

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-69762; File No. SR-FINRA-2013-023)

June 13, 2013

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of Proposed Rule Change Relating to Amendments to the Code of Arbitration Procedure for Customer Disputes Concerning Panel Composition

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 June 3, 2013, 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 FINRA Rule 12403 of the Code of Arbitration Procedure for Customer Disputes (“Customer Code”) to simplify arbitration panel selection in cases with three arbitrators. Under the proposed rule change, FINRA would no longer require a customer to elect a panel selection method, and parties in all customer cases with three arbitrators would get the same selection method. FINRA would provide all parties with lists of ten chair-qualified public arbitrators, ten public arbitrators, and ten non-public arbitrators. FINRA would permit the parties to strike four arbitrators on the chair-qualified public list and four arbitrators on the public list. However, any party

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

could select an all-public arbitration panel by striking all of the arbitrators on the non-public list.

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

Under the Customer Code, parties in arbitration participate in selecting the arbitrators who serve on their cases. Until January 31, 2011, the Customer Code contained one panel composition method for cases with three arbitrators (generally cases with claims of more than \$100,000).³ This method provided for a panel of one chair-qualified public arbitrator, one public arbitrator, and one non-public arbitrator. To begin the selection process, FINRA used the computerized Neutral List Selection System

³ See FINRA Rule 12401 which provides that if the amount of a claim is more than \$100,000, exclusive of interest and expenses, or is unspecified, or if the claim does not request money damages, the panel will consist of three arbitrators, unless the parties agree in writing to one arbitrator.

(“NLSS”) to generate random lists of ten chair-qualified public arbitrators, ten public arbitrators, and ten non-public arbitrators. The parties selected their panel through a process of striking and ranking the arbitrators on the lists generated by NLSS. The Customer Code permitted the parties to strike the names of up to four arbitrators from each list. The parties then ranked the arbitrators remaining on the lists in order of preference. FINRA appointed the panel from among the names remaining on the lists that the parties returned.

Customer advocates argued that the mandatory inclusion of a non-public arbitrator in a three-arbitrator case raised a perception that FINRA Dispute Resolution’s forum was not fair to customers. In order to address this perception, FINRA sought and received SEC approval to implement a new panel composition rule for customer cases with three arbitrators.⁴ Under current Rule 12403, customers may choose between two panel composition methods. The first method, the composition rules for majority public panel (Majority Public Panel Option), provides for a panel of one chair-qualified public arbitrator, one public arbitrator, and one non-public arbitrator. The Majority Public Panel Option is the same panel composition method that was in place prior to February 1, 2011, and it operates as described above.

The second method, the composition rules for optional all public panel (All Public Panel Option), allows any party to select an arbitration panel consisting of three public arbitrators. Under this provision, FINRA sends the parties the same three lists of randomly generated arbitrators that they would have received under the Majority Public

⁴ See Securities Exchange Act Rel. No. 63799 (January 31, 2011), 76 Federal Register 6500 (February 4, 2011), (File No. SR-FINRA-2010-053) and *Regulatory Notice* 11-05 (February 2011).

Panel Option, but FINRA allows each party to strike any or *all* of the arbitrators on the non-public arbitrator list. FINRA will not appoint a non-public arbitrator if the parties individually or collectively strike all the arbitrators appearing on the non-public list or if all remaining arbitrators on the non-public list are unable or unwilling to serve for any reason. In either instance, FINRA will select the next highest-ranked *public* arbitrator to complete the panel. By striking all the arbitrators on the non-public list, any party can ensure that the panel will have three public arbitrators.

Under Rule 12403, a customer may choose a panel composition method in the statement of claim (or accompanying documentation) or at any time up to 35 days from service of the statement of claim. In the absence of an affirmative choice by the customer, the Majority Public Panel Option is the default composition method. To ensure that the customer understands the options available, FINRA notifies the customer in writing that the customer may elect the All Public Panel Option within 35 days from service of the statement of claim. In its letter to the customer, FINRA explains how each panel composition method works.

Customer Elections and Award Results

Since implementation of the All Public Panel Option, customers in approximately three-quarters of eligible cases have chosen the All Public Panel Option.⁵ Customers using the Majority Public Panel Option have done so by default 77 percent of the time, rather than by making an affirmative choice (i.e., these customers did not make an election in their statement of claim or accompanying documentation, and did not respond to the follow-up letter FINRA sent).

⁵ The current panel composition rule went into effect on February 1, 2011. The percentage noted is for the period between February 1, 2011 and March 31, 2013.

As of March 31, 2013, customers selecting the All Public Panel Option have chosen to strike all of the non-public arbitrators in 66 percent of the cases during the ranking process. Customers have ranked one or more non-public arbitrators in 34 percent of cases and four or more in 13 percent of cases proceeding under the All Public Panel Option. Industry parties have ranked one or more non-public arbitrators in 97 percent of cases and have ranked four or more non-public arbitrators in 90 percent of cases. FINRA has been tracking the results of arbitration awards decided by all public panels and majority public panels since implementation of the rule change. For the period February 1, 2011 through March 31, 2013, investors prevailed 49 percent of the time in cases decided by all public panels and 34 percent of the time in cases decided by majority public panels.⁶

Proposal to Use One Panel Composition Method at the Forum

Based on FINRA's experience with having two panel composition methods, FINRA is proposing to amend Rule 12403 to use one panel composition method in all customer cases. The provisions in the All Public Panel Option as currently codified, with one clarifying change, would be the panel composition method for the forum. The clarifying change relates to striking and ranking arbitrators. Currently, Rule 12403(d)(3)(B)(i) states that "[e]ach separately represented party may strike up to four of the arbitrators from the chairperson and public arbitrator lists for any reason by crossing through the names of the arbitrators." FINRA is proposing to add clarity to that provision by amending it to state that "[e]ach separately represented party may strike up to four of

⁶ The results for awards issued by majority public panels include both instances where a customer selected the Majority Public Panel Option (affirmatively or by default), and instances where the parties selected a non-public arbitrator under the All-Public Panel Option.

the arbitrators from the chairperson list and up to four of the arbitrators from the public arbitrator list for any reason by crossing through the names of the arbitrators.”

FINRA believes that forum users would benefit by having one panel composition method for a number of reasons. First, having one panel composition method would simplify the arbitrator selection process for all parties and FINRA staff while leaving in place the method affirmatively chosen by customers in approximately three-quarters of customer cases. Second, it would ensure that every party has an opportunity to see the list of non-public arbitrators and rank or strike any or all of the arbitrators on the list. Third, the proposal would ensure that customers would not miss the opportunity to select an all public panel because of the inherent complexity of the rule. In its 2011 order approving adoption of the All Public Panel Option, the SEC noted commenter concerns that customers without attorneys, or attorneys new to the practice of securities arbitration, might not elect the All Public Panel Option within the prescribed deadline, or might not appreciate the significance of making such an election.⁷ At that time, FINRA responded by implementing the notification procedure discussed earlier. The proposed rule change would further ameliorate the commenter concerns.

Cross References

To implement the proposal, FINRA is proposing to correct several cross references in the Customer Code.

⁷ Supra note 3.

2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,⁸ 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 having one panel composition method, instead of the current two methods, would improve user experience at the forum. All parties would be subject to the same rules; there would be no confusion about panel composition; and less experienced parties would not be in the position to make an election that could inadvertently limit their options. For firms, one panel composition method brings certainty to the process and continues to assure that all parties have an opportunity to review the non-public arbitrator list.

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. FINRA considered the potential impact of the proposed rule change on efficiency, competition, and capital formation. FINRA believes that simplifying the arbitrator selection process will improve the efficiency of administering cases at the forum and would not increase the burden on parties to the arbitration.

The proposal would improve efficiency at the forum because FINRA staff would no longer be required to notify the customer in writing that the customer may elect the All Public Panel Option and would not have to wait for the 35-day period to expire before

⁸ 15 U.S.C. 78o-3(b)(6).

generating arbitrator lists. Improved efficiency may reduce expenses at the forum benefiting both investors and FINRA members.

In addition, the proposed rule change would not increase the burden of panel selection on the parties. FINRA would continue to send the parties the same three lists of arbitrators and the task of reviewing and analyzing arbitrator backgrounds would be the same.

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 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. Please include File Number SR-FINRA-2013-023 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-2013-023. 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, 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-2013-023 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.⁹

Elizabeth M. Murphy
Secretary

⁹ 17 CFR 200.30-3(a)(12).