

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-66575; File No. SR-FINRA-2011-067)

March 12, 2012

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Order Approving a Proposed Rule Change Amending FINRA Rules 13201 (Statutory Employment Discrimination Claims) and 2263 (Arbitration Disclosure to Associated Persons Signing or Acknowledging Form U4) Relating to Whistleblower Disputes in Arbitration

I. Introduction

On November 21, 2011, the Financial Industry Regulatory Authority, Inc. (“FINRA”) filed with the Securities and Exchange Commission (“SEC” or “Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Exchange Act” or “Act”)¹ and Rule 19b-4 thereunder,² a proposed rule change to amend FINRA Rule 13201 of the Code of Arbitration Procedure for Industry Disputes (“Industry Code”) to align the rule with statutes that invalidate predispute arbitration agreements for whistleblower disputes. Specifically, the proposed rule change would amend Rule 13201 to add a new provision to provide that a dispute arising under a whistleblower statute that prohibits the use of predispute arbitration agreements is not required to be arbitrated under the Industry Code. The proposed rule change would also make a conforming amendment to FINRA Rule 2263. The proposed rule change was published for comment in the Federal Register on December 12, 2011.³ The Commission received one comment letter, from the Securities Industry and Financial Markets Association (“SIFMA”), on

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Exchange Act Release No. 65896 (Dec. 6, 2011) (“Notice”).

the proposed rule change,⁴ and a response to SIFMA's comments from FINRA.⁵ The text of the proposed rule change and FINRA's Response Letter are available on FINRA's website at <http://www.finra.org>, at the principal office of FINRA, on the Commission's website at <http://www.sec.gov>, and at the Commission's Public Reference Room.

This order approves the proposed rule change.

II. Purpose

The proposed rule change would amend FINRA Rule 13201 (Statutory Employment Discrimination Claims) of the Industry Code, and FINRA Rule 2263 (Arbitration Disclosure to Associated Persons Signing or Acknowledging Form U4), to align the rules with statutes that invalidate predispute arbitration agreements for whistleblower disputes.

The Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act")⁶ amended the Sarbanes-Oxley Act of 2002 ("SOX")⁷ by adding a new paragraph (e) to 18 U.S.C. § 1514A (Nonenforceability of Certain Provisions Waiving Rights and Remedies or Requiring Arbitration of Disputes)⁸ to provide that:

⁴ See letter from Kevin M. Carroll, Managing Director and Associate General Counsel, SIFMA, dated January 3, 2012 ("SIFMA Letter").

⁵ See letter from Margo A. Hassan, Assistant Chief Counsel, FINRA, to Elizabeth M. Murphy, Secretary, Commission, dated March 5, 2012 ("Response Letter").

⁶ See Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203 (2010).

⁷ Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204 (2002).

⁸ See Dodd-Frank Act Section 922(c)(2).

- (1) WAIVER OF RIGHTS AND REMEDIES – The rights and remedies provided for in this section may not be waived by any agreement, policy form, or condition of employment, including by a predispute arbitration agreement.
- (2) PREDISPUTE ARBITRATION AGREEMENTS – No predispute arbitration agreement shall be valid or enforceable, if the agreement requires arbitration of a dispute arising under this section.

Prior to the Dodd-Frank Act, it was FINRA staff's articulated position that parties were required to arbitrate SOX whistleblower claims under the Industry Code.⁹

In light of the changes set forth in the Dodd-Frank Act that invalidate predispute arbitration agreements in the case of SOX whistleblower disputes, the proposed rule change would amend FINRA Rule 13201 of the Industry Code to make clear that parties are not required to arbitrate SOX whistleblower disputes, superseding any existing guidance to the contrary. While FINRA's main impetus for the proposed rule change was the need to update its staff's stated position on SOX whistleblower claims, FINRA proposed to make the rule text broad enough to cover any statutes that prohibit predispute arbitration agreements for whistleblower disputes.¹⁰

Rule 13201 of the Industry Code currently provides that a claim alleging employment discrimination, including sexual harassment, in violation of a statute, is not required to be arbitrated under the Industry Code. Such a claim may be arbitrated only if the parties have

⁹ See Arbitrability of Sarbanes-Oxley Whistleblower Claims by Laurence S. Moy, Pearl Zuchlewski, Linda A. Neilan and Katherine Blostein, The Neutral Corner (Volume 1 – 2008).

¹⁰ The Dodd-Frank Act also invalidated predispute arbitration agreements in other whistleblower statutes, including, for example, 7 USCA § 26(n) relating to Commodity Exchange Whistleblower Incentives and Protections.

agreed to arbitrate it, either before or after the dispute arose. The proposed rule change would amend Rule 13201 to add a new provision to provide that a dispute arising under a whistleblower statute that prohibits the use of predispute arbitration agreements is not required to be arbitrated under the Industry Code. The rule would state that such a dispute may be arbitrated only if the parties have agreed to arbitrate it after the dispute arose.

FINRA also would amend the title of Rule 13201 to reflect the addition of the new provision relating to whistleblower disputes. FINRA structured the proposed rule change to separate the provision relating to statutory employment discrimination claims from the provision relating to whistleblower disputes.

The proposed rule change also would make a conforming amendment to FINRA Rule 2263, which requires firms to provide each associated person with certain written disclosures regarding the nature and process of arbitration proceedings whenever the firm asks an associated person, pursuant to FINRA Rule 1010 (Electronic Filing Requirements for Uniform Forms), to manually sign a new or amended Form U4, or to otherwise provide written acknowledgment of an amendment to the form. The proposed rule change would amend FINRA Rule 2263 to add a disclosure provision stating that a dispute arising under a whistleblower statute that prohibits the use of predispute arbitration agreements is not required to be arbitrated under FINRA rules, and that such a dispute may be arbitrated at FINRA only if the parties have agreed to arbitrate it after the dispute arose.

As explained in the Notice, FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,¹¹ which requires, among other things, that FINRA rules must be designed to prevent fraudulent and manipulative acts and practices, to

¹¹ 15 U.S.C. 78o-3(b)(6).

promote just and equitable principles of trade, and, in general, to protect investors and the public interest. FINRA believes that the proposed amendments are consistent with the provisions of the Act noted above because they serve to align FINRA rules with those provisions in the Dodd-Frank Act that invalidate predispute arbitration agreements in the context of certain whistleblower disputes.

III. Discussion of Comment Letters

In the SIFMA Letter, the commenter raised three distinct concerns about the proposal. First, the commenter questioned FINRA's use of the word "dispute" in its proposed rule change. Specifically, the commenter believed that using the word "dispute" would allow a claimant in an arbitration to assert a whistleblower claim under a whistleblower statute in an effort to improperly remove the entire case (i.e., "dispute") from arbitration. The commenter suggested that FINRA replace "dispute" with "claim" because it would allow a claim asserted under a whistleblower statute to be severed and removed from the arbitration case but would not allow parties "to avoid arbitrating other claims in the case that are properly subject to securities arbitration."

In the Response Letter, FINRA stated that it purposefully used the word "dispute" in the proposed rule to track the language used in the Dodd-Frank Act. However, FINRA also stated that it would administer the proposed rule in a manner that would permit an associated person of a member to bring a whistleblower claim in court while claims that are part of the same case that are properly subject to arbitration could remain in arbitration. FINRA also stated, however, that it would comply with any court order responding to an associated person's request to consolidate such claims. Therefore, FINRA declined to make the requested change.

Second, the commenter suggested that the proposed rule should apply only to claims under applicable federal whistleblower statutes instead of both federal and state statutes. Specifically, the commenter believed that because the Federal Arbitration Act (“FAA”) “generally preempts state statutes that invalidate arbitration agreements,” it also generally preempts any state statutes that remove whistleblower claims from arbitration. Accordingly, the proposal should only apply to federal whistleblower statutes.

In its Response Letter, FINRA stated that it did not believe that it would be appropriate to compel a registered person to arbitrate a whistleblower dispute when there is a statute precluding enforcement of a predispute arbitration agreement, regardless of whether the statute is promulgated under federal or state law. FINRA further stated that it would continue to accept whistleblower claims under a state statute if the parties agreed to arbitrate the claim, or if a court ordered the claim to be arbitrated at the forum. Therefore, FINRA declined to make the requested change.

Third, the commenter recommended that FINRA include an effective date in its proposal so that the rule would only be applied prospectively.

In its Response Letter, FINRA stated that since Section 922 of the Dodd-Frank Act invalidates all predispute arbitration agreements relating to whistleblower disputes, FINRA believed it was inappropriate to establish a new effective date. Therefore, FINRA declined to make the requested change.

IV. Discussion and Commission’s Findings

The Commission has carefully reviewed the proposed rule change, the comments received, and FINRA’s response to the comments, in particular FINRA’s representation that it would comply with a court’s ruling to consolidate all claims (including whistleblower claims)

associated with a particular case. Based on its review, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities association.¹² In particular, the Commission finds that the proposed rule change is consistent with Section 15A(b)(6) of the Act,¹³ which requires, among other things, that FINRA rules 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.

More specifically, the Commission finds that that the proposed rule change to align FINRA Rule 13201 with statutes that invalidate predispute arbitration agreements for whistleblower disputes would ensure that a dispute arising under a whistleblower statute that prohibits the use of predispute arbitration agreements would not be required to be arbitrated.

While the Commission appreciates the commenter's concern about FINRA's choice of language, the proposed rule purposefully tracks the language used in the Dodd-Frank Act.

For the reasons stated above, the Commission finds that the rule change is consistent with the Act and the rules and regulations thereunder.

¹² In approving this proposed rule change, the Commission has considered the rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

¹³ 15 U.S.C. 78o-3(b)(6).

V. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,¹⁴ that the proposed rule change (SR-FINRA-2011-067) be, and it hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.¹⁵

Kevin O'Neill
Deputy Secretary

¹⁴ 15 U.S.C. 78s(b)(2).

¹⁵ 17 CFR 200.30-3(a)(12).