



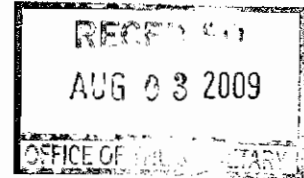
Financial Industry Regulatory Authority

Linda D. Fienberg  
President, Dispute Resolution  
and Chief Hearing Officer

August 3, 2009

Ms. Elizabeth M. Murphy  
Secretary  
The U.S. Securities and Exchange Commission  
100 F Street, N.E.  
Washington, D.C. 20549

4-586



**Re: Proposed Rule Change Petition Submitted by the Public Investors  
Arbitration Bar Association on June 11, 2009**

Dear Ms. Murphy:

The Financial Industry Regulatory Authority, Inc. (FINRA)<sup>1</sup> is responding to the Proposed Rule Change Petition (Petition) submitted by the Public Investors Arbitration Bar Association (PIABA) on June 11, 2009 to the U. S. Securities and Exchange Commission (SEC). The Petition,<sup>2</sup> submitted pursuant to the SEC's Rule of Practice 192(a),<sup>3</sup> requests that the SEC require by rule that the parties in an arbitration have the power to select an all-public panel in any investor claim in which the amount in dispute exceeds \$100,000. The Petition proposes that the core elements of FINRA's Public Arbitrator Pilot Program (Pilot) be made a permanent part of FINRA's Code of Arbitration Procedure for Customer Disputes (Customer Code) before the Pilot's expiration in October 2010.

As the world's leading securities dispute resolution forum, FINRA strongly supports the underlying goal of the Petition – to ensure that the dispute resolution forum is fair for all parties. FINRA believes its current policies and procedures facilitate a forum that is fair, neutral, and efficient. FINRA has a well-documented track record of continuously exploring ways to enhance the operation of its dispute resolution forum. For example, in October 2008, FINRA launched a two-year Pilot<sup>4</sup> that allows investors to choose a panel made up of three public arbitrators instead of two public arbitrators and

<sup>1</sup> Effective July 30, 2007, FINRA was formed through the consolidation of NASD and the member regulatory and dispute resolution functions of New York Stock Exchange Regulation, Inc. Exchange Act Release No. 56145 (July 26, 2007), 72 Fed. Reg. 42,169 (Aug. 1, 2007) (File No. SR-NASD-2007-023).

<sup>2</sup> Petition for Rulemaking Submitted to SEC, File No. 4-586, "Request rulemaking to eliminate the requirement that an arbitrator affiliated with the securities industry sit on all public investor cases arbitrated before FINRA in which the amount in controversy exceeds \$100,000," submitted by Brian Smiley, President, PIABA, June 11, 2009, available at <http://www.sec.gov/rules/petitions.shtml>.

<sup>3</sup> SEC Rules of Practice, 17 C.F.R. 201.192 (2008).

<sup>4</sup> Notice to Parties, FINRA's Public Arbitrator Pilot Program, available at <http://www.finra.org/ArbitrationMediation/Parties/ArbitrationProcess/NoticesToParties/index.htm>, and Public Arbitrator Pilot Program Frequently Asked Questions, available at <http://www.finra.org/ArbitrationMediation/Parties/ArbitrationProcess/NoticesToParties/P116995>.

one non-public arbitrator, as is currently the rule for investor cases with an arbitration panel of three persons.<sup>5</sup> Prior to starting the Pilot, FINRA sought input on the program from its various constituents through the National Arbitration and Mediation Committee (NAMC).<sup>6</sup> The NAMC provided relevant feedback that FINRA used to craft the Pilot's procedures.

We are gratified that PIABA views the Pilot favorably. PIABA's Petition incorporates most aspects of the Pilot, with only one notable exception. It would mandate the Pilot rules for all investor cases rather than providing investors with a choice in panel composition. Investors and their counsel in many Pilot-eligible cases have elected not to participate in the Pilot so, at this stage, that choice is important to preserve.

FINRA recommends that the Pilot, which is scheduled to end on October 5, 2010, be allowed to conclude. This will permit us to collect and analyze data from the Pilot and from Pilot participants that will allow us to make an informed decision on how to proceed concerning panel composition in investor cases heard by three arbitrators.

#### **FINRA's Public Arbitrator Pilot Program**

The Pilot, which is voluntary, allows investors to choose a panel made up of three public arbitrators instead of two public arbitrators and one non-public arbitrator, as is currently the rule for investor cases with an arbitration panel of three persons.<sup>7</sup>

The Pilot will run for two sequential years. Year one began October 6, 2008, and will end October 5, 2009. Year two will begin October 6, 2009, and end October 5, 2010.

Eleven firms volunteered to participate in the Pilot,<sup>8</sup> each contributing a set number of cases to the Pilot per year for two years. To make the data even more robust, for the second year of the Pilot starting this October, we will endeavor to expand the number of participating firms and to increase the case commitments from the firms already in the Pilot.

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<sup>5</sup> The panel in cases claiming \$100,000 or more in damages consists of three arbitrators, unless the parties agree in writing to one arbitrator. Rule 12401(c) of the Code of Arbitration Procedure for Customer Cases.

<sup>6</sup> The NAMC is a committee that meets approximately every quarter to discuss and vote on rules, policies and procedures relating to dispute resolution issues. The committee includes representatives from the public, the securities industry, and the arbitrators and mediators serving in FINRA's Dispute Resolution forum. The majority of the NAMC's members, including its Chair, are public representatives. See Rule 12102 of the Code of Arbitration Procedure for Customer Cases.

<sup>7</sup> See note 5. The panel in cases claiming less than \$100,000 consists of a single chair-qualified public arbitrator.

<sup>8</sup> See note 4 at Public Arbitrator Pilot Program Frequently Asked Questions, Question 3, for a list of participating firms.

Under the Pilot terms, at the sole election of the investor, any claim naming only a pilot firm is eligible to participate in the Pilot so long as the volunteered allotment for the firm has not been filled. The participating firms cannot select which cases enter the Pilot.<sup>9</sup> During the course of the Pilot, more than 500 arbitration cases involving those firms can be heard by all-public arbitration panels. As of July 17, the Pilot has reached 84 percent of the target goal of 276 cases for year one.

Investors who choose to have their claims heard under the Pilot - and the firm against which they are making their claim - receive the same three lists of potential arbitrators that parties to standard arbitration disputes receive:

- a list of eight chair-qualified public arbitrators;
- a list of eight public arbitrators; and
- a list of eight non-public arbitrators.

In non-Pilot cases, parties may strike up to four of the arbitrators from the chair-qualified, public arbitrator, and non-public lists for any reason, then rank the remaining arbitrators on those lists according to preference. However, parties participating in the Pilot (including the industry party) may strike all eight names on the non-public arbitrator list. If no non-public arbitrators survive the strike process, public arbitrators will complete the panel.

#### **Interim Results of the Pilot**

As of July 17, investors have filed 444 eligible cases; 52 percent of those investors have chosen the Pilot, resulting in 233 Pilot cases to date; 48 percent have elected not to participate.

Parties have completed arbitrator ranking in 193 of the 233 Pilot cases. By ranking one or more non-public arbitrators, the investor has chosen not to eliminate all non-public arbitrators from the list in 50 percent of the 193 cases that have completed ranking.

Although several cases have settled, arbitrators have not yet decided any claims. Once arbitrators begin deciding cases under the Pilot, FINRA will evaluate the program according to a number of criteria, including:

- percentage of investors who opt in to the Pilot;
- percentage of investors who choose an all-public panel after opting in;
- results of Pilot and non-Pilot investor cases, including the percentage of cases that settle before award (and how quickly they settle);
- length of hearings; and
- use of expert witnesses in Pilot and non-Pilot cases.

FINRA notes that the Pilot is in its nascent stages. Additional experience with the Pilot will allow us to generate meaningful data that FINRA can analyze and compare

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<sup>9</sup> Claims that also name a non-participating firm or an Associated Person are not eligible for the Pilot.

to similarly-situated non-Pilot cases. In the meantime, FINRA is working with a Subcommittee<sup>10</sup> of the NAMC to develop a survey to elicit feedback from all participants in Pilot cases. We also welcome suggestions from the SEC staff regarding other ways to measure the results of the Pilot. FINRA will use this feedback, along with the criteria set forth above, to assess the effectiveness of the Pilot, including whether the participants perceive the process to be fair. FINRA plans to report to the SEC the outcomes of the Pilot cases, the results of its evaluation, and participants' feedback, as this information becomes available. We will also make this information publicly available.

### **FINRA Dispute Resolution's Recent Initiatives Regarding Panel Composition**

FINRA is committed to a dispute resolution process that provides investors with an efficient, fair, and impartial forum for the resolution of claims. In recent years, FINRA has implemented many investor-friendly initiatives that enhance the effectiveness of its dispute resolution forum.<sup>11</sup> In this regard, we note two of these recent initiatives that relate specifically to panel composition:

- **Auction Rate Securities Procedures.** On August 7, 2008, FINRA implemented a new process for resolving claims involving auction rate securities (ARS) under the Customer Code. Qualifying claims in which the amount in dispute is not more than \$100,000 involving auction rate securities will be heard by a single public arbitrator.<sup>12</sup> Also pursuant to the current Customer Code, cases in which damages claimed are more than \$100,000 involving auction rate securities will be heard by a panel consisting of two public arbitrators and one non-public arbitrator.<sup>13</sup> However, the non-public arbitrators in these cases will not be individuals who, since January 1, 2005, either worked for a firm that sold auction rate securities or sold or supervised someone who sold auction rate securities.
- **Single Arbitrator Threshold.** On February 2, 2009, the SEC approved FINRA's proposal to amend Rules 12401 and 13401 to raise the amount in controversy for appointing a single arbitrator to \$100,000.<sup>14</sup> The arbitrator will be selected from the roster of arbitrators who are qualified to serve as chairpersons. This means that investors' claims for up to \$100,000 will be heard by a single public, chair-qualified arbitrator. The amendments increase the number of claims that will be decided only by public arbitrators to about one third of the investor claims filed

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<sup>10</sup> This group includes lawyers who represent investors.

<sup>11</sup> An exhaustive list of FINRA's investor-friendly initiatives can be found in "The Arbitration Policy Task Force Report – A Report Card" (July 27, 2007). The report is described in The Neutral Corner (August 2007) and may be accessed through this publication, available at <http://www.finra.org/ArbitrationMediation/Neutrals/Education/NeutralCorner/P036755>.

<sup>12</sup> FINRA, Arbitration & Mediation, "Panel Composition in Auction Rate Arbitration Cases," available at <http://www.finra.org/ArbitrationMediation/P116972>.

<sup>13</sup> Id.

<sup>14</sup> Exchange Act Release No. 59340 (February 2, 2009), 74 Federal Register 6335 (February 6, 2009) (File No. SR-FINRA-2008-047).

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with FINRA; they also streamline the dispute resolution process and decrease costs for users of the forum.<sup>15</sup>

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In summary, FINRA supports the goal of ensuring that its dispute resolution forum is fair for all parties. Moreover, FINRA appreciates the fact that the Petition used most of the elements of its Pilot in PIABA's rulemaking proposal. We believe, however, that the Pilot should be permitted to run its course through the October 2010 expiration date. We have already started to analyze results from the Pilot and hope to begin gathering data on concluded cases soon. We expect to gather statistical information as well as reactions from parties and counsel about their experience under the Pilot. With this information, FINRA will be able to make an informed decision on how to proceed with the procedures under the Pilot. We will update you regularly with our results and invite your input about appropriate information to capture.

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Thank you for the opportunity to comment on the Petition. If you have any questions, please don't hesitate to contact me on (202) 728-8407 or at [linda.fienberg@finra.org](mailto:linda.fienberg@finra.org).

Very truly yours,



Linda D. Fienberg  
President  
FINRA Dispute Resolution

cc:

Mr. Brian N. Smiley, President, Public Investors Arbitration Bar Association  
Mr. Daniel Gallagher, Jr., Co-Acting Director, Division of Trading and Markets, U. S. Securities and Exchange Commission  
Mr. James L. Eastman, Associate Director and Chief Counsel, Division of Trading and Markets, U. S. Securities and Exchange Commission  
Ms. Paula R. Jenson, Deputy Chief Counsel, Division of Trading and Markets, U. S. Securities and Exchange Commission  
Ms. Lourdes Gonzalez, Assistant Chief Counsel, Office of Sales Practices, Division of Trading and Markets, U. S. Securities and Exchange Commission

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<sup>15</sup> The amendments became effective on March 30, 2009, and apply to arbitration cases filed on or after the effective date. *Regulatory Notice* 09-13 (February 2009).