



Financial Industry Regulatory Authority

August 7, 2013

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

**Re: File No. SR-FINRA-2013-023 – Proposed Rule Change Relating to
Amendments to the Code of Arbitration Procedure for Customer
Disputes Concerning Panel Composition**

Dear Ms. Murphy:

The Financial Industry Regulatory Authority, Inc. ("FINRA") hereby responds to the comment letters received by the Securities and Exchange Commission ("SEC") with respect to the above rule filing. In this rule filing, FINRA is proposing to amend FINRA Rule 12403 of the Code of Arbitration Procedure for Customer Disputes ("Customer Code") to simplify arbitration panel selection in cases with three arbitrators.¹

Under current Rule 12403, customers may choose between two panel composition methods. The first method, the composition rules for majority public panel (Majority Public Panel Option), provides for a panel of one chair-qualified public arbitrator, one public arbitrator, and one non-public arbitrator. The second method, the composition rules for optional all public panel (All Public Panel Option), allows any party to select an arbitration panel consisting of three public arbitrators. Under Rule 12403, a customer may choose a panel composition method in the statement of claim (or accompanying documentation) or at any time up to 35 days from service of the statement of claim. In the absence of an affirmative choice by the customer, the Majority Public Panel Option is the default composition method.

Under the proposed rule change, FINRA would no longer require a customer to elect a panel selection method, and parties in all customer cases with three arbitrators would get the same selection method. FINRA would provide all parties with lists of 10 chair-qualified public arbitrators, 10 public arbitrators, and 10 non-public arbitrators. FINRA would permit each party to strike up to four arbitrators on the chair-qualified public list and up to four on the public list. However, any party could select an all public arbitration panel by striking all of the arbitrators on the non-

¹ See Securities Exchange Act Rel. No. 69762 (June 13, 2013), 78 FR 37267 (June 20, 2013) (File No. SR-FINRA-2013-023).

public list. If the parties collectively strike all of the non-public arbitrators on the list, or a ranked/selected non-public arbitrator is not available to serve, FINRA would not appoint a non-public arbitrator to the panel.

The SEC received 14 comment letters in total on the proposed rule change, 12 supporting the proposal as filed, and two expressing opposition to part of the proposal.² The commenters in support of the proposal state, among other things, that the proposal promotes investor protection,³ is beneficial for public investors,⁴ enhances efficiency,⁵ and promotes fairness at the forum.⁶ Two commenters object to the proposed rule change in part because a customer would no longer be guaranteed the option of having a non-public arbitrator on the panel.⁷ These commenters suggest that FINRA: 1) retain the two current panel composition methods; and 2) make the All Public Panel Option the default panel composition method instead of the Majority Public Panel Option.

As stated above, under the proposed rule change, FINRA would continue to send the list of 10 non-public arbitrators to the parties. Our panel selection data indicate that industry parties are ranking one or more non-public arbitrators in 97

² Comment letters were submitted by Steven B. Caruso, Esq., Maddox Hargett & Caruso, P.C., dated June 18, 2013 ("Caruso letter"); George Friedman, Esq., dated June 25, 2013 ("Friedman letter"); Seth E. Lipner, Professor of Law, Zicklin School of Business, Baruch College, Member Deutsch & Lipner, dated July 2, 2013 ("Lipner letter"); David P. Neuman, Stoltmann Law Offices, dated July 2, 2013 ("Neuman letter"); Christine Lazaro, Esq., Acting Director, and Pamela M. Albanese, Legal Intern, St. John's University School of Law, Securities Arbitration Clinic, dated July 9, 2013 ("St. John's Letter"); Philip M. Aidikoff, Partner, Aidikoff, Uhl & Bakhtiari, dated July 10, 2013 ("Aidikoff letter"); Ryan K. Bakhtiari, Aidikoff, Uhl & Bakhtiari, dated July 10, 2013 ("Bakhtiari letter"); Leonard Steiner, Attorney, dated July 10, 2013 ("Steiner letter"); Steve A. Buchwalter, Attorney, dated July 10, 2013, ("Buchwalter letter"); Jill I. Gross, Director, Investor Rights Clinic, Pace University School of Law, dated July 11, 2013 ("Pace letter"); Glenn S. Gitomer, McCausland Keen & Buckman, dated July 11, 2013 ("Gitomer letter"); Scott C. Ilgenfritz, President, Public Investors Arbitration Bar Association, dated July 11, 2013, ("PIABA letter"); David T. Bellaire, Esq., Executive Vice President and General Counsel, Financial Services Institute, dated July 11, 2013 ("FSI letter"); and Mark E. Sanders, Attorney, dated July 11, 2013 ("Sanders letter"). The Friedman and Pace letters do not support the proposal as filed.

³ See the Bakhtiari and Sanders letters.

⁴ See the Caruso, Neuman, Aidikoff, and PIABA letters.

⁵ See the St. John's and FSI letters.

⁶ See the Neuman and Gitomer letters.

⁷ See the Friedman and Pace letters.

percent of cases and four or more non-public arbitrators in 90 percent of cases. If the customer wants a non-public arbitrator, the customer has the option of ranking any or all of the non-public arbitrators on the list. In addition, if the parties agree that they want a non-public arbitrator on the panel, but collectively they strike all the arbitrators on the list, or an arbitrator they select is not available to serve, they could ask FINRA to send a supplemental list of non-public arbitrators for their review. FINRA would accommodate their request for a supplemental list.

Two of the commenters suggest that when poor broker conduct is at issue in an arbitration, a customer (or a customer representative) may want a non-public arbitrator on the panel because non-public arbitrators may be better situated to judge the conduct. The commenters are concerned that under the proposed rule change, the industry parties can strike all of the non-public arbitrators leaving the customer with all public panelists.⁸ While FINRA staff agrees that the non-public arbitrators on the roster are capable of identifying and judging poor broker conduct, staff also believes the public arbitrators on the roster are similarly capable of doing so. In addition, both customer and firm representatives frequently use expert witnesses at the hearing. If a customer is concerned about whether an all public panel will identify poor broker conduct, an expert witness can testify about industry practices. FINRA staff believes that customers will rarely incur additional expenses related to the use of expert witnesses and that the benefits of the proposal outweigh the potential for additional costs.

Since implementing the All Public Panel Option, customers and their representatives who use the forum have not been raising concerns to FINRA staff about not being able to have a non-public arbitrator on a panel. FINRA's experience using the two panel selection methods in the Customer Code for two years has convinced staff that a simpler approach to panel selection will benefit all parties using the forum and will improve the efficiency of case administration. Therefore, FINRA does not intend to amend the proposed rule change as suggested in the Friedman and Pace letters.

Two commenters raised concerns about the disparate results in awards issued by all public panels and majority public panels.⁹ The Pace letter urges FINRA and the Commission to explore the reasons for the differential between awards, and the FSI letter asks FINRA to continue to track award results to determine the impact that the All Public Panel Option has on customer case outcomes. FINRA agrees to continue to track award results separately for all public panels and majority panels for the foreseeable future and will consider the cause for any disparity if the data suggest the need to do so.

⁸ See the Friedman and Pace letters.

⁹ See the Pace and FSI letters.

The FSI letter asks FINRA to amend the public arbitrator definition to prevent attorneys who spend a significant portion of their time representing investors and claimants in FINRA arbitrations from serving as public arbitrators. FINRA is not proposing to amend its arbitrator definitions as part of the proposed rule change. Therefore, this comment is outside the scope of the proposed rule change. However, FINRA staff is currently reviewing its non-public and public arbitrator definitions, including the concern raised in the FSI letter.

The PIABA letter recommends that FINRA emphasize in the transmittal letter accompanying the arbitrator ranking form and the arbitrator disclosure reports that each party has the ability and right to have the case heard by an arbitration panel comprised of only public arbitrators. FINRA agrees to review its transmittal letter and make it clear earlier in the letter that any party has the option of selecting an all public panel.

Most of the comment letters support the proposed rule change as filed. FINRA believes that having one panel composition method will simplify the process for parties and FINRA staff, will provide certainty and uniformity among cases, and will ensure that customers do not miss the opportunity to select an all public panel if that would have been their preference. FINRA requests that the SEC approve the proposed rule change, as written.

If you have any questions, please contact me by telephone at (212) 858-4481 or by email at margo.hassan@finra.org.

Very truly yours,



Margo A. Hassan
Assistant Chief Counsel
FINRA Dispute Resolution