

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-67784; File No. SR-FINRA-2012-040)

September 5, 2012

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of Proposed Rule Change to Amend the By-Laws of FINRA Dispute Resolution, Inc. to Clarify That Services Provided by Mediators Should Not Cause Them to Be Classified as Industry Members under the By-Laws

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 August 23, 2012, 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 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 the By-Laws of FINRA Dispute Resolution, Inc. (By-Laws) to clarify that services provided by mediators, when acting in such capacity and not representing parties in mediation, should not cause the individuals to be classified as Industry Members under the By-Laws.

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.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

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 believes that mediators who are otherwise qualified should be eligible to become Public Members of the National Arbitration and Mediation Committee (NAMC), a committee appointed by the Board of Directors of FINRA Dispute Resolution, Inc. (FINRA DR). Currently, they cannot because of the definitions of Industry Member³ and Public Member⁴ in the FINRA Dispute Resolution By-Laws (By-Laws).

In a FINRA mediation, all parties agree on the selection of a mediator, agree on the compensation of the mediator, and agree on how to allocate the mediator’s compensation among the parties. Thus, a mediator receives part of the compensation in each case from an industry party. However, for mediations to which investors are parties, mediators represent neither the investors nor the FINRA-registered individuals or entities. Similarly, for mediations involving industry parties only, mediators represent neither the

³ See Dispute Resolution By-Laws, Article I(s) (Definitions – Industry Member).

⁴ See Dispute Resolution By-Laws, Article I(x) (Definitions – Public Member).

FINRA-registered individuals nor entities. In both types of mediations, FINRA believes that the revenue mediators receive from FINRA-registered individuals or firms for their mediation activity should not prevent mediators from being classified as Public Members under the By-Laws.

Pursuant to the Plan of Allocation and Delegation of Functions by FINRA to Subsidiaries (Delegation Plan), the NAMC has the powers and authority pursuant to FINRA's Rules to advise the FINRA DR Board on the development and maintenance of an equitable and efficient system of dispute resolution that will equally serve the needs of public investors and FINRA members, to monitor rules and procedures governing the conduct of dispute resolution, and to have such other powers and authority as is necessary to effectuate the purposes of FINRA's Rules.⁵ The Delegation Plan provides that the FINRA DR Board must appoint the NAMC, whose membership must consist of a majority of Public Members.⁶

Currently, under the By-Laws, a mediator could be classified as an Industry Member rather than a Public Member for purposes of Committee participation because of the services provided by a mediator to an industry party. Mediators are neutrals and do not represent any party in the mediation. In FINRA's mediation forum, mediators are retained only by agreement of all parties to a dispute rather than by any one party. Further, the parties compensate mediators jointly pursuant to that agreement. While mediators derive some of their revenue from brokers or dealers, FINRA does not believe

⁵ See Plan of Allocation and Delegation of Functions by FINRA to Subsidiaries - NASD Dispute Resolution, §III(C)(1)(b).

⁶ Id. See also Rules 12102(a) and 12102(a)(1) of the Code of Arbitration Procedure for Customer Disputes ("Customer Code") and Rules 13102(a) and 13102(a)(1) of the Code of Arbitration Procedure for Industry Disputes ("Industry Code").

the compensation earned in the capacity as a mediator compromises the mediator's neutrality. As such, FINRA believes that the unique role played by mediators should be recognized in the By-Laws. Further, FINRA believes that mediation activity in cases involving industry parties should not prevent individuals from being classified as Public Members under the By-Laws.

FINRA is, therefore, proposing to amend the definitions of Industry Members⁷ and Public Members⁸ in the By-Laws so that services provided by mediators, while acting in such capacity and not representing parties in mediation, would not cause these individuals to be classified as Industry Members.

Proposal to Amend the By-Laws

FINRA is proposing to amend the definitions of Industry Member⁹ and Public Member¹⁰ under the By-Laws. These amendments would create an exception for any services provided by mediators in the capacity as a mediator of disputes involving a broker or dealer and not representing any party in such mediations, so that mediators may be eligible to serve as Public Members of the NAMC if they are not otherwise disqualified from being classified as Public Members. Parties in a mediation select their mediator by agreement. The mediators work with all parties simultaneously to help them resolve a dispute. The mediator has no power to decide the outcome and does not represent any party in the matter.

⁷ See note 3, supra.

⁸ See note 4, supra.

⁹ See note 3, supra.

¹⁰ See note 4, supra.

The proposal would amend two parts of the definition of Industry Member.¹¹ First, Article I(s)(4) of the By-Laws defines an Industry Member as a committee member who provides professional services to brokers or dealers, and such services constitute 20 percent or more of the professional revenues received by the Director or member or 20 percent or more of the gross revenues received by the Director's or member's firm or partnership. The proposal would amend the definition to exempt any services provided in the capacity as a mediator of disputes involving a broker or dealer and not representing any party in such mediations from being considered professional services provided to brokers or dealers.

Second, Article I(s)(5) of the By-Laws defines an Industry Member as a committee member who provides professional services to a director, officer, or employee of a broker, dealer, or corporation that owns 50 percent or more of the voting stock of a broker or dealer, and such services relate to the director's, officer's, or employee's professional capacity and constitute 20 percent or more of the professional revenues received by the Director or member or 20 percent or more of the gross revenues received by the Director's or member's firm or partnership. Similar to the change in Article I(s)(4) described in the paragraph above, FINRA proposes to amend the definition to exempt any services provided in the capacity as a mediator of disputes involving a director, officer, or employee as described in this definition and not representing any party in such mediations from being considered professional services provided to such individuals.

¹¹ The By-Laws define an Industry Member using six criteria. The proposal would amend two of them, subsections (4) and (5). See Dispute Resolution By-Laws, Article I(s) (Definitions – Industry Member).

The proposed revisions to the definition of Industry Member would establish that any services provided in the capacity as a mediator of disputes involving a broker or dealer and not representing any party in such mediations would not be considered services provided to brokers or dealers or affiliated individuals for purposes of measuring the professional revenues received by the NAMC member. FINRA believes the proposed amendments to the Industry Member definition would acknowledge the capacity in which mediators derive revenue from parties, including industry parties, yet recognize that the revenue earned in the capacity would not compromise the person's neutrality.

The proposal would also amend the definition of Public Member. The By-Laws define a Public Member as a committee member who has no material business relationship with a broker or dealer or a self-regulatory organization registered under the Act (other than serving as a public director or public member on a committee of such a self-regulatory organization). The proposal would amend the definition by adding language to the parenthetical to clarify that acting in the capacity as a mediator of disputes involving a broker or dealer and not representing any party in such mediations is not considered a material business relationship with a broker or dealer. FINRA believes that the proposed amendment to the Public Member definition would recognize that a mediator's service as a mediator would not, in itself, create any relationships with the securities industry that could compromise the mediator's independent judgment or decision-making.

Moreover, the proposed revisions to the By-Law definitions would incorporate current rule language from the definitions of non-public and public arbitrators found in the Code of Arbitration Procedure for Customer Disputes and the Code of Arbitration

Procedure for Industry Disputes. In 2005, the SEC approved the then-NASD's new Interpretive Material (IM) 10308 which stated, among other things, that mediation fees received by mediators who are also arbitrators shall not be included in the definition of "revenue" for purposes of Rule 10308(a)(5)(A)(iv), so long as the mediator is acting in the capacity of a mediator and is not representing a party in the mediation.¹² FINRA believes that using current rule language to amend its By-Laws, as proposed, would facilitate the uniform interpretation and application of its rules.

2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A of the Act, including Section 15A(b)(2) of the Act, in that it provides for the organization of FINRA and FINRA Dispute Resolution in a manner that will permit FINRA to carry out the purposes of the Act, to comply with the Act, and to enforce compliance by FINRA members and persons associated with FINRA members with the Act, the rules and regulations thereunder, FINRA rules and the federal securities laws. FINRA further believes that the proposed rule change is consistent with Section 15A(b)(4) of the Act, which requires, among other things, that FINRA's rules assure a fair representation of its members in the selection of its directors and administration of its affairs and provides that one or more directors shall be representative of issuers and investors and not be associated with a member of FINRA, broker or dealer. FINRA believes that the proposal would assure fair administration of its Dispute Resolution

¹² See Securities Exchange Act Rel. No. 51325 (Mar. 7, 2005), 70 FR 12522 (Mar. 14, 2005). The IM was renumbered and the rule language modified and added to the definitions of non-public and public arbitrator when FINRA adopted the revisions to the Customer and Industry Codes. See Securities Exchange Act Rel. No. 55158 (Jan. 24, 2007), 72 FR 4574 (Jan. 31, 2007) (File Nos. SR-NASD-2003-158 and SR-NASD-2004-011).

affairs by providing another source of qualified and experienced candidates from which to select public members for the NAMC.

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 or capital formation that is not necessary or appropriate in furtherance of the purposes of the Act, as amended.¹³ Further, FINRA believes that the proposal will promote efficiency in the arbitration forum as it will provide another source of qualified and experienced candidates from which to select public members for the NAMC.

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.

¹³ 15 U.S.C. § 78c(f).

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-2012-040 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-2012-040. 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-2012-040 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.¹⁴

Kevin M. O'Neill
Deputy Secretary

¹⁴ 17 CFR 200.30-3(a)(12).