TESTIMONY OF ONNIG H. DOMBALAGIAN

Before the Subcommittee on Capital Markets
Committee on Financial Services
United States House of Representatives

"The Role of Self-Regulatory Organizations in U.S. Markets: Examining FINRA and the MSRB"

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Chair Wagner, Ranking Member Sherman, and Members of the Subcommittee:

Thank you for the opportunity to testify today on the role of self-regulatory organizations in U.S. capital markets, and specifically the efficiency and accountability of FINRA. My name is Onnig Dombalagian, and I am a professor of law at Tulane University School of Law. Since leaving the Securities and Exchange Commission to join the legal academy, I have studied and written about the legal and regulatory structure of U.S. securities markets with particular attention to the role of self-regulatory organizations ("SROs"). I have also had the privilege of serving two terms as a non-industry member of FINRA's National Adjudicatory Council (the body charged with hearing appeals from FINRA membership and disciplinary matters) and over two decades as an arbitrator for FINRA's dispute resolution services.

I am honored to appear before you, and I would like to commend the Subcommittee for its continued oversight of FINRA's significant role in regulating the securities industry. I am of course speaking in my personal capacity and not on behalf of Tulane University or the Law School.

I. Background

The history of the regulation of national securities associations is well documented.[1] Following the Crash of 1929, Congress enacted the Securities Exchange Act of 1934 to ensure that stock exchanges were no longer run as "private clubs to be conducted only in accordance with the interests of their members."[2] Congress nevertheless settled upon a self-regulatory framework for regulating the activities of stock exchange members, in part to avoid the "impracticality" of creating "a burgeoning bureaucracy" that would be "in danger of breaking down under its own weight." Under this framework, members of a registered securities exchange would be responsible for collectively governing their activities; governmental

[1] *See generally* JOEL SELIGMAN, THE TRANSFORMATION OF WALL STREET (3d ed. 2003); CHARLES R. GEISST, WALL STREET: A HISTORY (1997).

[2] H. Rep. 1383, 73d Cong., 2d Sess. p. 15 (1934).

regulation meanwhile would be used only "to supplement and supervise what in the first instance was self-regulation of the exchanges."[3]

In the Maloney Act of 1938, Congress established a comparable regulatory regime for the registration of "national securities associations" of broker-dealers that were not members of a national securities exchange.[4] The National Association of Securities Dealers (the "NASD"), FINRA's forerunner, is the only association to have registered under Section 15A of the Exchange Act. At the time, membership in the NASD was voluntary, though Congress gave broker-dealers substantial incentives to join.[5] The mandate of national securities associations under the Exchange Act (as currently stated) is to adopt rules "designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, … to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest."[6]

Over the decades, the NASD amassed greater responsibility for business conduct regulation in the brokerage industry. The Securities Acts Amendments of 1975 harmonized the regulation of stock exchanges and national securities associations, which facilitated the consolidation of business conduct rules and allocation of compliance examination authority between the New York Stock Exchange ("NYSE") and NASD. The transition to automated trading and the wave of exchange demutualization in the late 1990s and early 2000s exacerbated conflicts of interest inherent in market-based self-regulation. Accordingly, the NYSE and the NASD each undertook to formally separate their business operations from their regulatory functions.[7] The member regulation functions of the NYSE and NASD eventually merged into FINRA, which now serves as the principal authority for upholding just and equitable principles of trade in the securities industry.[8]

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[3] S. Doc. No. 93-13, 93d Cong., 1st Sess. at 139 (April 6, 1973) (quoting the recommendations of the Roper Committee, Hearing on H.R. 7852 and H.R. 8720 Before the House Comm. on Interstate and Foreign Commerce, 73d Cong., 1st Sess. at 513-14 (1934)).

[4] Maloney Act, Pub. L. No. 75-719, 52 Stat. 1070 (1938). Unlike the Exchange Act, the Maloney Act was adopted with the endorsement of several key securities industry associations—including the Investment Bankers Committee, a voluntary industry organization that promulgated best practices—as a preferable alternative to direct Commission regulation. Regulation of Over-the-Counter Markets, S. Rep. No. 1455, 75th Cong., 3d Sess. at 5 (1938).

[5] 15 U.S.C. § 78o-3(e).

[6] 15 U.S.C. § 78o-3(b)(6).

[7] Order Granting Approval of Proposed Rule Change and Amendment Nos. 1, 3, and 5 Thereto and Notice of Filing and Order Granting Accelerated Approval to Amendment Nos. 6 and 8 Relating to the NYSE's Business Combination With Archipelago Holdings, Inc., Exchange Act Release No. 53,382, 71 Fed. Reg. 11,251–52 (Mar. 6, 2006).

[8] THOMAS LEE HAZEN, TREATISE ON THE LAW OF SECURITIES REGULATION, § 14.3[3] (describing the creation of FINRA).

II. Self-Regulation in the Crucible

The Exchange Act's model of securities industry self-regulation is grounded in certain core principles, which continue to resonate today. These include the industry's familiarity with securities market operations, its reputational interest in upholding mutual and reciprocal principles of trade, and the ability to shift the financial burden of regulation to the industry through membership fees and other revenue sources. As markets have evolved, SROs including FINRA also maintain critical infrastructures for advancing the goals of the national market system, such as information processing and dissemination services, market and member surveillance systems, and other utilities.[9]

In recent years, both industry and academic commentators have questioned FINRA's effectiveness and accountability, and in some cases the constitutionality of its rulemaking and disciplinary activities.[10] Some scholars argue that SROs such as FINRA have "transition[ed] from self-regulation to quasi-governmental regulation" over the past fifty years.[11] These arguments are propounded, in part, based on Congress's determination in 1983 to require most all registered broker-dealers to become members of a registered securities association. This statutory amendment effectively made FINRA membership a condition of registration as a broker-dealer operating a public business.[12] It is thus not unexpected that some firms and outside observers may regard FINRA as an alter ego of the Commission, but without direct judicial oversight of its rulemaking or disciplinary processes.

Others conversely criticize unmanaged conflicts of interest in FINRA's governance and excessive lenity in its rulemaking and disciplinary activity. Some scholars have questioned the composition of FINRA's governing bodies, particularly with respect to the processes by which public members are nominated and the management of their conflicts of interest.[13] There is also criticism of FINRA's exercise of discretion over the allocation of fines, disgorgement, and other monies collected in disciplinary proceedings. Some FINRA members have lodged concerns about disparities with respect to settlements or disciplinary actions involving large firms, as compared to small or mid-size firms. These disparities may reflect practical limitations on FINRA's disciplinary leverage, such as its limited investigative tools and

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[9] Onnig H. Dombalagian, *Securities and Derivatives Exchanges in the United States*, *in* FINANCIAL MARKET INFRASTRUCTURES: LAW AND REGULATION 144–53 (Jens-Hinrich Binder & Paolo Saguato eds., EU Fin. Regul. Series, Oxford Univ. Press 2021).

[10] *See, e.g.*, Emily Hammond, *Double Deference in Administrative Law*, 116 COLUM. L. REV. 1705 (2016).

[11] *See, e.g.,* William A. Birdthistle & M. Todd Henderson, *Becoming a Fifth Branch*, 99 CORNELL L. REV. 1 (2013).

[12] 15 U.S.C. § 78o(b)(8). The Commission has the authority to conditionally or unconditionally exempt any broker or dealer or class of brokers or dealers from this requirement. 15 U.S.C. § 78o(b)(9).

[13] *See, e.g.*, Benjamin P. Edwards, *The Dark Side of Self-Regulation*, 85 UNIV. CIN. L. REV. 573 (2017) (questioning the independence of FINRA's public representatives).

reliance on the threat of suspension or expulsion to impose remedial sanctions.[14] Some such commentators also question the effectiveness of FINRA disciplinary sanctions, as it is increasingly possible for financial advisors to enter into a range of securities-related activities without being associated with a registered broker-dealer.[15]

Perhaps the most frequent criticism inveighed in respect of FINRA is the structural shift away from market-driven regulation to consolidated business conduct oversight and the resulting perception of the bureaucratization of FINRA.[16] The size and scope of FINRA's activities naturally invite public scrutiny. As of year-end 2024, FINRA reported that its membership comprises over 3,200 firms, which collectively employ over 630,000 registered representatives. In fiscal 2024, FINRA collected nearly $1.4 billion in operating revenues, of which approximately two thirds represented regulatory fees assessed on its members. By comparison, the SEC received budget authority of approximately $2.2 billion for FY 2024. With the increasing size and specialization of FINRA staff, there may be a fear—particularly among small or mid-sized firms—that fair representation in FINRA's decision-making processes is increasingly constrained.[17]

Retail investors and their advocates also regularly express frustration with FINRA's public-facing operations, such as its dispute resolution forum. It is challenging to provide a forum for adjudication of securities claims that preserves meaningful access to justice while also ensuring transparency, due process, and reviewability of arbitration decisions. Some commentators have argued that the industry practice of forced securities arbitration "uniquely impacts small claims investors and diminishes their access to justice."[18] The qualifications of public arbitrators are also a subject of recurring concern, insofar as FINRA must recruit arbitrators not only competent to adjudicate securities claims but also sufficiently disinterested to render fair and impartial awards.

Other commentators suggest that "criticisms of the fairness of securities arbitration stem primarily from misunderstandings as to the law, not to defects in the arbitration process or failures of the arbitrators."[19] The arbitration process may be particularly frustrating to

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[14] Fiero v. Fin. Indus. Regul. Auth., 660 F.3d 569, 574 (2d Cir. 2011) (concluding that FINRA "has no authority to bring judicial actions to collect monetary sanctions" under state law).

[15] *See, e.g.*, Colleen Honigsberg et al., Regulatory Arbitrage and the Persistence of Financial Misconduct, 74 STAN. L. REV. 737 (2022).

[16] *See, e.g.*, Onnig H. Dombalagian, *Self and Self-Regulation: Resolving the SRO Identity Crisis*, 1 BROOKLYN J. CORP. FIN. & COM. L. 317 (2007) (anticipating such concerns).

[17] 15 U.S.C. § 78o-3(b)(4). Similar concerns have arisen in the context of stock exchanges, as the need to assure both public and shareholder representation necessarily dilutes member representation on exchange boards.

[18] Nicole Iannarone, *Investor Justice*, 109 MINN. L. REV. 1153, 1181 (2025).

[19] Jill I. Gross, *McMahon Turns Twenty: The Regulation of Fairness in Securities Arbitration*, 76 U. CIN. L. REV. 493, 518 (2008).

investors insofar as arbitration awards are generally not explained and are not easily set aside under the Federal Arbitration Act.

III. Improving Efficiency and Accountability

FINRA has undertaken initiatives to modernize its rules in response to these and other criticisms from its members and the public. The stated aims of its FINRA Forward initiative include eliminating outdated requirements, streamlining compliance obligations, and improving coordination and harmonization across regulatory areas. FINRA has concomitantly undertaken steps to improve the transparency of its regulatory policy agenda[20] and internal cost/benefit analysis processes,[21] to revise its sanctions guidelines to calibrate monetary sanctions for individuals and small firms, and to clarify the use of monies assessed in disciplinary proceedings.[22] With regard to arbitration, FINRA has recently announced initiatives to improve the quality of arbitration panels and to limit the burdens imposed by discovery and motion practice.

Over the years, this Subcommittee has entertained broader proposals that would structurally alter the Exchange Act's self-regulatory framework for registered securities associations. These proposals naturally entail trade-offs between ensuring the accountability of SROs to the public and accommodating the operational flexibility and adaptability of the securities industry.

One line of reform focuses on increasing FINRA's accountability to the public. Some proposals in this vein aim to increase the transparency of FINRA's rule-writing process (such as by including greater cost-benefit analysis) or of its compensation, nomination, and governance practices. Others would establish direct Congressional authority to review or audit FINRA's revenues and expenditures, or to direct the use of fines, penalties, or other monies collected by FINRA. I believe the Commission can address many of these concerns through existing authority under Sections 15A and 18 of the Exchange Act—much as it has addressed the governance structures of for-profit exchanges through proposed rulemaking and registration

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[20] *See, e.g.,* FINRA Quarterly Regulatory Policy Agenda, https://www.finra.org/rules-guidance/rulemaking-process/regulatory-policy-agenda.

[21] *See* FINRA, *FINRA Rulemaking Process*, https://www.finra.org/rules-guidance/rulemaking-process (discussing FINRA's rulemaking process, including internal cost-benefit analysis and presentation in committees, circulars to members, and industry conferences).

[22] FINRA asserts that it charges membership fees to finance the cost of supervision and enforcement and does not anticipate revenues from fines for budgetary purposes. Moreover, FINRA states that it allocates revenues actually earned from fines to limited purposes. *See* FINRA, *Report on Use of 2024 Fine Monies* (May 30, 2025), https://www.finra.org/about/annual-reports/report-use-2024-fine-monies.

approvals.[23] Congress has indeed required the GAO to assess the SEC's review of these areas of concern.[24]

Still other proposals would transfer FINRA's authorities and duties to the SEC.[25] There is some historical precedent. From 1965 to 1983, the SEC operated an "SEC Only" program for the direct regulation of broker-dealers who were not otherwise members of an SRO. This program was discontinued, in part because of the cost of federal supervision and the SEC's limited ability to adopt ethical standards of trade through administrative law.[26] Today, the SEC operates a concurrent compliance inspections and examination program, which buttresses but does not duplicate FINRA supervision. Moreover, Dodd-Frank has granted the Commission authority to adopt federal business conduct rules in select areas of business conduct regulation.[27] The SEC's limited exercise of such authority to date raises the question whether the Commission believes it has or would be assured the resources to enforce any such rules, particularly if they were to preempt or otherwise displace FINRA rules.

Another line of reform would encourage greater differentiation or competition in regulatory oversight services, with a view to eliminating structural conflicts of interest or even in some cases facilitating broker-dealer or customer choice. Some proposals in this vein include segregation of rulemaking, compliance inspection, and enforcement functions (mirroring, for example, the relationship between FINRA and the MSRB or other SROs).[28] Others would introduce an opportunity for competition among national securities associations or other SROs in the provision of rulemaking, disciplinary or dispute resolution services.[29] Such competition, of course, existed when each of the NYSE and NASD maintained its own rulemaking, disciplinary, and dispute resolution programs. The challenge for policymakers

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[23] *See* Exchange Act Release No. 50700, 69 Fed. Reg. 71,255 (Dec. 8, 2004).

[24] Section 964 of the Dodd-Frank Act requires the GAO to review ten areas of SEC's oversight of FINRA every three years, including governance and the identification and management of conflicts of interest; examinations; executive compensation practices; arbitration services; reviews of advertising by its members; cooperation with and assistance to state securities regulators; use of funding to support FINRA's mission; policies on the employment of former FINRA employees; effectiveness of its rules; and transparency of FINRA governance and activities.

[25] *See, e.g.,* Restoring Accountability in Market Supervision (RAMS) Act, H.R. 2689, 119th Cong. 1st Sess.

[26] H.R. Rep. No. 98-106 (1983); *see* Benjamin P. Edwards, *Supreme Risk*, 74 FLA. L. REV. 543 (2022).

[27] 15 U.S.C. § 78o(k) & (l).

[28] *See, e.g.,* Program for Allocation of Regulatory Responsibilities Pursuant to Rule 17d-2; Notice of Filing of Proposed Plan for the Allocation of Regulatory Responsibilities Between the Financial Industry Regulatory Authority, Inc. and Texas Stock Exchange LLC, 91 Fed. Reg. 4757 (Feb. 2, 2026).

[29] *See, e.g.,* William A. Birdthistle & M. Todd Henderson, *Becoming a Fifth Branch*, 99 CORNELL L. REV. 1 (2013); Onnig H. Dombalagian, *Let's NMS with Texas: The Implications of the Texas Stock Exchange for Self-Regulation,* 5 U. CHI. BUS. L. REV. (2026 forthcoming) (discussing such proposals).

would be to reintroduce the benefits of such diversification without the associated duplication of costs, inconsistent outcomes, and loss of synergies.

While I share many of these reservations, I strongly believe in the unique synthesis of regulatory and industry expertise that enables our self-regulatory framework to identify and expeditiously respond to market developments. More specifically, the interaction between the SEC (a politically accountable government agency) and FINRA (a self-regulatory body organized as a membership association) is a time-tested way of setting and enforcing norms within the securities industry. The SEC was indeed constituted in part for the express purpose of overseeing self-regulation at the stock exchanges. As in the context of for-profit exchanges, the Commission enjoys ample power and influence to address the most pressing concerns regarding the efficiency of FINRA's processes and the accountability of its officers and directors.

I also acknowledge there is a compelling interest in ensuring that FINRA is transparent and accountable to both the industry and the public—with respect to its regulatory program, its senior management, the collection and use of fee revenues and other monies, and its corporate governance practices. Enhanced oversight of its activities (whether by the SEC and the GAO or directly by Congress and this Subcommittee) is critical for an organization of FINRA's size and influence. I nevertheless believe it is preferable that specific reform efforts take place at the level of the Commission, in ongoing dialogue with FINRA, its membership, and investor advocacy groups.

There are concrete steps Congress could take in the short term to reinforce FINRA's effectiveness within the current self-regulatory paradigm. One of the principal areas of concern is the continuing asymmetry between the regulation of broker-dealers and other financial services providers. Congress could give FINRA, through the SEC, enhanced authority to coordinate collection and dissemination of information through BrokerCheck regarding the disciplinary history of all securities and financial professionals, including, for example, investment advisers and insurance professionals. Such authority, in tandem with initiatives to standardize and preserve the integrity of the information provided through BrokerCheck, would provide invaluable information to investors and consumers of financial services.

Congress should also consider targeted strategies for improving the securities industry's dispute resolution framework. For example, several investor advocacy organizations continue to challenge the use of pre-dispute arbitration agreements, particularly with respect to high-value claims and class actions. FINRA neither mandates nor prohibits such agreements.[30] While Congress has granted the Commission broad authority to impose conditions or limitations on these agreements, the Commission's mandate is not clear. The Supreme Court's jurisprudence under the Federal Arbitration Act may also be viewed as limiting opportunities for reforming the review of arbitral awards. Further guidance from Congress would simplify

[30] FINRA Rule 2268 ("Requirements When Using Predispute Arbitration Agreements for Customer Accounts").

the SEC's own cost-benefit analysis and eliminate uncertainties as to the scope of the SEC's authority.

Finally, Congress could enhance the robustness of the SEC's rule review process by revisiting the Commission's flexibility to approve or disapprove FINRA rules of significant import.[31] Congress required the SEC to expedite review of SRO rulemaking in Dodd-Frank in part to ensure that exchanges can compete on an equal footing with non-exchange trading systems.[32] As revealed in a recent study of SRO rulemaking, the SEC routinely invokes pre-approval review of FINRA and MSRB rules because of their significant implications for the securities industry.[33] The statutory timetable for SEC approval thus appears to frustrate the SEC's ability to conduct the kind of extended on-the-record cost/benefit analysis some public commentators favor.

IV. Conclusion

Chair Wagner and Ranking Member Sherman, I commend the Subcommittee's efforts to examine the efficiency and accountability of the self-regulatory framework—particularly as it applies to FINRA and the MSRB. As the SEC has reminded us in recent years, our system of private self-regulation is as old as the Republic itself.[34] It has nevertheless evolved over the years through legislative and regulatory interventions that have channeled its operational and financial advantages while trimming conflicts, curbing excesses, and providing federal resources to buttress industry oversight. In this spirit, I believe that our system of self-regulation in the securities industry can continue to serve investors, market participants, and the public interest. I appreciate the Subcommittee's attention to these issues and look forward to your questions.

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[31] 15 U.S.C. § 78s(b)(2).

[32] S. REP. NO. 111-176 (2010).

[33] *See, e.g.*, James Fallows Tierney, *Overseeing Private Rulemaking: Evidence from SEC Review of SRO Rules*, U. PA. J. BUS. L. 589 (2025).

[34] *See, e.g.*, Brief for Respondent, Smith v. SEC, No. 24-3907 (6th Cir. July 10, 2025), 2025 WL 2023492 at *65 (asserting "there is an 'unbroken tradition,' as old as the republic, of private, self-regulatory organizations conducting their own procedures to decide whether their own members have violated applicable standards and, if so, whether they should be disciplined according to the rules of the private organization").