manager, with Total Assets Under Management of \$366.6 billion as of December 31, 2016."¹⁰³ The Blackstone Group has multiple FINRA member subsidiaries, including Blackstone Advisory Partners L.P.¹⁰⁴ Her position with the Blackstone Group seemingly creates a "material business relationship" with brokerage firms.

Conflicts of Interest from Asset Management Activities

Lazarus also faces conflicts of interest related to her service on Blackstone's board of directors because Blackstone relies on FINRA's broker-dealer firms to distribute its fund offerings—giving rise to material business relationships with FINRA member-firms that are not Blackstone subsidiaries. Blackstone's Annual Report explained that its business faces risks from improper sales of its funds by FINRA's member-firms:

in some cases we seek to distribute our unregistered funds to such retail investors indirectly through feeder funds sponsored by brokerage firms
. accessing retail investors and selling retail directed products exposes us to

¹⁰² *Id.*

¹⁰³ See Blackstone Group, Form 10-K, at 5, Feb. 24, 2017, <https://www.sec.gov/Archives/edgar/data/1393818/000119312517056300/d280098d10k.htm>.

¹⁰⁴ See BrokerCheck Report for Blackstone Advisory Partners, L.P.

new and greater levels of risk, including heightened litigation and regulatory enforcement risks. . . . to the extent that our investment products are being distributed through third parties we are exposed to reputational damage and possible legal liability to the extent such third parties improperly sell our products to investors¹⁰⁵

As a Public Governor, Lazarus enjoys substantial influence to shape Blackstone's regulatory environment, including setting the standards for evaluating whether FINRA's member-firms "improperly sell" Blackstone's "products to investors."¹⁰⁶ As the primary securities regulator for brokerage firms, FINRA's rules determine whether member-firms "improperly" sell investors interests in Blackstone funds. Lax standards and enforcement decrease the risks that Blackstone faces.

Substantial Financial Stake in Financial Services Firm

In addition to her other connections to Blackstone, Lazarus also directly owns 35,343 shares in the Blackstone Group as of July 21, 2017.¹⁰⁷ Lazarus owns an additional 2,950 Blackstone shares indirectly.¹⁰⁸ Her most recent acquisition of Blackstone stock came on July 9, 2017, when she acquired an additional 4,567 shares as a part of a Blackstone incentive compensation plan.¹⁰⁹ At the Blackstone Group's current stock price, this gives Lazarus a direct and indirect ownership stake of approximately \$1.3 million.

Lazarus' ownership of Blackstone creates the appearance of a conflict which may diminish the vigor with which she seeks investor protections.

Lazarus's connection to FINRA

Lazarus has been an executive at Ogilvy & Mather from 1995 through 2012. She now serves as the Chairman Emeritus of Ogilvy. In 2015, Ogilvy created FINRA's BrokerCheck advertising campaign.¹¹⁰ The financial connection between Ogilvy and FINRA may negatively impact public confidence in Lazarus's ability to closely supervise FINRA's management.

Joshua S. Levine

FINRA's website reveals that Joshua S. Levine serves as a Public Governor while working as a Managing Director affiliated with Kita Capital Management, LLC.¹¹¹ Levine's LinkedIn profile makes clear that he co-founded Kita Capital Management, LLC

¹⁰⁵ See Blackstone Group, Form 10-K, at 41, Feb. 24, 2017, <https://www.sec.gov/Archives/edgar/data/1393818/000119312517056300/d280098d10k.htm> (describing regulatory risks for improper sales to retail investors).

¹⁰⁶ *Id.*

¹⁰⁷ Rochelle B. Lazarus, Form 4 (July 12, 2017), <https://www.sec.gov/Archives/edgar/data/1393818/000120919117044903/xslF345/doc4.xml>.

¹⁰⁸ *Id.*

¹⁰⁹ *Id.*

¹¹⁰ See FINRA Launches National Ad Campaign Promoting BrokerCheck, (June 1, 2015), <http://www.finra.org/newsroom/2015/finra-launches-national-ad-campaign-promoting-brokercheck>.

¹¹¹ FINRA, Joshua S. Levine, <http://www.finra.org/about/joshua-levine> (last visited Oct. 13, 2017).

and that it provides “capital, operations and advice to technology-driven organizations.”¹¹² Levine has extensive connections with FINRA members, as well as serving on a number of boards.

Overboarding Concern

In addition to his position as a Public Governor at FINRA, Levine’s “Board Service and Affiliations” includes six different entities: Fresh Direct, LLC, OPAQ Networks, Inc., Fantex Holdings, Inc., NPower Inc., Classroom Inc., and MSTERIO Inc.¹¹³ His position as a Managing Director at Kita Capital Management as well as his extensive commitments to other boards may diminish his efficacy as a Public Governor and significantly impede his ability to devote time, attention, and thought to investor protection issues.

Fiduciary Duties to Entities with recently registered FINRA Member Subsidiaries

Levine serves on the board of directors of Fantex Holdings, Inc. (Fantex Holdings). As of 2016, Fantex Holdings owned Fantex Brokerage Services, LLC (Fantex Brokerage), a previously registered FINRA member-firm.¹¹⁴ Although Fantex Brokerage has withdrawn its registration, Levine’s role with Fantex Holdings creates an incentive for him to focus on industry profitability over investor protection.

Long Industry Career

Like many Public Governors, Levine has had a long industry career. He served as a Managing Director at Morgan Stanley from 1985 to 1997 before joining Deutsche Bank as a Managing Director from 1997 to 1999.¹¹⁵ He became the Chief Technology and Operations Officer for E*TRADE Financial from 1999 to 2005.¹¹⁶ Although his current FINRA profile indicates that he has served as a Managing Director for Kita Capital Management without interruption since 2005,¹¹⁷ past FINRA Annual Reports characterized him as “retired.”¹¹⁸ The inconsistent disclosures raise questions about the quality of FINRA’s past disclosures and governance.

Eileen Murray

FINRA recently appointed Eileen Murray to serve as a Public Governor beginning in 2016.¹¹⁹ Murray serves as the co-CEO of the world’s largest hedge fund, Bridgewater

¹¹² See LinkedIn, Joshua S. Levine, available www.linkedin.com.

¹¹³ FINRA, Joshua S. Levine, <http://www.finra.org/about/joshua-levine> (last visited Oct. 13, 2017).

¹¹⁴ See BrokerCheck Report for Fantex Brokerage Services, LLC, available <https://brokercheck.finra.org>.

¹¹⁵ FINRA, Joshua S. Levine, <http://www.finra.org/about/joshua-levine> (last visited Oct. 13, 2017).

¹¹⁶ *Id.*

¹¹⁷ *Id.*

¹¹⁸ See FINRA, 2016 Annual Report 63 (“Joshua S. Levine (Public), Retired, New York, NY”), available <http://www.finra.org/about/annual-reports-financials>; FINRA, 2015 Annual Report 65, available <http://www.finra.org/about/annual-reports-financials> (“Joshua S. Levine (Public), Retired, New York, NY”).

¹¹⁹ FINRA, Eileen Murray, <http://www.finra.org/about/eileen-murray> (last visited Oct. 13, 2017).

Associates.¹²⁰ Murray is not appropriately categorized as a Public Governor because of her extensive and on-going connections to the industry.

Long Industry Career

Murray has also had a long industry career, increasing the risk that she may more naturally sympathize with industry over public investor perspectives.¹²¹

Current Securities Industry Affiliation

Murray has a strong, current securities industry affiliation. Under FINRA's own rules for arbitrator classifications, Murray would not qualify as a public arbitrator because of her employment by the world's largest hedge fund.¹²²

Randal K. Quarles (Recent Governor)

FINRA had Randal K. Quarles as one of its recent Public Governors.¹²³ He served as a Public Governor while working as the Managing Partner & Co-founder of the Cynosure Group.¹²⁴ Quarles co-founded the Cynosure Group in 2014.¹²⁵ It has invested in several registered investment adviser firms.¹²⁶ After being nominated by the Trump administration, Mr. Quarles was recently confirmed as a Federal Reserve Governor.¹²⁷

Securities Industry Affiliation

Quarles has a long securities industry affiliation. Under FINRA's own rules for arbitrator classifications, Quarles would not qualify as a public arbitrator because of affiliation with a registered investment adviser firm.¹²⁸

¹²⁰ *Id.*

¹²¹ *Id.*

¹²² See FINRA, FINRA Rule 12100 (y), http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=4099, (last visited Oct. 24, 2017).

¹²³ FINRA, Randal K. Quarles

¹²⁴ *Id.*

¹²⁵ See PR Web, *Eccles Family Backs New Investment Firm, The Cynosure Group*, June 5, 2014, <http://www.prweb.com/releases/the-cynosure-group/private-equity-investors/prweb11916306.htm> (last visited Oct. 24, 2017) (noting that "Quarles spent many years working as a partner at the Wall Street law firm of Davis Polk & Wardwell, where he was the co-head of the firm's Financial Institutions Group and advised on transactions that included a number of the largest financial sector mergers ever completed").

¹²⁶ See e.g. Jeff Benjamin, *Private equity investors zero in on the RIA business*, INVESTMENTNEWS, Aug. 9, 2017, <http://www.investmentnews.com/article/20170809/FREE/170809925/private-equity-investors-zero-in-on-the-ria-business> (describing a Cynosure investment into Savant Capital Management).

¹²⁷ Binyan Appelbaum, *Randal Quarles Confirmed as Federal Reserve Governor*, N.Y. TIMES, Oct. 5, 2017, https://www.nytimes.com/2017/10/05/us/politics/randal-quarles-confirmed-as-federal-reserve-governor.html?_r=0.

¹²⁸ See FINRA, FINRA Rule 12100 (y), http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=4099, (last visited Oct. 24, 2017).

Membership in Industry-Funded Lobbying Organization

Quarles also served as a member of the Board of the U.S. Chamber of Commerce (U.S. Chamber).¹²⁹ The U.S. Chamber describes itself as the “world’s largest business organization representing the interests of more than 3 million businesses.”¹³⁰ FINRA-regulated firms have contributed substantial sums to the U.S. Chamber.¹³¹ Serving these interests, the U.S. Chamber has filed a lawsuit attempting to block a proposed rule that would require many financial advisers to give advice in the best interests of their clients.¹³²

Quarles faced a conflict of interest to the extent that his duties to represent business perspectives and the public interest conflicted. For an example of a debate that has split business and public advocacy groups, consider the Department of Labor’s new rule imposing a fiduciary duty on financial advisers giving advice in connection with retirement accounts.¹³³ The American Association of Retired Persons strongly supports the rule because it wants to close “loopholes in the law that allow some financial advisers to give investment advice that earns them a higher fee — even if it’s not the best advice.”¹³⁴ The U.S. Chamber opposes the rule and has filed a lawsuit seeking judicial action to strike it down.¹³⁵

Shedding some light on Mr. Quarles’s views, the U.S. Chamber led a particularly aggressive lobbying campaign opposing the rule. According to a report published by *Public Citizen*, the U.S. Chamber created “astroturf” opposition to the rule.¹³⁶ In one instance, a person that the U.S. Chamber featured on a website showcasing small

¹²⁹ See U.S. Chamber, Board of Directors, <https://www.uschamber.com/about/board-directors> (last visited Oct. 13, 2017).

¹³⁰ *About the U.S. Chamber*, U.S. CHAMBER OF COMMERCE, <https://www.uschamber.com/about-us/about-the-us-chamber> (last visited July 6, 2016).

¹³¹ For example, in 2014, Prudential Financial contributed \$185,000 to the U.S. Chamber with \$75,000 earmarked for lobbying. *2014 Political Activities and Contributions Report*, PRUDENTIAL 21 (April 2015), http://www.prudential.com/media/managed/public/PAC_Annual_Report_14-Final.pdf.

¹³² See Andrew Ackerman & Leslie Scism, *Obama Retirement-Savings Rule Faces Industry-Led Court Battle*, WALL ST. J. (May 31, 2016), <http://www.wsj.com/articles/industry-groups-prepare-lawsuit-over-obama-retirement-rule-1464704230> (“Big business and financial industry trade groups are taking to the courts”).

¹³³ See U.S. Dep’t of Labor, *Conflict of Interest Final Rule*, <https://www.dol.gov/ebsa/regs/conflictsofinterest.html>.

¹³⁴ David Certner, *Why AARP Backs a New Retirement Plan Advice Rule*, AARP BLOG (July 22, 2015), <http://blog.aarp.org/2015/07/22/aarp-files-comments-on-new-retirement-plan-advice-rule/>.

¹³⁵ See Andrew Ackerman & Leslie Scism, *Obama Retirement-Savings Rule Faces Industry-Led Court Battle*, WALL ST. J. (May 31, 2016), <http://www.wsj.com/articles/industry-groups-prepare-lawsuit-over-obama-retirement-rule-1464704230> (“Big business and financial industry trade groups are taking to the courts”).

¹³⁶ PUBLIC CITIZEN, *SACRIFICING THE PAWNS: HOW THE U.S. CHAMBER OF COMMERCE RECRUITS SMALL BUSINESS OWNERS TO LOBBY AGAINST THEIR OWN SELF-INTEREST* 8 (2016), <http://www.chamberofcommercewatch.org/wp-content/uploads/2016/06/Sacrificing-the-Pawns-final.pdf>. The term “astroturfing” refers to manufacturing grass-roots opposition to regulation on behalf of business and industry interests; see also John Kennedy, *Need a Grass-Roots Campaign? Industries Learn How to Hire One*, SUN SENTINEL (Oct. 28, 1996), http://articles.sun-sentinel.com/1996-10-28/business/9610280244_1_legislators-astroturfing-lobbyist.

business opposition to the rule “did not realize he was listed on the webpage as opposing it” and asked *Public Citizen*, “Who do I call to get this down?”¹³⁷

At Quarles’ confirmation hearing, Senator Cortez-Masto questioned him about his concurrent membership on the Board of the U.S. Chamber and on FINRA’s Board of Governors as a “Public Governor.”¹³⁸ Quarles claimed that he had represented the public on the FINRA board “without any influence from or discussion with the Chamber of Commerce.”¹³⁹

Quarles’s past dual roles raised the appearance of a conflict of interest. They also raised questions as to how FINRA selects its Public Governors and whether it gives representation to stakeholders that lack a means of electing representatives to FINRA’s governing board.

Reforms

For FINRA to be effective at its stated investor protection mission, it should welcome reforms to improve its governance. After reviewing FINRA’s existing Public Governors, PIABA recommends that FINRA alter its by-laws to more closely police conflicts of interest at its Board of Governors and that it appoint persons with a history of advocating for investor protections to its Board of Governors.

Address Conflicts of Interest

FINRA’s apparently lax interpretation of its current by-laws permit too many unresolved significant conflicts of interest. FINRA should address the issue in one of two ways: (1) promulgate a stronger interpretation of “material business relationship” in its governance guidelines and adopt policies to address these conflicts; or (2) amend the definition of Public Governor within its by-laws to capture these conflict-producing and confidence-undermining relationships. A “material business relationship” with a FINRA member firm should include serving on the board of a firm that has FINRA member subsidiaries or affiliates, distributes financial products through FINRA members, or accepts donations or contributions from FINRA member firms for lobbying activities. These material business relationships generate the appearance of a conflict and undercut investor and public confidence in FINRA’s responsible exercise of state power. Moreover, Public Governors should not have any type of material business relationship with the financial services industry. FINRA recognized this when it excluded investment company, hedge fund, mutual fund, and other financial services employees from the definition of a public arbitrator. FINRA should adopt a definition of Public Director which excludes the same sorts of affiliations to the financial services industry.

¹³⁷ Daniel Dudis & Bartlett Naylor, *Taking a Hard Look at a Campaign Critical of a Fiduciary Rule*, N.Y. TIMES (June 9, 2016), http://www.nytimes.com/2016/06/10/business/dealbook/taking-a-hard-look-at-a-campaign-critical-of-a-fiduciary-rule.html?smid=tw-nytimesbusiness&smtyp=cur&_r=0.

¹³⁸ See CSPAN, Senator Cortez Masto on FINRA Conflicts, July 27, 2017, <https://www.c-span.org/video/?c4678228/senator-cortez-masto-finra-conflicts>.

¹³⁹ *Id.*

Limit Overlapping Board Service

PIABA remains concerned that FINRA's Public Governors may not have sufficient time to devote to investor protection issues. PIABA recommends that FINRA limit outside board commitments to ensure that Public Governors have adequate time to advance FINRA's investor protection mission. Because FINRA's Board of Governors plays a critical role in financial regulation, it should impose limits on concurrent service on other boards. For persons without other employment, FINRA should limit additional board commitments to four or less additional boards. For persons with full-time employment, FINRA should limit additional board commitments to two or less additional boards

Proposed Alternative Slate

FINRA should move to nominate Public Governors with a demonstrated interest in investor protection issues. FINRA should seek nominations for Public Governors from organizations devoted to investor protection, such as the American Association of Retired Persons, the Consumer Federation of America, the North American Securities Administrators Association, and PIABA. Because Public Governors should also have some familiarity with the securities industry, PIABA suggests that FINRA consider the candidates listed below.¹⁴⁰

Jill I. Gross

Professor Jill I. Gross is a nationally known expert in the field of securities dispute resolution and teaches at the Elizabeth Haub School of Law at Pace University. Professor Gross teaches courses in the areas of dispute resolution, ethics, securities law and lawyering skills. She was Director of the Pace Investor Rights Clinic from 1999-2015. Gross has familiarity with the securities industry and a demonstrated commitment to investor protection.

Phyllis Borzi

Phyllis Borzi served as the Assistant Secretary of Labor for the Employee Benefits Security Administration of the United States Department of Labor from 2009 to 2017. During that time, she directed the Department of Labor's fiduciary duty rulemaking. Borzi has familiarity with the securities industry and a demonstrated commitment to investor protection.

Jordan Thomas

Jordan Thomas is a partner at Labaton Sucharow. He previously served as Assistant Chief Litigation Counsel in the Division of Enforcement at the SEC, where he had a leadership role in the development of the SEC Whistleblower Program. During his time at the SEC, Thomas brought enforcement cases that resulted in monetary sanctions and

¹⁴⁰ No person listed below participated in any way in the drafting of this report.

relief for harmed investors in excess of \$35 billion. Thomas has familiarity with the securities industry and a demonstrated commitment to investor protection.

Robert S. Banks

Robert Banks is an attorney that has spent his career representing investors. In 2017, he received the North American Securities Administrators Association's (NASAA) Investor Champion Award. FINRA appointed Banks to serve three terms as a public member of the NAMC, and he has chaired several of its important subcommittees. He has a demonstrated ability to work well with FINRA while advocating for investor protection. Banks has familiarity with the securities industry and a demonstrated commitment to investor protection.

Teresa J. Verges

Teresa Verges served as the Assistant Director of Enforcement for the Securities and Exchange Commission attorney before launching the University of Miami School of Law's Investor Rights Clinic. She has familiarity with the securities industry and a demonstrated commitment to investor protection.

Conclusion

PIABA questions the appropriateness of FINRA appointing Public Governors which have clear industry ties. PIABA has significant concerns about 5 of FINRA's 13 Public Governors and one recently-departed governor, almost half of the Public Governors. PIABA is concerned that FINRA is not following its own by-laws and is not meeting its obligation to ensure adequate public representation on its Board to ensure protection of investors and the public interest. FINRA's predecessor, the NASD, has seen the harms that may result if the industry has undue influence over its regulation. However, simply calling someone "public" does not solve the problem. If the governors are not truly "public," FINRA risks repeating past scandals, and impairing investor confidence in the industry.

It is essential that FINRA's Board of Governors include investor advocates and representatives. The industry's interests are sufficiently represented by the 10 Industry Governors. The public's interests should be as adequately represented.