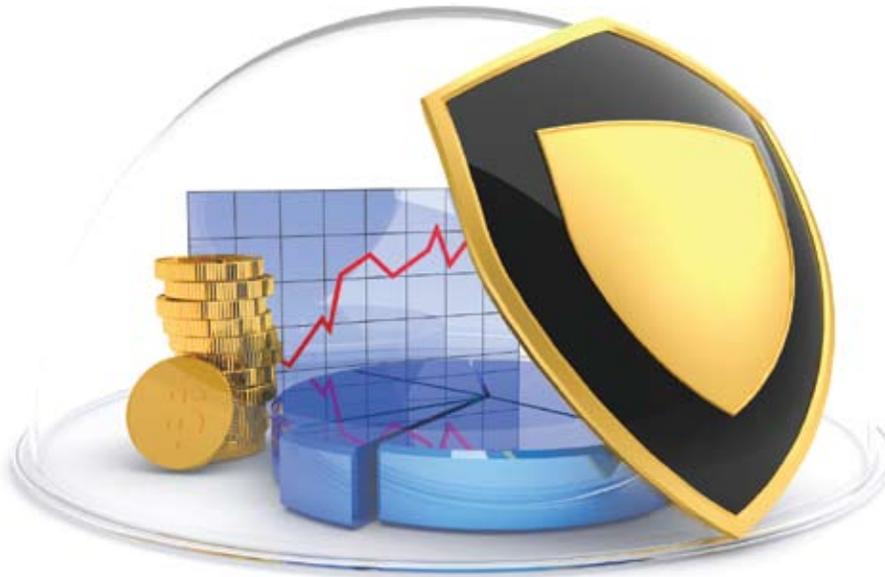


Self-Regulation: Background And Recent Developments

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This outline provides a brief introduction to the role of self-regulatory organizations (“SROs”) in the securities industry. Although SRO regulation covers a wide range of topics, including listing requirements, market structure, membership, and allocation of costs, this outline will cover just three areas: (1) the basic structure of oversight of SROs by the United States Securities and Exchange Commission (“SEC” or “Commission”); (2) the process by which new and amended SRO rules are approved by the SROs and the SEC; and (3) recent developments and trends in self-regulation.

A. Background On Self-Regulation In The Securities Industry

1. Securities exchanges provided regulation of their markets long before the adoption of the federal securities laws. The following sources provide detailed background information on the history and scope of self-regulation in the United States:
 - a. 2 Kenneth B. Winer & Samuel J. Winer, *Securities Enforcement: Counseling & Defense*, Chapter 25, “SRO Regulatory Matters” (Matthew Bender 2009).

- b. 6 Louis Loss & Joel Seligman, *Securities Regulation*, Chapter 7, “Regulation of the Securities Markets” (Aspen Law & Business, 3d ed. 2002).
- c. Norman S. Poser & James A. Fanto, *Broker-Dealer Law and Regulation*, Chapter 4, “An Overview of the Regulatory System” (Aspen, 4th ed. 2007 & Supp. 2008) (“Poser & Fanto”).
- d. Securities and Exchange Commission, *Concept Release Concerning Self-Regulation*, 69 Fed. Reg. 71256 (proposed Dec. 8, 2004), available at <http://sec.gov/rules/concept/34-50700.pdf>.
- e. Securities and Exchange Commission, *Concept Release: Request for Comment on Nasdaq Petition Relating to the Regulation of Nasdaq-Listed Securities*, Exchange Act Release No. 34-47849 (May 14, 2003) available at <http://sec.gov/rules/concept/34-47849.htm>.
- f. Securities and Exchange Commission, *Concept Release: Regulation of Exchanges*, Exchange Act Release No. 34-38672 (May 23, 1997), available at <http://sec.gov/rules/concept/3438672.txt>.
- g. Testimony of Mary L. Schapiro, Chairman and CEO, NASD, Before the Committee on Banking, Housing and Urban Affairs, May 17, 2007, available at www.finra.org/Newsroom/Speeches/Schapiro/P019169.

B. Federal Regulation Of SROs

1. The SEC recently reaffirmed that:

“[s]elf-regulation, with oversight by the Commission, is a basic premise of the Exchange Act. For example, Congress recognized the regulatory role of national securities exchanges in Section 6 of the Exchange Act, requiring all existing securities exchanges to register with the Commission and to function as self-regulatory organizations.

Commission Guidance and Amendment to the Rules Relating to Organization and Program Management Concerning Proposed Rule Changes Filed by Self-Regulatory Organizations, Exchange Act Rel. No. 34-58092 (effective July 11, 2008), available at <http://sec.gov/rules/final/2008/34-58092.pdf>.

2. *Self-Regulatory Organizations*

- a. The Securities Exchange Act of 1934 (the “Exchange Act”) set forth requirements for the registration and regulation of national securities exchanges. The Maloney Act of 1938 added a provision for the self-regulation of the over-the-counter securities market through the registration of a national securities association. The Maloney Act added requirements to the Exchange Act that make it unlawful for any registered broker or dealer to effect any transaction in, or induce or attempt to induce the purchase or sale of, any security (other than commercial paper, bankers’ acceptances, or commercial bills) unless the broker or dealer either is a member of a securities association registered pursuant to section 15A or effects transactions in securities solely on a national securities exchange of which it is a member. Exchange Act §15(b)(8). Later amendments to the Exchange Act established requirements for registered clearing agencies and the Municipal Securities Rulemaking Board (MSRB). Exchange Act §17A, §15B.
- b. The SEC supervises numerous SROs, consisting of registered national securities exchanges, the Financial Industry Regulatory Authority (FINRA), the only registered national securities association, the MSRB, and several registered clearing agencies. Current SROs include:

- i. BATS Exchange, Inc. (BATS)
- ii. Board of Trade of the City of Chicago, Inc. (CBOT)
- iii. CBOE Futures Exchange, LLC (CFE)
- iv. Chicago Board Options Exchange (CBOE)
- v. Chicago Mercantile Exchange (CME)
- vi. Chicago Stock Exchange (CHX)
- vii. Depository Trust Company (DTC)
- viii. Financial Industry Regulatory Authority (FINRA) (formerly the National Association of Securities Dealers, or NASD)
- ix. Fixed Income Clearing Corporation (FICC) (formerly Government Securities Clearing Corporation)
- x. International Securities Exchange (ISE)
- xi. Municipal Securities Rulemaking Board (MSRB)
- xii. NASDAQ OMX BX, Inc. (BX) (formerly Boston Stock Exchange)
- xiii. NASDAQ OMX PHLX, Inc. (PHLX) (formerly Philadelphia Stock Exchange)
- xiv. National Futures Association (NFA)
- xv. Options Price Reporting Authority (OPRA)
- xvi. National Securities Clearing Corporation (NSCC)
- xvii. National Stock Exchange (NSX) (formerly Cincinnati Stock Exchange)
- xviii. New York Stock Exchange (NYSE)
- xix. NYSE Amex LLC (NYSEAmex) (formerly NYSE Alternext US LLC)
 - (1) NYSE Alternext US LLC was formerly the American Stock Exchange. *See* Self-Regulatory Organization (SRO) Rulemaking and National Market System (NMS) Plans, <http://sec.gov/rules/sro.shtml>; Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Change the Name of the NYSE Alternext U.S. LLC to NYSE Amex LLC, 74 Fed. Reg. 11,803 (Mar. 19, 2009).
- xx. NYSE Arca, Inc. (NYSE Arca) (formerly Pacific Exchange, Inc.)
- xxi. Options Clearing Corporation (OCC)
- xxii. Stock Clearing Corporation of Philadelphia (SCCP) (acquired by NASDAQ OMX)

3. *Basic Requirements Of SROs*

- a. The term “self-regulatory organization” is defined as:

any national securities exchange, registered securities association, or registered clearing agency, or (solely for purposes of Sections 19(b), 19(c), and 23(b)) the Municipal Securities Rulemaking Board established by Section 15B.

Exchange Act §3(a)(26).

- b. Basic requirements for SROs are set forth in the following sections of the Exchange Act: section 6 for registered national securities exchanges; section 15A for registered securities associations; section 15B for the MSRB; and section 17A for registered clearing agencies. Section 11A(c) governs SROs' collection, processing, distribution, and publication of information with respect to quotations and transactions. Section 19 gives the SEC responsibility for registration and oversight of SROs. Section 31 requires each national securities exchange and each national securities association to pay to the Commission fees designed to recover the government's costs of supervising and regulating securities markets. SROs are required to make and keep certain records and disseminate them to the Commission as specified by rule. Exchange Act §17(a)(1) and Rule 17a-1.
- c. Specific market structure requirements apply to registered national securities exchanges and registered securities associations. For example, national securities exchanges must have rules concerning listing requirements (section 6(h)(3)) and national securities exchanges and registered securities associations must prevent the use, distribution, or publication of fraudulent, deceptive, or manipulative information with respect to quotations for and transactions in securities (section 11A(c)(1)). Additional market structure requirements applicable to SROs are set out in rules promulgated by the Commission pursuant to the Exchange Act. Other provisions cover the types of rules SROs can and must have, the ability of SROs to enforce their rules, and the effect of SRO rules on competition.
- d. Among the most important common requirements for national securities exchanges and registered securities association organizations are the following:
 - i. The rules shall be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest.
 - ii. Its members and persons associated with its members shall be appropriately disciplined for violation of the provisions of the Exchange Act, the rules or regulations thereunder, or the rules of the self-regulatory organization.
 - iii. The rules of the self-regulatory organization shall be in accordance with the applicable provisions of the Exchange Act, and, in general, provide a fair procedure for the disciplining of members and persons associated with members.
 - iv. The rules of the self-regulatory organization shall not impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Exchange Act. See section 6(b)(5)-(8) of the Exchange Act for national securities exchanges and section 15A(b)(6)-(9) of the Exchange Act for registered securities associations. Slightly different provisions, contained in section 17A(b)(3)(F)-(I) of the Exchange Act, pertain to registered clearing agencies. Section 15B(b)(2)(C) requires, among other things, that the rules of the MSRB be designed to "prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade."

4. *SEC Oversight Of SROs*

- a. The basic provisions for SEC oversight of self-regulatory organizations are contained in section 19 of the Exchange Act. The Securities Acts Amendments of 1975 gave the Commission increased authority over SROs. The 1975 Amendments required SROs to file any new rule or rule change with the Commission and, in most cases, obtain Commission approval before the rule becomes effective. Section 19 includes the following basic provisions:
- i. Procedures for the registration of national securities exchanges, registered securities associations, and registered clearing agencies. Exchange Act §19(a).
 - ii. Procedures for SEC approval of new SRO rules and amendment of SRO rules. Exchange Act §19(b).
 - iii. Authority to abrogate, add to, and delete from (collectively “amend”) the rules of an SRO (other than a registered clearing agency). Exchange Act §19(c).
 - iv. A requirement to notify the Commission of disciplinary actions and denial of membership applications taken by SROs and a provision for review of such actions. Exchange Act §19(d)–(f).
 - v. A requirement to comply with the provisions of the Exchange Act, the regulations thereunder, and the SRO’s own rules and, absent reasonable justification or excuse, to enforce compliance by its members and associated persons with such provisions (additionally, FINRA is required to enforce compliance with MSRB rules by its members and associated persons). Exchange Act §19(g).
 - vi. Authority for the SEC to sanction an SRO for failure, without reasonable justification or excuse, to enforce the provisions of the Exchange Act, the regulations thereunder, or the SRO’s rules, Exchange Act §19(h). The SEC can also sanction officers and directors of an SRO for willful violations of the Exchange Act, the rules thereunder, or the SRO’s rules; willful abuse of authority; or failure to enforce SRO rules without reasonable justification or excuse. Exchange Act §19(h)(4). *See, e.g., In re Salvatore F. Sodano*, Exchange Act Release No. 59141 (Dec. 22, 2008), available at <http://sec.gov/litigation/opinions/2008/34-59141.pdf> (charges against the former Chairman and chief executive officer of the American Stock Exchange LLC (“Amex”) for violations of section 19(h)(4) of the Exchange Act for failure to enforce compliance with the Exchange Act, the rules and regulations thereunder, and Amex’s rules).
- b. The Commission’s Division of Trading and Markets takes primary responsibility for reviewing SRO rule filings. Most rules are approved by the authority delegated to this Division. SEC Rule 30-3(a)(12); SEC Office of Inspector General, *SRO Rule Filing Process*, Audit 438 (Mar. 31, 2008), at 4, available at www.sec.gov/about/oig/audit/2008/438final.pdf.
- c. The Self-Regulatory Organization groups within the SEC’s Office of Compliance Inspections and Examinations (“OCIE”) are responsible for examining SROs to ensure that they and their members comply with applicable federal securities laws and SRO rules. According to OCIE’s web page:
- “OCIE’s SRO groups conduct routine and risk-based inspections of SRO regulatory programs, including: market surveillance, investigation, disciplinary, broker-dealer examination, listing and arbitration programs, among others. In the market surveillance area, OCIE staff examine whether the stock markets have systems and procedures in place to uncover possible market manipulation and other violations. In the listing area, staff examine whether stock markets

are ensuring that listed companies satisfy all applicable financial and corporate governance listing standards.” Office of Compliance Inspections and Examinations, www.sec.gov/about/offices/ocie/ocie_offices.shtml.

- d. The SEC’s Division of Enforcement investigates and brings disciplinary actions against SROs and their employees for violations of the federal securities laws. For examples of SEC actions against SROs, see 2 Poser & Fanto §4.01[D]. Actions against SROs typically take the form of reports issued pursuant to section 21(a) and proceedings pursuant to section 19(g) of the Exchange Act.

5. *SRO Rulemaking*

- a. SRO rule filings are generally made pursuant to a standard notice and comment process under Exchange Act §19(b)(1) and Rule 19b-4. The Commission processed 1,014 proposed rule changes in 2006 and 1,143 in 2007. *SRO Rule Filing Process*, Office of Inspector General, SEC, Audit 438 (March 31, 2008) at 4. For a description of the rulemaking process at FINRA see *Commission Guidance and Amendment to the Rules Relating to Organization and Program Management Concerning Proposed Rule Changes Filed by Self-Regulatory Organizations*, Exchange Act Release No. 34-58092 (effective July 11, 2008); *SRO Rule Filing Process*, Office of Inspector General, SEC, Audit 438 (March 31, 2008); “FINRA Rulemaking Process” at www.finra.org/Industry/Regulation/FINRARules/Rulemaking-Process/index.htm. SROs must file a copy of a rule change with the Commission along with a statement of the basis and purpose of the change. The Commission publishes proposed rule changes in the *Federal Register* and on its website and gives interested persons an opportunity to comment on the proposed rule change. SRO rule proposals are available on the SEC’s website at www.sec.gov/rules/sro.shtml. Users can also submit comments through the website. The Commission approves a proposed rule change if it finds that the change is consistent with the requirements of the Exchange Act and the rules and regulations thereunder that apply to the organization. Exchange Act §19(b)(2).
- b. SROs can also file proposed rule changes for expedited consideration under Exchange Act §19(b)(3)(A) if the rule filing meets certain criteria specified in Rule 19b-4(f). As with a proposed rule change filed pursuant to section 19(b)(2) of the Exchange Act, the Commission publishes notice in the *Federal Register* and on its website of a proposed rule change designated for immediate effectiveness under section 19(b)(3)(A).

i. Rule 19b-4(f) provides:

A proposed rule change may take effect upon filing with the Commission pursuant to Section 19(b)(3) of the Exchange Act, 15 U.S.C. 78s(b)(3)(A), if properly designated by the self-regulatory organization as:

- (1) Constituting a stated policy, practice, or interpretation with respect to the meaning, administration, or enforcement of an existing rule;
- (2) Establishing or changing a due, fee, or other charge applicable only to a member;
- (3) Concerned solely with the administration of the self-regulatory organization;
- (4) Effecting a change in an existing service of a registered clearing agency that:
 - (i) Does not adversely affect the safeguarding of securities or funds in the custody or control of the clearing agency or for which it is responsible; and

- (ii) Does not significantly affect the respective rights or obligations of the clearing agency or persons using the service;
- (5) Effecting a change in an existing order-entry or trading system of a self-regulatory organization that:
 - (i) Does not significantly affect the protection of investors or the public interest;
 - (ii) Does not impose any significant burden on competition; and
 - (iii) Does not have the effect of limiting the access to or availability of the system; or
- (6) Effecting a change that:
 - (i) Does not significantly affect the protection of investors or the public interest;
 - (ii) Does not impose any significant burden on competition; and
 - (iii) By its terms, does not become operative for 30 days after the date of the filing, or such shorter time as the Commission may designate if consistent with the protection of investors and the public interest; provided that the self-regulatory organization has given the Commission written notice of its intent to file the proposed rule change, along with a brief description and text of the proposed rule change, at least five business days prior to the date of filing of the proposed rule change, or such shorter time as designated by the Commission.

c. Any SRO proposed rule change that has taken effect pursuant to section 19(b)(3)(A) or (B) may be enforced to the extent that it is not inconsistent with the provisions of the Exchange Act, the rules and regulations thereunder, and applicable federal and state law. At any time within 60 days after a proposed rule change is filed, the Commission may summarily abrogate the rule change and require the proposal to be refiled. Exchange Act §19(b)(3)(C).

6. *Review Of Disciplinary Actions By SROs*

- a. SROs must provide the Commission with notice of all actions taken by SROs. Exchange Act §19(d) and SEC Rule 19d-1. This includes denials of membership and limitations on the use of services offered by the SRO. 2 Poser & Fanto §4.04[D] at n.185.
- b. Any person “aggrieved” by an SRO action may petition for review. Additionally, the SEC may initiate review on its own motion. Review by the SEC is on a *de novo* basis. Exchange Act §25(a).
- c. A person aggrieved by a final order of the SEC can appeal to the United States Court of Appeals. Exchange Act §25(a).

C. Recent Developments In Self-Regulation

1. *Consolidation Of The NASD And New York Stock Exchange Rulebooks*

- a. In July 2007, the National Association of Securities Dealers (“NASD”) and the member regulation, enforcement, and arbitration functions of the New York Stock Exchange (“NYSE”) merged and formed the Financial Industry Regulatory Authority (“FINRA”). NYSE maintained important regulatory responsibilities for violations of NYSE Rules and applicable federal laws or regulations that occur on or through the systems and facilities of the New York Stock Exchange. NYSE Regulation, Inc., is a not-for-profit corporation dedicated to strengthening market integrity and investor protection. Information about NYSE Regulation is available at www.nyse.com/regula-

[tion/nyse/1145313073247.html](http://www.nyse.com/press/2006/11/28/nyse_nasd_merge.html). Mary Schapiro, NASD Chairman and CEO at the time, said in a statement:

When the new organization is in place and fully integrated, there will be one set of rules, one set of examiners and one enforcement staff.... Duplicative and inconsistent regulation and overlapping jurisdiction will become a thing of the past.

Tomoch Murakami Tse, *NASD, NYSE Say They Will Merge Their Regulatory Bodies*, WASH. POST., Nov. 29, 2006, at D03, available at www.washingtonpost.com/wp-dyn/content/article/2006/11/28/AR2006112801696.html. Since then, FINRA has made significant headway in its rulebook consolidation process, an effort to combine the NASD and NYSE rulebooks.

- b. As explained in a March 2008 Information Notice, FINRA Information Notice, *Rulebook Consolidation Process*, Mar. 12, 2008, available at www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p038121.pdf, the FINRA staff goes through four steps before a rule is even proposed. First, it reviews existing NASD and NYSE rules to identify ones that are duplicative or obsolete. These rules are excluded from the Consolidated Rulebook. Second, the staff studies member conduct rules, member application and registration rules, and financial and operational rules that applied to “dual members” of both NASD and NYSE. The purpose of this is to identify differences between the rules with an eye toward harmonizing them. Third, the staff is evaluating altogether new approaches to brokerage regulation, such as a possible “tiered approach” based on firms’ sizes and business models. As part of this, it is also looking to other countries as models. Fourth, the staff has identified rules from the existing NASD and NYSE rulebooks that seem to work and that can be transferred into the Consolidated Rulebook without major changes.
- c. Once the staff proposes a rule, it goes to one or more FINRA committees and, if approved, then to the FINRA Board of Directors. FINRA Rulemaking Process, www.finra.org/Industry/Regulation/FINRARules/RulemakingProcess/index.htm. If the Board approves, a regulatory notice is sent to members asking for comments. These notices are also posted on the FINRA website, finra.org, where interested parties are invited to comment. Requests for Comments, www.finra.org/Industry/Regulation/RequestsforComments/index.htm. Once the Board has reviewed these comments and is satisfied with a proposed rule, the Exchange Act requires that FINRA file it with the SEC for publication in the *Federal Register*. Exchange Act §19(b)(1). See B.5, *supra*. There, the proposed rule is subject to public comment and review before the SEC ultimately approves or rejects it.
- d. Once the SEC approves a proposed rule, FINRA publishes its effective date in a regulatory notice that is also available on the FINRA website. FINRA Information Notice, *Rulebook Consolidation Process*, Oct. 6, 2008, available at www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p117155.pdf. FINRA also adds the newly approved rule to its online rule conversion charts, which map how prior NASD and NYSE rules have been incorporated into the Consolidated FINRA Rulebook.
 - i. There are three different rule conversion charts on the FINRA page to show members how rules have moved within the rulebook. One chart shows where former NASD rules have gone in the FINRA Consolidated Rulebook. Another shows where former NYSE rules have gone. The third does this in reverse: showing where the current FINRA rules came from. See:

- (1) NASD to FINRA, www.finra.org/Industry/Regulation/FINRARules/p085560.
- (2) NYSE to FINRA, www.finra.org/Industry/Regulation/FINRARules/p085667.
- (3) FINRA to NASD and NYSE, www.finra.org/Industry/Regulation/FINRARules/p085668.

e. Richard Ketchum, the newly appointed Chairman and CEO of FINRA, announced in March 2009 that FINRA is “about 70 percent complete with Board approval of the rulebook consolidation.” Richard G. Ketchum, Remarks from the SIFMA Compliance & Legal Division’s Annual Seminar, Mar. 23, 2009, *available at* www.finra.org/Newsroom/Speeches/Ketchum/P118256. More than 500 rules have already been approved by the SEC. *See generally* Rule Conversion Chart: FINRA to NASD and NYSE, *supra*.

2. Consolidated Supervision Rules

- a. Two major rules that are yet to be ratified concern supervision. Proposed FINRA Rule 3110 would cover “Supervision,” and Proposed Rule 3120 would cover “Supervisory Control Systems.” FINRA Regulatory Notice, *Supervision and Supervisory Controls*, May 14, 2008, *available at* www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p038506.pdf. These proposed rules are based primarily on NASD Rules 3010 and 3012, but make significant changes. For instance, NASD Rule 3010(a)(2) currently requires firms to designate a principal to supervise each business the firm operates “for which registration as a broker/dealer is required.” Proposed FINRA Rule 3110(a)(2) would require firms to designate a principal to supervise *every* business the firm operates *without regard for whether registration is required*. *Id.* at 4.
- b. The FINRA Board approved these proposed rules for internal notice and comment in May 2008, with the comment period expiring in June 2008. FINRA received many objections to the proposed rules during the comment period, many of them centering on this apparent expansion of FINRA’s jurisdiction. *See, e.g.*, Letter from National Association of Independent Broker-Dealers, Inc. (June 13, 2008), www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/noticecomments/p038755.pdf; Letter from The Beacon Financial Group Inc. (June 6, 2008), www.finra.org/Industry/Regulation/Notices/Comments/P038796; Letter from National Planning Holdings, Inc. (June 12, 2008), www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/noticecomments/p038794.pdf. *See generally* Comments on Regulatory Notice 08-24, www.finra.org/Industry/Regulation/Notices/2008/P038502. No further action has been taken on these supervisory rules to date, but in the immediate wake of the Madoff scandal, FINRA Executive Vice President Grace Vogel remarked that the scandal “caused us to rethink certain things” regarding the supervisory role of broker-dealers. Edward Benson, *Madoff Causes FINRA Rethink on Supervisory Rules...*, COMPLIANCE REPORTER, Dec. 22, 2008, at 1, *available at* www.compliancereporter.com/pdf/CR122208.pdf.

D. Changing SRO Landscape

1. Although there are numerous SROs, including several new exchanges, in many significant aspects SRO oversight of the securities industry is being consolidated. The merger of NASD with NYSE

enforcement functions is described above. Three examples of functional consolidation are described below.

2. *Insider Trading Surveillance*

a. Twelve SROs announced in August of 2008 that they had reached an agreement to consolidate the surveillance, investigation, and enforcement of insider trading in equity securities. *FINRA and NYSE Regulation Announce Agreement With Ten U.S. Exchanges to Strengthen Surveillance, Investigation and Enforcement to Prevent Insider Trading*, FINRA News Release, August 13, 2008. Under the agreement, each SRO gives responsibility for the detection of insider trading to FINRA for Amex- and NASDAQ-listed securities and to NYSE Regulation for New York Stock Exchange- and NYSE Arca-listed securities, no matter where trading occurs in the United States.

i. Market centers participating in the agreement, which was approved by the SEC, are the American Stock Exchange, the Boston Stock Exchange, the CBOE Stock Exchange, the Chicago Stock Exchange, the International Securities Exchange, the NASDAQ Stock Market, the National Stock Exchange, the New York Stock Exchange, NYSE Arca, the Philadelphia Stock Exchange, and FINRA.

3. *Short Interest Reporting*

a. Beginning in June 2008, firms were required to report short interest positions in all securities, including NASDAQ, NYSE Alternext US LLC (now NYSE Amex LLC), NYSE, NYSE Arca, and OTC equity securities through FINRA's web-based regulation filing applications system. FINRA Regulatory Notice 08-13, "FINRA Consolidates the Collection of Short Interest Data" (March 2008). *See supra*.

4. *Regulatory Services Agreements For NYSE, FINRA, And Other SROs*

a. Increasingly, SROs contract out a significant portion of their regulatory obligations. For example, through a regulatory services agreement, NYSE Arca is responsible for the regulation of trading on Amex Options. NYSE Arca Regulation, www.nyse.com/regulation/nysearca/1221692422975.html. NYSE Regulation oversees NYSE Arca Regulation and NYSE Amex Regulation through regulatory services agreements. NYSE Regulation, www.nyse.com/regulation/nyse/1145313073247.html. FINRA has provided regulatory services for NASDAQ, Amex, The BATS Exchange, Inc., the Trade Reporting Facilities (TRFs), the State Regulatory Registry, LLC, and other exchanges; these services include surveillance, monitoring, development, legal services, and enforcement activities. FINRA 2007 Year in Review and Annual Financial Report at 57, available at http://apps.finra.org/annual_report/2007/ar07.pdf; *Program for Allocation of Regulatory Responsibilities Pursuant to Rule 17d-2*, Exchange Act Release No. 34-58818 (Oct. 20, 2008), available at <http://sec.gov/rules/other/2008/34-58818.pdf>. Fees from these agreements were reported on FINRA's financial statements under the heading Contract Services. "Contract services fees were \$62.7 million in 2007, compared with \$27.2 million in 2006—an increase of \$35.5 million, or 130.5 percent." *Id.* at 10.

E. Self-Regulation For Investment Advisors

1. Broker-dealers are subject to oversight by one or more SROs and the SEC. Investment advisors are subject to oversight by states or the SEC, but are not subject to SRO oversight. "Brokers are largely

regulated by [FINRA], which is funded by the brokerage business itself and inspects firms every one or two years. . . . Advisers are regulated by the states or the [SEC], which examines firms every six to 10 years on average.” Jason Zweig, *The Fight Over Who Will Guard Your Nest Egg*, WALL ST. J., Mar. 28, 2009, at B1, available at <http://online.wsj.com/article/SB123819596242261401.html>.

2. Furthermore, federally registered investment advisors have a fiduciary duty to their customers; broker-dealers have a duty of suitability in making recommendations to their customers, but do not have a categorical fiduciary duty. “Unlike the case of investment advisers (addressed below), broker-dealers are not categorically bound—by statute, regulation, or precedent—to a per se rule imposing fiduciary obligations toward clients. Instead, the existence of fiduciary obligations within a broker-client relationship has historically been significantly more contingent, turning ultimately on the factual nature of the relationship (usually as interpreted by courts and arbitrators).” *Investor and Industry Perspectives on Investment Advisers and Broker-Dealers 10* (RAND Institute for Civil Justice 2008) (“RAND Report”). “[F]ederally registered investment advisers owe fiduciary obligations to their clients as a categorical matter. As noted already, such obligations require the adviser to act solely with the client’s investment goals and interests in mind, free from any direct or indirect conflicts of interest that would tempt the adviser to make recommendations that would also benefit him or her.” RAND Report at 13.
3. The debate over different regulatory schemes for broker-dealers and investment advisors gained new urgency in the past year. In January 2008, a RAND Institute study commissioned by the SEC renewed the debate by concluding that “investors typically fail to distinguish broker-dealers and investment advisers along the lines defined by federal regulations.” RAND Report at 118. The Madoff scandal brought the controversy to the forefront as politicians, regulators, and investors sought to allocate blame for the loss of billions of dollars. FINRA Chairman Ketchum recently called “the disparity between oversight regimes for broker-dealers and investment advisers . . . the most glaring example of what needs to be fixed in the current system.” He explained, “[t]here is no doubt that Madoff and others have cynically designed their schemes to fit between the jurisdictional cracks to decrease the likelihood of detection.” Ketchum, Remarks from the SIFMA Compliance & Legal Division’s Annual Seminar, Mar. 23, 2009, available at www.finra.org/Newsroom/Speeches/Ketchum/P118256. See also Zweig, *supra*, (“It’s time to get to one standard, a fiduciary standard that works for both broker-dealers and advisers. . . . Both should have a fundamental first responsibility to their customers.”). Mary Schapiro, as Chairman of the SEC, recently noted that her agency is looking into “[h]armonizing the responsibilities of investment advisers and broker-dealers, so that investors who use either can expect a uniform level of professionalism and accountability.” Chairman Mary L. Schapiro, Address to the Council of Institutional Investors, Apr. 6, 2009, available at www.sec.gov/news/speech/2009/spch040609mls.htm.
4. Anything more than marginal change to the current framework will require legislative action. In testimony to the Senate, Chairman Schapiro stated: “We are studying whether to recommend legislation to break down the statutory barriers that require a different regulatory regime for investment advisers and broker-dealers, even though the services they provide often are virtually identical from the investor’s perspective.” Chairman Mary L. Schapiro, Testimony Concerning Enhancing Investor Protection and Regulation of the Securities Markets, Mar. 26, 2009, available at www.sec.gov/news/testimony/2009/ts032609mls.htm.