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Filed Electronically
Ms. Vanessa A. Countryman, Secretary
U.S. Securities and Exchange Commission
100 F. Street, N.E.
Washington, DC 20549

Re: Notice of Filing of Amendment No. 1 and Order Instituting Proceedings to Determine Whether to Approve or Disapprove the Proposed Rule Change, as modified by Amendment No. 1, to Amend the Codes of Arbitration Procedure to Make Various Clarifying and Technical Changes to the Codes, Including in Response to Recommendations in the Report of Independent Counsel Lowenstein Sandler LLP; File No. SR–FINRA–2022–033

Dear Ms. Countryman:

Pickard Djinis and Pisarri LLP[1] submits these comments in response to the above-referenced proposal to amend the FINRA Code of Arbitration Procedure for Customer Disputes ("Customer Code") and the Code of Arbitration Procedure for Industry Disputes (together, the "Codes").[2] While we applaud certain of the proposed amendments for offering much-needed clarify to confusing or obsolete portions of the Codes, we are concerned that other sections of the proposed amendments compound the harms of amendments to the Codes adopted earlier this year which specifically amended the Codes' rules related to expungement of customer complaints. We urge FINRA to consider instead much-needed improvements to the expungement provisions of the Codes in order to genuinely effectuate the relief brokers seek through the FINRA

[1] Pickard Djinis and Pisarri LLP is a law firm specializing in securities regulation relating to broker-dealers and their registered persons, investment advisers, and service providers thereto. For over forty years our firm has participated in the FINRA arbitral forum on behalf of member firms, their registered representatives, and clients raising customer complaints about registered persons.

[2] Securities and Exchange Commission, Title: Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of a Proposed Rule Change To Amend the Codes of Arbitration Procedure To Make Various Clarifying and Technical Changes to the Codes, Including in Response to Recommendations in the Report of Independent Counsel Lowenstein Sandler LLP, Release No. 34-96607 (January 6, 2023), 88 FR 2144 (January 12, 2023) ("Proposing Release");Securities and Exchange Commission, Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of Amendment No. 1 and Order Instituting Proceedings to Determine Whether to Approve or Disapprove the Proposed Rule Change, as modified by Amendment No. 1, to Amend the Codes of Arbitration Procedure to Make Various Clarifying and Technical Changes to the Codes, Including in Response to Recommendations in the Report of Independent Counsel Lowenstein Sandler LLP, Release No. 34-97291 (April 23, 2023) ("Request for Comment").

arbitral forum and provide accurate disclosure information to the investing public.

Preliminary Statement

As an initial matter, we believe it is important to place the amendments currently offered for public comment in regulatory context. The FINRA arbitral forum was created in response to a Commission directive that "more effective, efficient, and economical dispute resolution procedures" be available for disputes between broker-dealers and their customers.[3] This forum was expressly instructed of consider "simplifying the mechanisms for resolution of customer disputes with brokers and dealers" to protect investors against the pitfalls of litigation, described as "burdensome and complex and. . . not cost effective for investors."[4] Above all, the Codes are intended to be "simple and inexpensive."[5] Brokers are generally required to submit all controversies related to their securities business to the FINRA arbitral forum; certain matters, including expungement of false customer complaint information from the Central Registration Depository records of brokers, are subject to the Codes without exception.

In early 2022, the law offices of Lowenstein Sandler were retained by FINRA to independently review certain aspects of FINRA Dispute Resolution Services' ("DRS") policies and procedures in its arbitration forum. The focus of Lowenstein Sandler review concerned the arbitrator ranking and selection process in connection with actions initiated by broker-dealers to expunge customer complaint information from the Central Registration Depository ("CRD"). Lowenstein Sandler published a report in June of 2022[6] noting certain deficiencies in the Codes, and making minor suggestions as to potential improvements to the Codes' provisions generally with respect to arbitrator selection in expungement proceedings.

In 2023, FINRA proposed, and the Commission approved, widespread amendments to the Codes, which implemented changes far beyond the recommendations of the Lowenstein Report. The amendments currently available for public comment supplement these widespread amendments, and, like the earlier amendments, generally move FINRA further away from the Codes' required goal of providing a simple and inexpensive dispute resolution forum for market participants.

We will address each proposed amendment to the Codes in turn.

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[3] Securities and Exchange Commission, Implementation of an Investor Dispute Resolution System, Release No. 34-13470 (April 26, 1977)

[4] *Id*.

[5] Securities and Exchange Commission, Notice of Filing of Proposed Rule Change by New York Stock Exchange, Inc., Release No. 16038 (July 18, 1979).

[6] *See* FINRA, The Report of the Independent Review of FINRA's Dispute Resolution Services—Arbitrator Selection Process, https://www.finra.org/sites/default/files/2022-06/report-independent-review-drs-arbitrator-selection-process.pdf ("Lowenstein Report").

Amendments to the Codes

Arbitrator List Selection Process Proposed Rule Changes (each an "ALS Proposed Change")

(1) Codify current practice by: (a) requiring the Director to manually review the arbitrator list(s) generated by NLSS for any conflicts of interest; (b) authorizing the Director to remove an arbitrator for such a conflict; and (c) authorizing the Director to randomly generate a replacement arbitrator in the event an arbitrator is removed.

We do not object to ALS Proposed Change (1) provided that the screening by the Director is limited to conflicts of interest of the type screened out by the Neutral List Selection System ("NLSS"), and does not provide the Director with unlimited discretion to strike arbitrators for potential or suspected conflicts of interest or bias.[7] Our understanding of the current practice is that the conflicts of interest for which an arbitrator is struck by the NLSS are generally limited to close connections with a party, including former employees of a party and individuals holding securities accounts with a party. The manual review confirms that parties with conflicts have been eliminated by screening for information potentially not captured by the NLSS, including familial relationships, unregistered financial affiliate conflicts, etc. We suggest that the Codes define "conflicts of interest" to clarify to the parties what relationships will cause an arbitrator to be struck by NLSS or manually by the Director.[8]

(2) Codify current practice by requiring the Director to provide the parties with a written explanation of their decision "to grant or deny a party's request to remove an arbitrator . . ."

We do not object to ALS Proposed Change (2), subject to our above note concerning the Director's discretion to strike potential arbitrators.

(3) Expressly authorize the Director to remove an arbitrator for a conflict of interest or bias, either upon request of a party or on the Director's own initiative, "[a]fter the Director sends the lists generated by the list selection algorithm to the parties, but before the first hearing session begins."

We object to ALS Proposed Change (3) to the extent that "conflict of interest or bias" may be raised by one party to allege that an arbitrator is biased in favor of the opposing party. As noted above, there is no clear definition of "conflict of interest" in the Codes; nor, by rule or guidance, do the Codes clarify how "bias" and "conflicts of interest" differ. The proposed rule change fails to explain whether a request to strike by a party must be supported in writing and whether it will be

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[7] We note that the Proposing Release states that "[t]he proposed rule change would amend the Codes to clarify the current practice that the Director will exclude arbitrators from the lists based upon a review of current conflicts of interest"; however, the Proposing Release later states that "the Director may remove an arbitrator for conflict of interest or bias, either upon request of a party or on the Director's own initiative." To avoid conflation of these distinct terms, we urge FINRA to adopt a clear definition of "conflicts of interest" into the Codes and either clearly define or remove reference to "bias."

[8] We note that the Lowenstein Report found several "ambiguities" with respect to how conflicts of interest are determined in the DR Manual, with certain types of conflicts defined broadly in some regions and narrowly in others. Lowenstein Report at 34. Although some publicly available FINRA guidance generally describes potential conflicts of interest (*see* FINRA, How Parties Select Arbitrators, *available at* https://www.finra.org/arbitration-mediation/arbitrator-selection), we note that the Proposing Release repeatedly seeks to formalize other FINRA guidance and "clarify current practice" to avoid inconsistent application of certain guidance. We urge that the same standard be applied to conflicts of interest.

independently reviewed by the Director or granted immediately upon request. To permit a party at its whim to strike for perceived "conflicts of interest or bias" flings the door wide to allow parties to exert greater control over the arbitral selection process than they had under the previous rule set. It is unclear, for example, if a party may review previous decisions by an arbitrator (all of which are made public in FINRA's Arbitration Awards Online database) to determine whether the arbitrator has, more often than not, ruled in favor of a customer or member firm, and submit a "bias" complaint on this basis alone. This proposed change seems designed to model the arbitrator selection process against the United States jury selection process, permitting the sort of "peremptory challenges" that would make the FINRA arbitral forum "burdensome and complex and. . . not cost effective for investors."[9]

If FINRA wishes to give parties to the arbitration power in selecting arbitrators, the solution is simple: restore the arbitration ranking system previously in place. A workaround by which parties may object to selected arbitrators only after the entire panel has been selected seems designed to introduce aggressive strategizing into the pre-hearing period when settlement discussions frequently occur. The odds that a randomly selected arbitrator on a randomly generated list will present a conflict of interest not discovered by the NISS or Director but known to an opposing party are extremely low; conversely, the odds that parties will take advantage of the ability to challenge a panel at any time prior to the hearing to bargain for a favorable settlement or delay the arbitral process are all but certain. At a minimum, we suggest that, unless "bias" and "conflicts of interest" are clearly defined, "bias" be struck from this amendment to avoid inconsistent treatment of a broad term.

Procedural Rule Changes (each a "Procedural Change")

(1) Provide that "prehearing conferences" will generally be held by video and "hearings" on the merits will generally be held in person, unless "the parties agree to, or the panel grants a motion for, another type of hearing session."

While we generally support Procedural Change (1), we suggest that it be amended to provide that another type of hearing session will be approved if *agreed to by a majority of the parties*. Where there are more than two parties to an arbitration, we suggest that the majority should prevail without the matter needing to be put to a motion and considered at a prehearing session. Given the success of FINRA's transition to video hearings in the last three years and the costs of travel to in-person hearings, we presume that video hearings will be a preferred method by parties going forward, and allowing a single party to overrule the choice of two or more parties by selecting, or forcing the parties to initiate the lengthy motions process for, the more costly and burdensome option turns yet another factor of the arbitral process into a settlement bargaining tool.

(2) Provide that any abbreviated hearing (i.e., special proceeding) in a simplified arbitration (i.e., a case involving $50,000 or less, exclusive of interest and expenses) will be held by video, unless: (a) the customer requests at least 60 days before the first scheduled hearing that it be held by telephone or (b) the parties agree to another format.

We have no objection to Procedural Rule Change (2).

[9] Release No. 16038, *supra* note 5.

(3) Require parties in simplified arbitrations to redact personal confidential information from documents filed with the Director.

We have no objection to Procedural Rule Change (3). As noted further in our "Additional Comments" section below, we urge FINRA to consider providing for additional redaction of personal information throughout the Codes.

(4) Amend the definition of "hearing session" to indicate that, during a single day, "the next hearing session begins after four hours of hearing time has elapsed."

We request greater clarity on Procedural Change (4), as it is unclear from the Proposal whether fees for two full sessions will be assessed after four hours and one minute of hearing time have elapsed. In our understanding of the current system, fees are assessed "by adding the number of hearing hours, subtracting time spent for lunch, and dividing that number by four hours."[10] This appears to ensure that the party to whom fees are assessed does not pay the fees of an entire half-day hearing session if such session does not last a full four hours. Assuming that Procedural Change (4) would not cause the party to whom fees are assessed (who is, in our experience, typically the member firm or registered person party) to pay for "session time" not actually spent in session, we have no objection to Procedural Change (4).

(5) Require a respondent filing an answer containing a third-party claim to: (a) execute a Submission Agreement that lists the name of the third-party; and (b) file the updated Submission Agreement with the Director.

We have no objection to Procedural Change (5).

(6) Amend various aspects of the rules governing the filing of amended pleadings to, among other things, extend those rules to the filing of third-party claims,

We have no objection to Procedural Change (6), and appreciate FINRA's willingness to acknowledge elements of the Codes which require clarification.

(7) Amend rules governing when an arbitration panel may decide a motion to combine separate but related claims or reconsider the Director's previous decision upon a party's motion

We have no objection to Procedural Change (7).

(8) Amend rules governing motions practice to, among other things, address the timing of the Director's delivery of pleadings to the arbitrator panel.

We have no objection to Procedural Change (8). As noted above, we appreciate FINRA identifying aspects of the arbitral process which require clarification.

[10] Proposing Release, 88 FR 2146

(9) Expressly provide that any party generating a list of documents and other materials prior to the first scheduled hearing may provide that list to other parties, but must not combine it with a witness list in a single document filed with the Director.

It is our experience that arbitral panels in the FINRA forum prefer identifying admissible documents and materials prior to the hearing to avoid mid-hearing delays, and may use exhibit lists before and during the hearing for ease of reference. Procedural Change (9) appears to be a solution in search of a problem; nevertheless, we have no strong objection to it.

(10) Amend rules governing hearing records to: (a) identify which party must distribute transcripts of the official record; and (b) codify that executive sessions (i.e., private discussions of the arbitrator panel) will not be recorded.

We have no objection to Procedural Change (10).

(11) Codify current practice by permitting a panel to dismiss a claim or arbitration without prejudice if it finds insufficient service upon a respondent.

We have no objection to Procedural Change (11).

(12) Require a panel to issue an "award" (i.e., a document describing the final disposition of a case) if it grants a motion to dismiss all claims after a party's case-in-chief.

We object strongly to Procedural Change (12) given FINRA's current rule set purportedly requiring that all arbitration awards be made public in a permanent, unredacted database. The FINRA Arbitration Awards Online (AAO) database collates every arbitration award handed down in the FINRA forum. FINRA takes the position that there are no circumstances in which such awards may be redacted or expunged, making the details of such award part of a broker's online record with no ability by the broker to reduce the award's digital footprint. Additionally, we are seriously concerned by FINRA's current practice of selling licenses to third-party distributors, including major research distributors like LexisNexis, to republish details of arbitration awards through other public channels. While FINRA may profit off increased arbitral awards being issued in their forum, the unfortunate result to market participants is that the details of each award gain a prominent position in each broker's online record.

Awards typically reiterate the details of the customer complaint information about each broker, regardless of the complaint's merit. A Motion to Dismiss will be granted after Claimant's case-in-chief and before Respondents(s) present their own case, meaning that an award in such a case will not reflect any defense by Respondent(s) and may imply that the case was decided on technical or other unpersuasive grounds. In a trust-based industry where even the appearance of impropriety may irreparably harm a broker's relationships with clients,[11] ensuring that the details of every frivolous, bad faith or otherwise unmerited customer complaint which progresses to an arbitration will remain part of the broker's record does a grave disserve to FINRA's members. If a customer

[11] We are aware of a scenario where customer complaint information described in an arbitration award located in the AAO was discovered by a potential client of the affected broker during normal due diligence. Notwithstanding that the broker in question had prevailed in original arbitration and expunged the details of the complaints from his CRD record in a subsequent arbitration, the customer complaint information misleadingly disclosed in the AAO caused the potential client to reject the broker's services.

complaint has so little merit that it is disposed of through a Motion to Dismiss—an extraordinary high standard in FINRA arbitration[12]—there is no regulatory purpose in ensuring that the member firm and/or registered representatives implicated by the complaint continue to have their reputations tainted by the allegations.

Additional Comments

While we are heartened to see FINRA's robust response to criticisms of certain aspects of the Codes in the last several years, we are disappointed that FINRA has overhauled its arbitral forum while leaving intact one of the Codes' primary flaws. We urge FINRA to amend the Codes' provisions related to expungement of customer complaint information.

As noted above, arbitration in the FINRA Dispute Resolution forum is the primary means by which customer complaints against broker-dealers and their current and former associated persons are addressed before a fact-finding body. The Codes provide that complaints against brokers which are determined by an arbitral panel to be "factually impossible or clearly erroneous" and/or "false" may be "expunged" from BrokerCheck and the Central Registration Depository ("CRD"), which FINRA has acknowledged are the best and most reliable tools for educating investors on brokers' background and disciplinary history.

For such a record to be expunged, a broker typically must, following a positive outcome in the original arbitration (which may constitute the broker winning dismissal by arbitrator order or by the claimant withdrawing the complaint before hearing), initiate a secondary arbitration or certain other court proceeding to request that the record of the arbitration won by the broker be expunged, generally because the complaints against the broker are "factually impossible or clearly erroneous" and/or "false". If the panel agrees, the broker must obtain an order from a court of competent jurisdiction that confirms the arbitration award containing expungement relief. This process has, of course, now been seriously complicated by amendments to the Codes adopted earlier this year, which time-bar certain claims from being expunged and remove options for brokers to seek simplified proceedings to expunge demonstrably false information.

This expungement process will result in the broker's CRD and Broker-Check reports being expunged of disclosure of all records of the disproven allegations. However, records of both the original arbitration and the arbitration awards ordering expungement are nevertheless published in the AAO and republished by FINRA-licensed online distributors. FINRA has maintained that there is no process by which AAO records may be expunged or redacted. Because the broker-dealer parties have typically demonstrated in three separate instances—twice in the DRS forum and once before a court of competent jurisdiction—that the original complaints had no merit, the current FINRA arbitration process all but guarantees that false and misleading information about financial professionals remain prominent in the online profiles of such professionals.

Because FINRA has never sought and the Commission has never approved a FINRA rule under the Codes setting forth FINRA authority to prevent certain records from being published in, or removing records already published in, the AAO, there is currently no mechanism available to remove information from or redact records in the AAO. This system is therefore clogged with decades-old records about arbitral awards, including those which have been expunged and hold no value to investors. The AAO has become near-unworkable as a tool for the public interest.

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[12] *See* FINRA Rule 12504. *See also* FINRA Dispute Resolution Services Arbitrator's Guide (Feb. 2021) (stating that a panel may only grant a motion to dismiss a claim after presentation of the case-in-chief if the "testimony and documents do not support any possible recovery.").

The records expunged from the CRD but nevertheless published on the AAO are easily accessible by any individual using a standard search engine to research financial professionals. Adding to investor confusion, there is no mechanism in the AAO to link arbitral awards won by the same broker, so the award won in original arbitration and the arbitration award ordering expungement cannot easily be sequentially reviewed. Records of the original arbitration, which frequently contain detailed accounts of the false complaints against the broker-dealer, are therefore likely to be viewed by an average searcher in a vacuum.

FINRA making no provision for the removal or redaction of AAO records is especially troublesome given how permissive other FINRA rules are with regards to redaction of personal information. FINRA can and does remove, redact, and refrain from publishing certain disciplinary action orders and settlements—matters which, unlike expungement records, contain an explicit finding of misbehavior, rather than a finding that no misbehavior occurred. FINRA Rule 8313, which governs the release of disciplinary complaints, decisions and other information, provides in pertinent part, "FINRA reserves the right to redact, on a case-by-case basis . . . information that raises significant . . . privacy concerns that are not outweighed by investor protection concerns." And as the current proposed amendments demonstrate in Procedural Change (3), FINRA is aware that documents in arbitration may expose personal information and have public reach. Redaction would easily prevent misleading information from becoming part of a broker's permanent online record, and yet FINRA has passed by another opportunity to make this minor adjustment to the Codes.

These deficiencies in the Codes cause serious confusion to investors seeking information on their broker or prospective broker. While the AAO is intended to assist investors in evaluating the disciplinary records of financial professionals, the current system allows genuine findings of misbehavior by brokers to be lost in a crowded field of outdated awards and complaints sufficiently demonstrated to be false. The issues with the AAO have become so extreme that FINRA, before allowing investors to access the AAO, advises investors to "perform independent research" to determine if the information they are viewing on the AAO is accurate.[13] However, FINRA provides no additional information as to how such research may be performed. In acknowledging that its own forum is so flawed as to be untrustworthy but taking no steps to correct the deficiencies, FINRA DRS has only served to eliminate a key tool meant to assist investors in selecting investment professionals. We are disappointed that recently adopted amendments and the proposed amendments to the Codes not only ignore these serious deficiencies but compound them by making expungement itself a far more difficult remedy to obtain and increasing the number of arbitration awards containing false allegations against brokers.

[13] *See* FINRA, Arbitration Awards Online, *available at* https://www.finra.org/arbitration-mediation/arbitration-awards.

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We appreciate the opportunity to submit these comments. We would be happy to supply any additional information you may desire about the matters discussed above. Kindly contact the undersigned at [redacted] if we can be of further assistance.

Respectfully submitted,

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