

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-60878; No. SR-FINRA-2009-041)

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing Amendment No. 1 and Order Granting Accelerated Approval of a Proposed Rule Change, as modified by Amendment No. 1 Thereto, to Amend Rules 12100, 12506, and 12902 of the Code of Arbitration Procedure for Customer Disputes and Rule 13100 of the Code of Arbitration Procedure for Industry Disputes to Implement Conforming Changes

October 26, 2009

I. Introduction

On June 5, 2009, Financial Industry Regulatory Authority, Inc. (“FINRA” or the “Corporation”) (f/k/a National Association of Securities Dealers, Inc. (“NASD”)) 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 Rules 12100(r), 12506(a), and 12902(a) of the Code of Arbitration Procedure for Customer Disputes (“Customer Code”) and Rule 13100(r) of the Code of Arbitration Procedure for Industry Disputes (“Industry Code”) to amend the definition of “associated person,” streamline case administration procedure, and clarify that customers could be assessed hearing session fees based on their own claims for relief in connection with an industry claim. The proposed rule change was published for comment in the Federal Register on July 2, 2009.³ The Commission received one comment on the

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Securities Exchange Act Release No. 60159 (June 22, 2009), 74 FR 31779 (“Notice”).

proposed rule change.⁴ On August 10, 2009, FINRA responded to the comment letter.⁵ On October 16, 2009, FINRA filed Amendment No. 1 to the proposed rule change.⁶ The Commission is publishing this notice and order to solicit comments on Amendment No. 1 and to approve the proposed rule change, as modified by Amendment No. 1, on an accelerated basis.

II. Description of Proposed Rule Change

On January 24, 2007, the SEC approved amendments to the NASD Code of Arbitration Procedure (“old Code”) in connection with rules applicable to customer disputes and to industry disputes,⁷ a final step in the reorganization of the old Code into three separate procedural codes: the Customer Code, the Industry Code, and the Mediation Code (the “Code Revision”).⁸ The Code Revision simplified the language of the old Code, codified current dispute resolution practices, and implemented several substantive changes to dispute resolution rules. Since the SEC approved the Code Revision, Dispute Resolution staff (“staff”) has found rule language that was omitted inadvertently from the Customer Code and the Industry Code (collectively, “Codes”), as well as rule language that could be improved to

⁴ See letter from Brian M. Smiley, Public Investors Arbitration Bar Association, to Elizabeth M. Murphy, Secretary, Commission, dated July 29, 2009 (“PIABA Letter”).

⁵ See letter from Mignon McLemore, FINRA Dispute Resolution, to Elizabeth M. Murphy, Secretary, Commission, dated August 10, 2009 (“FINRA Response”).

⁶ Amendment No. 1 was a partial amendment that made minor technical edits to the rule text and the description of the proposal, and therefore does not require notice and comment.

⁷ See Securities Exchange Act Release No. 55158 (January 24, 2007), 72 FR 4574 (January 31, 2007) (File Nos. SR-NASD-2003-158 and SR-NASD-2004-011).

⁸ The Mediation Code was filed separately with the Commission as SR-NASD-2004-013. The Commission approved the Mediation Code on October 31, 2005, and it became effective on January 30, 2006. See Securities Exchange Act Rel. No. 52705 (October 31, 2005), 70 FR 67525 (November 7, 2005) (SR-NASD-2004-013).

better convey FINRA’s intent or to clarify current practice regarding certain dispute resolution rules. To address these concerns, FINRA proposed to amend:

- Rules 12100(r) and 13100(r) of the Codes (the definition of “person associated with a member”) so that the definition in the Codes conforms to the definition in FINRA’s By-Laws;
- Rule 12506(a) of the Customer Code (Document Production Lists) to encourage parties to download the Discovery Guide from FINRA’s Web site instead of having a copy mailed to them automatically when a claim is filed; and
- Rule 12902(a) of the Customer Code (Hearing Session Fees, and Other Costs and Expenses) to clarify that the arbitrators may assess hearing session fees against a customer in connection with a claim filed by a member against a customer in cases where there is also a responsive customer claim.

A discussion of the proposed amendments to each rule follows.

Rules 12100(r) and 13100(r) – Person Associated with a Member

As defined by Rules 12100(r) and 13100(r), a “person associated with a member” or an “associated person” generally is an individual who is licensed by FINRA to buy and sell securities for a FINRA member and its customers.⁹ This associated person works for a

⁹ Rules 12100(r) and 13100(r) define “person associated with a member” to mean:

- (1) A natural person registered under the Rules of FINRA; or
- (2) A sole proprietor, partner, officer, director, or branch manager of a member, or a natural person occupying a similar status or performing similar functions, or a natural person engaged in the investment banking or securities business who is directly or indirectly controlling or controlled by a member, whether or not any such person is registered or exempt from registration with FINRA under the By-Laws or the Rules of FINRA.

member and, in most cases, is the individual with whom customers communicate to discuss their accounts or securities transactions.

FINRA stated that it intended the definition of associated person in the Codes to match the By-Laws definition,¹⁰ except for one phrase relating only to Procedural Rule 8210. To that end, FINRA proposed to amend Rules 12100(r) and 13100(r) of the Codes to make these definitions consistent with the definition in FINRA’s By-Laws. The proposal would amend the definition of “person associated with a member” in the Codes to: (1) insert the word “other” before the second reference to “natural person” to clarify that the definition does not include corporate entities; and (2) insert the criterion that a natural person includes someone who has applied for registration.

FINRA stated that it believes that amending the definition in Rules 12100(r) and 13100(r) to clearly exclude corporate entities from the definition of associated person would remove any ambiguity concerning how the definition will be applied. Further, amending these rules to expand the forum’s jurisdiction to natural persons who have applied for

For purposes of the Code, a person formerly associated with a member is a person associated with a member.

¹⁰ FINRA’s By-Laws define “person associated with a member or associated person of a member” as:

(1) a natural person who is registered or has applied for registration under the Rules of the Corporation; (2) a sole proprietor, partner, officer, director, or branch manager of a member, or other natural person occupying a similar status or performing similar functions, or a natural person engaged in the investment banking or securities business who is directly or indirectly controlling or controlled by a member, whether or not any such person is registered or exempt from registration with the Corporation under these By-Laws or the Rules of the Corporation; and (3) for purposes of Rule 8210, any other person listed in Schedule A of Form BD of a member.

See By-Laws of the Corporation, Article I, Definitions (rr).

registration would ensure that these individuals, who may be working in some capacity with a firm while awaiting their license, are subject to FINRA's rules, and hence would be required to arbitrate should a dispute involving them arise. Moreover, FINRA noted that this amendment would conform the definitions under the Codes to the Corporation's definition of person associated with a member.¹¹

Rule 12506 – Document Production Lists

During the arbitration process, parties can request discovery of documents, names of witnesses, and other information from each other to prepare their cases for the arbitration hearing. To help parties understand what information they should disclose, FINRA staff provides a copy of the FINRA Discovery Guide¹² to parties when the Director serves the statement of claim. The Discovery Guide provides parties in customer cases with guidance on which documents they should exchange without arbitrator or staff intervention (called Document Production Lists)¹³ and provides guidance to arbitrators in determining which documents parties are presumptively required to produce.¹⁴

¹¹ See supra note 10.

¹² In January 1996, FINRA (then-NASD) created a Discovery Guide to assist customers in an arbitration with directing discovery and resolving discovery disputes. The Discovery Guide was approved by the SEC after a public comment period, see Securities Exchange Act Release No. 41833 (September 2, 1999), 64 FR 49256 (September 10, 1999), and was made available for use in arbitration proceedings involving customer disputes upon the publication of Notice to Members 99-90 (November 1999).

¹³ Many of the provisions of the Discovery Guide were incorporated into the Codes as part of the Code Revision. See supra note 7.

¹⁴ Although there are discovery rules in each Code, the Discovery Guide applies only in customer arbitration disputes.

Rule 12506 of the Customer Code states that when the Director serves the statement of claim, “the Director will provide the FINRA Discovery Guide and Document Production Lists to the parties.” In light of the availability of Dispute Resolution forms, guides and the claim filing system on FINRA’s Web site, FINRA stated that it believes that it is no longer necessary to disseminate the Discovery Guide to parties automatically when they file a claim in the dispute resolution forum. Further, many parties and counsel who use FINRA’s arbitration forum are repeat users who are likely to have a current copy of the Discovery Guide in their files. Due to these circumstances, FINRA believes that automatic distribution of the Discovery Guide is not an efficient use of resources.

Therefore, FINRA proposed to amend Rule 12506(a) to state that, when the Director serves the statement of claim, the Director will notify parties of the location of the Discovery Guide (which includes the Document Production Lists) on FINRA’s Web site, but will not provide a copy except upon request. FINRA stated that it believes the proposed change would enhance the efficiency of the case administration process, and would reduce FINRA’s printing and mailing costs. Moreover, FINRA stated that the proposal would encourage parties, especially those who frequently use the forum, to download relevant information from FINRA’s Web site as needed.

Rule 12902 – Hearing Session Fees, and Other Costs and Expenses

Under the old Code, arbitrators could allocate hearing session fees against any party. Rule 10332(c)¹⁵ of the old Code protected customers from potentially higher forum fees (now hearing session fees) triggered by amounts sought in industry claims by prohibiting the

¹⁵ Rule 10332(c) of the old Code stated, in relevant part, that “no fees shall be assessed against a customer in connection with an industry claim that is dismissed; however, in cases where there is also a customer claim, the customer may be assessed forum fees based on the customer claim.”

arbitrators from assessing forum fees against customers if the industry claim was dismissed. Moreover, the rule protected customers from higher forum fees by requiring the amount of the forum fees to be based on the amount awarded to an industry party and not on the amount of damages requested by the industry claim. However, Rule 10332(c) also provided that customers could be fairly subject to potential forum fees based on their own claims for relief in connection with the industry claim.¹⁶

During the Code Revision, FINRA inadvertently omitted from the corresponding provision, Rule 12902(a)(4) of the Customer Code, the provision in old Rule 10332(c) that permitted the forum to assess fees against the customer based on the customer's claim in an industry dispute. Thus, FINRA proposed to amend Rule 12902(a)(4) to incorporate the omitted language at the end of the rule to state specifically that "in cases where there is also a customer claim, the customer may be assessed a filing fee under Rule 12900(a), and may be subject to hearing session fees."

FINRA noted that the proposed amendment does not reflect a change in FINRA's stated policy or practice. Under the Customer Code, if a customer files a claim, counterclaim, cross claim or third party claim, Rule 12900(a)(1) requires the customer to pay a filing fee. Moreover, the first sentence of Rule 12902(a)(4) addresses the instance in which a customer may be assessed hearing session fees in connection with a claim filed by a member or associated person.¹⁷ Similarly, the proposed amendment to Rule 12902(a)(4)

¹⁶ For example, if a member filed a claim against a customer, and the arbitrators dismissed the claim, the customer would not be assessed any forum fees. However, if, in connection with the industry claim, the customer filed a counterclaim against the member, the customer would be subject to potential forum fees based on the customer's own claim for relief.

¹⁷ Rule 12902(a)(4) maintains the protection of old Rule 10332(c) by requiring that "the amount of hearing session fees the customer must pay must be based on the amount

would make clear to customers that if they file a claim in connection with a claim filed by a member, they may be subject to filing fees and hearing session fees based on their own claim for relief.¹⁸ FINRA stated that it believes the proposed amendment would clarify the forum's policy concerning fees in connection with a customer counterclaim for relief and make the Code easier to administer for staff.

III. Summary of Comments and Amendment No. 1

The Commission received one comment in response to the proposed rule change.¹⁹ The commenter supported the proposed amendments to Rules 12100(r) and 13100(r), and noted that the changes would help to clarify which disputes are subject to FINRA's jurisdiction. The commenter also supported the proposed amendment to Rule 12506(a),

actually awarded to the member or associated person, rather than on the amount claimed by the member or associated person.”

¹⁸ Rule 12900(a)(1) provides, in part, that:

Customers, associated persons, and other non-members who file a claim, counterclaim, cross claim or third party claim must pay a filing fee The Director may defer payment of all or part of the filing fee on a showing of financial hardship.

FINRA staff explained that the reference to Rule 12900(a) was intended to assist customers, and that the language of Rule 12902(a)(4) coupled with the reference to Rule 12900(a) should communicate the requirement that in industry cases in which there is also a customer claim, the customer will be assessed a filing fee, the payment of which may be deferred in whole or part upon a showing of financial hardship. Telephone call between Kenneth Andrichik and Mignon McLemore, FINRA Dispute Resolution, and Paula Jenson and Joanne Rutkowski, Division of Trading and Markets, Commission, September 17, 2009.

¹⁹ PIABA Letter.

which would encourage parties to download the Discovery Guide from the FINRA Web site.²⁰

In Amendment No. 1, FINRA proposed a limited amendment to the proposed amendment of Rule 12902 to remove a potentially confusing internal reference.

²⁰ The commenter suggested that FINRA continue to make parties and their attorneys aware of the Discovery Guide, and to provide a copy of the Discovery Guide to a party upon request. In response, FINRA noted that, when a claim is filed in its arbitration forum, staff sends a letter to the parties notifying them of case administration procedures and other information. If the proposed rule change is approved, FINRA will include in the letter a link to the Discovery Guide on FINRA's Web site. The proposed change to Rule 12506(a) states that "the director will notify parties of the location of the FINRA Discovery Guide and Document Production Lists on FINRA's Web site, but will provide a copy to the parties upon request."

The commenter also asked FINRA to ensure the version of the Discovery Guide that is posted "is actually the version that was disseminated by way of Notice to Members 99-90." PIABA Letter. In response, FINRA explained that there are two versions of the Discovery Guide, one for claims filed prior to April 16, 2007, and one for claims filed thereafter. Both are published on the FINRA Web site, and each is conspicuously labeled with the relevant date of applicability. FINRA stated that the 1999 version of the Discovery Guide was re-formatted and re-designed in March 2003 but substantively is the same document that was the subject of Notice to Members 99-90. FINRA Response.

Finally, the commenter opposed the proposed change to Rule 12902 because the "new language could discourage customers from filing counterclaims." PIABA Letter. In response, FINRA explained that the proposed amendment does not represent a new fee to be imposed on customers. Rule 12902(a)(4) still restricts the hearing session fees that arbitrators may assess against customers in claims brought by member firms. If a customer files a claim, counterclaim, cross claim or third party claim, Rule 12900(a)(1) requires customers to pay a filing fee, and if that claim is heard by an arbitrator or arbitrators, Rule 12902(a)(4) contemplates that hearing session fees may be allocated against the customer. FINRA stated that the proposed amendment to Rule 12902(a)(4) reflects current practice and is intended to clarify that if customers file a claim in connection with a claim filed by a member, the customers may be subject to filing fees and hearing session fees based on their own claim for relief. FINRA Response.

IV. Discussion and Findings

After careful 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.²¹ In particular, the Commission finds that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,²² which requires, among other things, that the Association's 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. The proposed rule change would ensure that individuals who have applied for registration are bound by FINRA's rules, and therefore subject to the jurisdiction of the dispute resolution forum. It would also assist in the efficient administration of the arbitration process by streamlining certain procedures and clarifying the allocation of hearing fees.

V. Accelerated Approval

The Commission finds good cause, pursuant to Section 19(b)(2) of the Act,²³ for approving the proposed rule change, as amended by Amendment No. 2 thereto, prior to the 30th day after the date of publication in the Federal Register. The changes proposed in Amendment No. 1 are minor and technical in nature. Accordingly, the Commission finds that good cause exists to approve the proposal, as modified by Amendment No. 1, on an accelerated basis.

²¹ In approving this proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

²² 15 U.S.C. 78o-3(b)(6).

²³ 15 U.S.C. 78o-3(b)(5).

VI. 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-2009-041 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-2009-041. 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 inspection and copying in the Commission's Public Reference Room. 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 the File Number SR-FINRA-2009-041 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

VII. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,²⁴ that the proposed rule change (SR-FINRA-2009-041), as amended, be, and hereby is, approved on an accelerated basis.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.²⁵

Florence E. Harmon
Deputy Secretary

²⁴ 15 U.S.C. 78s(b)(2).

²⁵ 17 CFR 200.30-3(a)(12).