

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-62134; File No. SR-FINRA-2010-022)

May 19, 2010

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of Proposed Rule Change Relating to Amending the Codes of Arbitration Procedure to Increase the Number of Arbitrators on Lists Generated by the Neutral List Selection System

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² notice is hereby given that on April 29, 2010, the Financial Industry Regulatory Authority, Inc. (“FINRA”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been substantially prepared by FINRA. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

FINRA is proposing to amend Rules 12403 and 12404 of the Code of Arbitration Procedure for Customer Disputes (“Customer Code”) and Rules 13403 and 13404 of the Code of Arbitration Procedure for Industry Disputes (“Industry Code”) to increase the number of arbitrators on each list generated by the Neutral List Selection System (“NLSS”).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

The text of the proposed rule change is available on FINRA's Web site at <http://www.finra.org>, at the principal office of FINRA and at the Commission's Public Reference Room.

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, FINRA included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. FINRA has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

The NLSS is a computer system that generates, on a random basis, lists of arbitrators from FINRA's rosters of arbitrators (*i.e.*, public, non-public, and chair rosters) for each arbitration case. The parties select their panel through a process of striking and ranking the arbitrators on the lists.

Currently, parties are sent lists of available arbitrators, along with detailed biographical information on each arbitrator. In a three-arbitrator case, other than one involving a dispute among members, the parties receive three lists of eight arbitrators each – one public, one chair-qualified and one non-public. Each party is permitted to strike up to four of the eight names on each list and ranks the remaining names in order of preference. FINRA appoints the panel from among the names remaining on the lists that

the parties return.³

When there are no names remaining on a list, or when a mutually acceptable arbitrator is unable to serve, a random selection is made to "extend the list" by generating names of additional arbitrators to complete the panel. Parties may not strike the arbitrators on the extended lists, but they may challenge an arbitrator for cause (e.g., on the basis of conflict of interest).

Prior to 2007, FINRA permitted parties unlimited strikes of proposed arbitrators on lists. This often resulted in parties collectively striking all of the arbitrators on each list generated through NLSS. When this occurred, staff would use NLSS to "extend the list" by generating names of additional arbitrators to complete the panel.

Parties expressed concern about extended list arbitrator appointments because they could not strike arbitrators from an extended list. In response to this concern, in 2007, FINRA changed the arbitrator appointment process through a rule change that limited the number of strikes each party may exercise to four, in an effort to reduce the frequency of extended list appointments.⁴ Under the current rule, FINRA permits each party to strike up to four arbitrators from each list of eight arbitrators generated through NLSS and up to eight arbitrators from each list of 16 arbitrators generated through NLSS. The rules limiting strikes have significantly reduced extended lists and thus increased the

³ In an arbitration between members, the panel consists of non-public arbitrators, and so the parties receive a list of 16 arbitrators from the FINRA non-public roster, and a list of eight non-public arbitrators from the FINRA non-public chairperson roster. See FINRA Rules 13402 and 13403. Each separately represented party may strike up to eight of the arbitrators from the non-public list and up to four of the arbitrators from the non-public chairperson list. See FINRA Rule 13404.

⁴ Exchange Act Release No. 55158 (January 24, 2007), 72 FR 4574 (January 31, 2007) (File No. SR-NASD-2003-158).

percentage of cases in which FINRA initially appoints arbitrators from the parties' ranking lists. However, after each side exercises its strikes, typically only one or two persons remain eligible to serve on the case. Therefore, when FINRA grants a challenge for cause or an arbitrator withdraws, FINRA often must appoint the replacement arbitrator using an extended list. Forum users, including both investor and industry parties, continue to express concerns about extended list appointments.⁵

As a result of these concerns, FINRA is proposing to amend Rule 12403 of the Customer Code to expand the number of arbitrators on each list (public, non-public, and public chairperson) generated through NLSS from eight arbitrators to 10 arbitrators. Thus, in every two party case, at least two arbitrators would remain on each list after strikes.⁶ The additional number of arbitrators will increase the likelihood that the parties will get panelists they chose and ranked, even when FINRA must appoint a replacement arbitrator. In cases with more than two parties, expanding the lists from eight to 10 arbitrators should significantly reduce the number of arbitrator appointments needed from extended lists.⁷

FINRA is also proposing to amend Rule 13403 of the Industry Code to expand the

⁵ The rationale for the proposed rule change was confirmed in a phone conversation between Margo Hassan, FINRA Dispute Resolution, and Joanne Rutkowski, Division of Trading and Markets, Commission, May 18, 2010.

⁶ FINRA is not proposing to expand the number of allowable strikes for each party.

⁷ Under the rules, each *separately* represented party is entitled to strike four arbitrators from an eight arbitrator list. If, for example, a case involves a customer, a member and an associated person, and each party is separately represented, even with 10 arbitrators there is a chance that all of the arbitrators will be stricken from the list.

number of arbitrators on lists generated through NLSS.⁸ For disputes between members, FINRA would expand the number of arbitrators on the non-public chairperson list generated through NLSS from eight arbitrators to 10 arbitrators and the number of arbitrators on the non-public list from 16 arbitrators to 20 arbitrators. For disputes between associated persons, or between or among members and associated persons, FINRA would expand the number of arbitrators on each list (public, non-public, and public chairperson) generated through NLSS from eight arbitrators to 10 arbitrators.

FINRA considered whether increasing each list of arbitrators would be unduly burdensome for parties since parties would be reviewing the backgrounds of additional arbitrators during the ranking and striking stage of the arbitrator appointment process. In instances where FINRA appoints arbitrators by extended lists, parties still need to review arbitrators' backgrounds to determine, for example, whether to challenge an extended list arbitrator for cause.

FINRA staff discussed expanding the lists with both investor and industry representatives, and asked the representatives to address the potential burden of reviewing additional arbitrators. The representatives uniformly stated that they would prefer to review additional arbitrators at the ranking and striking stage of the arbitrator appointment process in order to reduce the incidences of extended list appointments.

2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,⁹ which requires, among other things, that FINRA rules

⁸ Again, FINRA is not proposing to expand the number of allowable strikes for each party.

⁹ 15 U.S.C. 78o-3(b)(6).

must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. Forum users have criticized extended list appointments and asked FINRA to reduce the number of arbitrators appointed in this way. Expanding the number of arbitrators on lists generated through NLSS would reduce extended list appointments and would provide parties with more control in the arbitrator selection process because of the increased likelihood that arbitrators from each initial list would remain on the list after the parties complete the striking and ranking process. The proposal would enhance investor and industry participants' satisfaction with the arbitration process.

B. Self-Regulatory Organization's Statement on Burden on Competition

FINRA does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

Written comments were neither solicited nor received.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 35 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) by order approve such proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-FINRA-2010-022 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-FINRA-2010-022. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent

amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for Web site viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 p.m. Copies of such filing also will be available for inspection and copying at the principal office of FINRA. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-FINRA-2010-022 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.¹⁰

Florence E. Harmon
Deputy Secretary

¹⁰ 17 CFR 200.30-3(a)(12).