

## NASD/NYSE Consolidation

On November 28, 2006, the NASD and the New York Stock Exchange (NYSE) announced a plan to consolidate their member regulation operations into a new SRO, called the Financial Industry Regulatory Authority (FINRA), that will be the single, private-sector regulator for all securities firms doing business with the public in the United States. This commentary from Complinet gives some of the essential information you'll need to prepare

The consolidation of NYSE Regulation and NASD is designed to create a single regulator for the 5,100 broker-dealers within the United States, eliminating overlapping regulation, reducing inefficiency and strengthening the competitiveness of American markets.

FINRA will be staffed with the current 2,400-person NASD organization and approximately 470 of NYSE Regulation's member regulation, arbitration and related enforcement team.

### Background

The merging of the SROs is a culmination of many factors including pressure from the industry and the SEC. Influential in the evolution of this change was scrutiny over the last few years of the NYSE regarding specialist activities, compensation of management and independence of the regulatory function from the business once it became public. In November 2004, the SEC issued a concept release on the future of self-regulation to discuss and solicit comments on the role and operation of SROs in today's markets. The release focused on questions about the fairness and efficiency of the current SRO structure and proposed different scenarios.

Since the concept release, pressure to eliminate regulatory duplication, increase regulatory efficiency and reduce the costs associated with regulation has continued. Recently discussions and criticisms have included how the current regulatory structure impinges on the competitiveness of the US markets in the global marketplace. These mounting pressures and scrutiny have resulted in the consolidation and most likely affected the timing of the announcement. Some industry members have speculated that the increasing pressures from the public and the SEC forced the NASD and the NYSE to publicly announce the merger prior to having many of the critical details worked out and agreed to by both sides.

### Consolidation

Although not all details have yet been communicated, here is a summary of what has been announced:

- FINRA will be responsible for all member regulation, arbitration and mediation and all other current NASD responsibilities including market regulation by

contract for NASDAQ, the American Stock Exchange and the International Securities Exchange.

- FINRA will oversee all member compliance examinations, rule writing, professional training, licensing and registration, and industry utilities like the Alternative Display Facility, the OTC Bulletin Board and Trade Reporting Facilities.
- NYSE Regulation will continue to oversee market surveillance and listed company compliance at the New York Stock Exchange and NYSE Arca.
- FINRA will operate from Washington, DC, New York, NY, and 18 District and Dispute Resolution office locations. None of the NASD or NYSE Regulation offices are anticipated to be closed as a result of the consolidation.
- Leadership has publicly stated there would be no layoffs as a result of the merger and any "right-sizing" would be achieved through normal attrition.
- A 23-person Board of Governors will oversee FINRA: ten Governors will be from inside the securities industry, eleven Governors will be appointed from outside the securities industry, the CEO will serve on the Board of Governors, as will the Non-Executive Chairman.
- It is anticipated that most of 2007 will be spent integrating staffs, systems and rulebooks and firms can expect to see more significant changes in 2008.

### **Chronology of announcements and events**

- November 28, 2006 Intention for merger announced
- December 6, 2006, the NASD Board of Governors approved By-Law amendments to implement required governance changes for the consolidation to take place.
- On January 21, 2007 NASD member firms approved changes to the by-laws to allow for the consolidation.
- On March 20, 2007 NASD filed the amended By-Laws with the SEC. The SEC comment period closed April 16 [SEC Release No. 34-55495 and File No. SR-NASD-2007-023](#) Notice of Filing of Proposed Rule Change to Amend the By-Laws of NASD to Implement Governance and Related Changes to Accommodate the Consolidation of the Member Firm Regulatory Functions of NASD and NYSE Regulation, Inc. (*NASD proposed rule change*)
- March 16, 2007 Mary Schapiro announced leadership and structural moves for a new, consolidated SRO.
- May 11, 2007 Mary Shapero announced the expectation that by this summer (mid-June), the New SRO, with a new name, will be up and running.

## **Plan for a single, combined rulebook**

A critical component of the merger is the intention that the members of the consolidated, FINRA will be subject to a new rulebook. All announcements to date have been clear that the new rulebook will not be available for day one of FINRA. Although there has been no public commitment as to when the new rulebook will be final, leadership has said that it will take a minimum of 18 months to two to three years. Until such time as there is a merger rulebook, the current rulebooks will remain in effect:

- Dual firms will be subject to both rule sets
- NASD only firms will be subject to current NASD rules
- NYSE only firms will be subject to current NYSE rules

It is anticipated that the new rulebook will be some sort of combined product or mixture of what the NASD and NYSE rulebooks are currently. In discussing the plan for a single rulebook in her May 17, 2007 testimony before the Senate Banking Committee, Mary Schapiro stated that she envisions the new rulebook to be a compilation which draws on the strengths of both rule sets. She believes the two existing SRO rulebooks complement one another with the NASD manual focusing on sales practices and the NYSE manual excelling in the financial and operational areas. She projects that the complementary sections of the rulebooks can, in large measure, be moved wholesale into the new succeeding rulebook.

Trying to mitigate some of the fears that this merger and FINRA will be overly burdensome to small firms, she clarified in her testimony that smaller broker-dealers will not be burdened by rules that are inapplicable to the scope or nature of their business for the ease of consolidating rulebooks. They will be careful in calibrating the rules to have application to the appropriate firms by attempting to take a tiered approach to accommodate firms of different sizes and business models.

## **Rule harmonization**

As a precursor to a combined rulebook, for over a year the NASD and the NYSE have been working on a rule harmonization project to identify where there are differences in the rules and attempt to bring them together while reducing duplication. There have already been proposed amendments filed.

The review process essentially consists of identifying inconsistencies between the NYSE rules and the NASD rules, determining which SRO standard makes more regulatory sense, and then recommending rule changes that would either confirm an NYSE standard to its NASD counterpart or vice versa. In some instances, a hybrid approach was taken and included amendments to corresponding rules of both SROs.

## Concerns of the industry

Until the merger is complete and the new regulatory regime is in place and operating, many in the industry are currently in a wait and see mode. Some general concerns are:

- How the consolidation will affect firms and compliance professionals' day-to-day jobs?
- How and whether firms can plan for the changes?
- Whether the merger will reduce regulatory duplication?
- Whether the merger will make things easier or harder?
- Whether the merger will reduce costs for firms?
- Will the merger change exam obligations? If so, how?
- Will firms' interaction with the SEC or other regulators and exchanges change as a result?
- What will the impact be on small firms?

Some concerns related to the new rulebook:

- Timing of new rulebook
- Will there be substantive changes?
- How will firms deal with new rules and regulations?
- Will firms need to hire new or temporary staff to assist?
- How will the new or amended rules affect policies and procedures? Training? Operations?
- Will firms need to change systems?

As the convergence of NYSE Regulation and NASD draws near, Complinet has the tools your company needs to make the transition as efficient and low-risk as possible. Our Policy Manager solution provides an interactive platform for you link, consolidate and disseminate information across the enterprise. We dynamically connect your internal policies with specific rule changes, track regulatory developments and their impact, update and archive past policies, and communicate changes to targeted users.

The changeover of your company's policies with the development of FINRA could become a manually burdensome process, but with Complinet it doesn't have to be.

For more information on this topic and to see how Complinet can help visit our website on [www.complinet.com/themerger](http://www.complinet.com/themerger).