

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-78729; File No. SR-FINRA-2016-033)

August 30, 2016

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of a Proposed Rule Change Amending Rule 12400 of the Code of Arbitration Procedure for Customer Disputes and Rule 13400 of the Code of Arbitration Procedure for Industry Disputes Relating to Broadening Chairperson Eligibility in Arbitration

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on August 18, 2016, Financial Industry Regulatory Authority, Inc. (“FINRA”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been 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 FINRA Rule 12400 of the Code of Arbitration Procedure for Customer Disputes (“Customer Code”) and FINRA Rule 13400 of the Code of Arbitration Procedure for Industry Disputes (“Industry Code,” and together with the Customer Code, the “Codes”) to provide that an attorney arbitrator would be eligible for the chairperson roster if he or she completes chairperson training and serves as an arbitrator through award on at least one arbitration, instead of two arbitrations, administered by a self-regulatory organization (“SRO”) in which hearings were held.

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

The text of the proposed rule change is available on FINRA's website 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

**Background**

FINRA rules require chairpersons, who play a vital role in the administration of arbitration cases, to have arbitrator experience and training to ensure the quality and efficiency of arbitrations. FINRA Rules 12400 and 13400 address the Neutral List Selection System ("NLSS")<sup>3</sup> and arbitrator rosters and provide, among other matters, that an arbitrator is eligible for the chairperson roster if he or she has completed chairperson training provided by FINRA and:

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<sup>3</sup> The NLSS is a computer system that generates, on a random basis, lists of arbitrators from FINRA's rosters of arbitrators for the selected hearing location for each proceeding. FINRA maintains a roster of non-public arbitrators (as defined in FINRA Rules 12100(p) and 13100(p)), a roster of public arbitrators (as defined in FINRA Rules 12100(u) and 13100(u)), and a roster of arbitrators who are eligible to serve as chairperson of a panel.

- Has a law degree and is a member of a bar of at least one jurisdiction and has served as an arbitrator through award on at least two arbitrations administered by an SRO in which hearings were held (an “attorney arbitrator”); or
- Has served as an arbitrator through award on at least three arbitrations administered by an SRO in which hearings were held.

FINRA’s Office of Dispute Resolution (“ODR”) offers 71 hearing locations, including at least one in each state of the United States, one in San Juan, Puerto Rico, and one in London, UK. ODR maintains a diverse roster of approximately 6,750 arbitrators, of which approximately 3,060 are currently classified as public. Approximately 1,000 of the 3,060 are chair-qualified. Despite the size of the public chairperson roster, forum users have raised concerns of a diminished public chairperson roster resulting from amendments to the “public arbitrator” definition that became effective on June 26, 2015.<sup>4</sup> As a result of the amended public arbitrator definition, FINRA reclassified approximately 13.8 percent (487 out of 3,512) of its public arbitrator roster as non-public and approximately 2.6 percent (93 out of 3,512) of its public arbitrator roster were temporarily disqualified and made ineligible for service.<sup>5</sup> Many of the arbitrators who were reclassified or disqualified were chair-qualified.

Currently, the public chairperson roster in each hearing location ranges from fewer than 40 to over 200. Forum users recognize the risk that when the caseload increases, the ratio of

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<sup>4</sup> See Securities Exchange Act Release No. 74383 (February 26, 2015), 80 FR 11695 (Order Approving Filing No. SR-FINRA-2014-028) (in part narrowing the public arbitrator definition by adding disqualifications relating to, among other things, affiliations with the securities industry concerning an arbitrator’s family member or place of employment).

<sup>5</sup> There were an estimated 2,932 public arbitrators after the amended public arbitrator definition became effective. Arbitrator recruitment since July 2015 added approximately 128 to the public arbitrator roster, thereby reaching approximately 3,060 public arbitrators as of this rule filing.

cases to qualified public chairpersons is higher and FINRA may not have a sufficient number of public chairpersons on its roster.

To expand the roster of public chairpersons in locations where the ratio of cases to qualified public chairpersons is higher, FINRA asks many public chairpersons to serve in multiple hearing locations. FINRA reimburses these chairpersons for their travel, lodging, and meals. However, party representatives have told FINRA staff that it is inconvenient to schedule hearings with out-of-town arbitrators. Moreover, during inclement weather, arbitrators may not be able to travel to the hearing location, which would then require parties to reschedule and incur additional costs. In addition, some forum users suggest that these arbitrators may also need instruction on the state laws, procedures, and customs for the hearing venue.

FINRA has had limited success in enrolling new public chairpersons. One reason is that for the last few years, FINRA's arbitration caseload has remained low, and public arbitrators were not serving on a sufficient number of cases through award to meet the case experience requirements for attorney arbitrators outlined above. In 2015, only 24% of cases closed by award. However, thus far in 2016, there has been an increase in case filings (up 20% compared to the same period in 2015). If this trend persists, the need for more public chairpersons could outpace the qualification pipeline under the current eligibility criteria.

#### **Proposed Amendments to Rules 12400(c) and 13400(c)**

FINRA is proposing to amend Rules 12400(c) and 13400(c) to provide that an attorney arbitrator would be eligible for the chairperson roster if he or she completes chairperson training and serves as an arbitrator through award on at least one arbitration, instead of two arbitrations, administered by an SRO in which hearings were held. Reducing the case experience requirement from two arbitrations to one arbitration could add more than 270 attorney arbitrators

across 59 of the 71 hearing locations, resulting in a nearly 30 percent increase in the number of arbitrators who might be eligible to serve as public chairpersons once they take chairperson training.

FINRA is also proposing to replace the bullets in Rules 12400 and 13400 with numbers for ease of citation.

## 2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,<sup>6</sup> 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. FINRA believes that the proposed rule change would protect investors and the public interest by potentially increasing the number of eligible public chairpersons in all hearing locations, without negatively impacting the quality of the chairperson rosters. The proposal would address concerns raised by forum users of FINRA's diminished public chairperson roster resulting from the amended public arbitrator definition and the inconvenience of scheduling hearings with out-of-town arbitrators.

### 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. Attorney arbitrators have the skillset to efficiently manage hearings and the experience to decide motions, among other matters. Their service as an arbitrator through award on one arbitration provides them with valuable experience regarding the arbitration forum. FINRA rules also require chairperson training before an attorney arbitrator becomes eligible to serve on a case as

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<sup>6</sup> 15 U.S.C. 78o-3(b)(6).

chairperson. The path to becoming chair-qualified is not mandatory however. ODR prompts candidates to register for chairperson training when they meet the other minimum qualifications. Any arbitrator who would like additional experience prior to serving as chairperson can defer the training until he or she gains that experience. In addition, ODR recently implemented a chairperson mentorship program to offer new chairpersons an additional resource for refining their chairperson skills. FINRA believes that by potentially increasing local chairpersons in hearing locations, FINRA would address forum users' concerns about scheduling out-of-town public chairpersons. Local arbitrators may also need less instruction on state laws, procedures, and customs. In addition, if the caseload increases, FINRA may not need to expand the use of public chairpersons from outside hearing locations, thereby avoiding additional forum user concerns.

The proposed rule change is expected to provide a greater selection of local chairpersons for forum users, thereby potentially lowering instances in which chairpersons must travel. In addition, during the arbitrator selection process, FINRA supplies all parties with Arbitrator Disclosure Reports<sup>7</sup> that include the arbitration case history for each potential arbitrator. Parties can strike arbitrators from the list for any reason. FINRA believes that the transparency of the Arbitrator Disclosure Report will continue to ensure that parties can make informed decisions regarding their chairperson selection and that the proposed rule change will increase the parties' choices.

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.

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<sup>7</sup> The Arbitrator Disclosure Report contains background information about the potential arbitrator, such as the arbitrator's name, classification, skills, employment, education, training, conflict information, and any publicly available awards the arbitrator issued.

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

Within 45 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 or disapprove 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](mailto:rule-comments@sec.gov). Please include File Number SR-FINRA-2016-033 on the subject line.

#### Paper Comments:

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

All submissions should refer to File Number SR-FINRA-2016-033. 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 website (<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 website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549-1090, 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-2016-033 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.<sup>8</sup>

Robert W. Errett  
Deputy Secretary

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<sup>8</sup> 17 CFR 200.30-3(a)(12).