



THE FINANCIAL INDUSTRY REGULATORY AUTHORITY Not Self-Regulation after All

Many Americans rely on brokers to assist them with their investments. The primary regulator of brokers is the Financial Industry Regulatory Authority (FINRA), a growing regulatory force in American securities markets. Many policymakers look at FINRA as a potential regulator of investment advisers, and FINRA is seeking to expand its role in regulating stock exchanges as well.

FINRA refers to itself as “the largest independent regulator of securities firms doing business with the public in the United States.” As of the end of 2012, it regulated approximately 4,100 firms, 161,000 branch offices, and 636,000 registered securities representatives. FINRA performs a wide range of functions and enforces its own rules and the federal securities laws. Sanctions for violations of its rules include censures, fines, restitution to harmed investors, suspensions, and permanent bars from the industry. FINRA’s board of governors is intentionally weighted against industry members, with a majority of the 24-member board not permitted to have ties to the industry. This arrangement is inconsistent with the characteristics of a typical self-regulatory organization.

In a [new paper](#) for the Mercatus Center at George Mason University, senior research fellow [Hester Peirce](#) demonstrates that FINRA is not structured in a way to produce high-quality regulation and is not accountable to the government, the industry, or the public.

LACK OF ACCOUNTABILITY

Despite having regulatory powers similar to those of the Securities and Exchange Commission (SEC), FINRA is not subject to the same mechanisms that hold other federal regulators accountable to Congress, the president, and the public. These include politically accountable directors or commissions leading the agency, oversight by Congress through budget-setting authority, the constraints of the Administrative Procedure Act and benefit-cost analysis in connection with rule-making, and public access to documents through the Freedom of Information Act.

For more information, contact
Kate De Lanoy, 703-993-9677, kdelanoy@mercatus.gmu.edu
Mercatus Center at George Mason University
3434 Washington Boulevard, 4th Floor, Arlington, VA 22201

These types of constraints on government regulators help improve the quality of regulation because regulators are required to submit proposed plans and rules to third parties that can hold the regulator accountable to the public and can raise questions about problematic policy decisions. FINRA is not subject to these accountability mechanisms.

SEC OVERSIGHT

FINRA is subject to SEC oversight. FINRA reports to the SEC, and the SEC examines FINRA. The SEC can disapprove FINRA rules and revise or reverse FINRA disciplinary and regulatory decisions. Nevertheless, FINRA sets its own rulemaking and disciplinary agendas and budget without SEC input. In practice, FINRA operates with substantial independence of the SEC.

REGULATORY ASPIRATIONS

FINRA has actively sought opportunities to expand its regulatory authority. For example, FINRA has argued that it should become the regulatory body for investment advisers and has gradually expanded its role as a regulator of securities markets. Additionally, Congress recently gave FINRA responsibility for registering and overseeing crowdfunding portals, the intermediaries through which companies will be able to raise small amounts of equity funding. As FINRA expands its regulatory reach beyond its oversight of broker-dealers, it may look even less like a self-regulatory organization and more like a government regulatory agency.

POTENTIAL REFORMS

As FINRA's reach expands, policymakers should acknowledge that FINRA is a very powerful regulator that is neither a self-regulator nor a government regulator. FINRA's lack of accountability to the industry it regulates, the government, and the public could be addressed by

- enhancing FINRA's public disclosure and procedural obligations;
- folding FINRA into the SEC so that these regulatory functions would be subject to the procedural and disclosure requirements that apply to other government regulatory agencies; or
- remaking FINRA into a true self-regulatory organization—a regulator that is actually run by the industry it regulates—and allowing the emergence of competing self-regulatory organizations.

The final reform is the most promising, because self-regulatory organizations—with their expertise and industry funding—offer advantages over governmental regulators.

CONCLUSION

FINRA currently wields governmental powers without the procedural and disclosure requirements by which a government regulatory agency would be constrained. Reforms are needed to ensure that this powerful regulator of financial markets is accountable to the public whom it is supposed to protect.