

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-81196; File No. SR-FINRA-2017-025)

July 24, 2017

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of a Proposed Rule Change Relating to the Definition of Non-public Arbitrator

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 July 10, 2017, 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 FINRA Rule 12100 of the Code of Arbitration Procedure for Customer Disputes (“Customer Code”) and FINRA Rule 13100 of the Code of Arbitration Procedure for Industry Disputes (“Industry Code” and together, “Codes”), to define a non-public arbitrator to mean a person who is otherwise qualified to serve as an arbitrator, and is disqualified from service as a public arbitrator under the Codes.

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.

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

<sup>2</sup> 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

FINRA classifies arbitrators under the Codes as either “non-public” or “public.” The Codes define these terms.<sup>3</sup> The non-public arbitrator definition lists affiliations that might *qualify* a person to serve as a non-public arbitrator at the forum. Conversely, the public arbitrator definition enumerates criteria that *disqualify* an applicant from inclusion on the public arbitrator roster.

In 2015, the SEC approved amendments to the definitions of non-public arbitrator and public arbitrator in the Codes.<sup>4</sup> Among other things, the amendments provided that persons who worked in the financial industry for any duration during their careers would always be classified as non-public arbitrators and the amendments added new disqualifications to the public arbitrator definition relating to an arbitrator’s provision of services to parties in securities arbitration and litigation and to revenues earned from the financial industry by an arbitrator’s co-workers. The amendments also broadened the disqualifications based on the activities or affiliations of an

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<sup>3</sup> See FINRA Rules 12100(r) and 13100(r) for the definition of non-public arbitrator and Rules 12100(y) and 13100(x) for the definition of public arbitrator.

<sup>4</sup> See Securities Exchange Act Rel. No. 74383 (February 26, 2015), 80 FR 11695 (March 4, 2015).

arbitrator's family members. The intent of the proposed rule change was to address concerns about arbitrator neutrality raised by forum users.<sup>5</sup> For example, prior to the 2015 amendments, the Codes, with specified exceptions, permitted former financial industry employees who ended their industry affiliations to qualify as public arbitrators five years after leaving the financial industry. Forum users raised concerns about the neutrality of these individuals, and indicated that they did not believe former industry employees should ever serve as public arbitrators. In response to these concerns, the 2015 amendments eliminated the five-year cooling-off period, thereby classifying all former financial industry employees as non-public arbitrators.

Under the definitions as revised in 2015, the non-public arbitrator roster is composed of individuals who work, or worked, in the financial industry, or provide services to the financial industry or to parties engaged in securities arbitration and litigation. The public arbitrator roster is composed of individuals who do not have any significant affiliation with the financial industry. These arbitrators have never been employed by the industry, do not provide services to the industry or to parties engaged in securities arbitration and litigation, and do not have immediate family members or co-workers who do so.

### **Eligibility Gap**

The 2015 amendments to the arbitrator definitions created an eligibility gap whereby certain otherwise qualified arbitrators<sup>6</sup> could not serve in any capacity. The eligibility gap was created when FINRA narrowed the public arbitrator definition as described above. Over 800 public arbitrators were disqualified from the public arbitrator roster under the revised public

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<sup>5</sup> Regulatory Notice 15-18 (Definitions of Non-Public and Public Arbitrator) describes the changes made to the arbitrator definitions.

<sup>6</sup> Unless waived by FINRA at its discretion, arbitrator applicants must have a minimum of five years of paid business and/or professional experience and at least two years of college-level credits. Qualification criteria can be found at <http://www.finra.org/arbitration-and-mediation/finra-arbitrators>.

arbitrator definition. In addition, more than 100 of these disqualified arbitrators did not meet any of the criteria outlined in the non-public arbitrator definition for service on the non-public arbitrator roster. As a result of this eligibility gap, FINRA removed them from service at the forum.

In most instances, the basis for removal from the roster was an affiliation relating to an arbitrator's family members or co-workers. For example, a real estate attorney in a large law firm that has a securities practice would be disqualified from service as a public arbitrator if the firm derived \$50,000 or more in a calendar year from providing services to securities entities. In addition, employment as a real estate attorney would not qualify the arbitrator to serve as a non-public arbitrator under the current definition. Therefore, the arbitrator falls into the eligibility gap. In addition to losing over 100 public arbitrators, the eligibility gap required FINRA to reject over 140 arbitrator applicants in 2016 who met FINRA's minimum arbitrator qualifications.

### **Proposed Rule Change**

FINRA is proposing to amend the Codes to allow FINRA to appoint individuals to the non-public arbitrator roster if they meet FINRA's general arbitrator qualification criteria,<sup>7</sup> but cannot be classified as public arbitrators. FINRA would amend the non-public arbitrator definition to delete the specific criteria for inclusion on the non-public arbitrator roster. Instead, Rules 12100(r) and 13100(r) would provide that the term "non-public arbitrator" means a person who is otherwise qualified to serve as an arbitrator, and is disqualified from service as a public arbitrator.

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<sup>7</sup> See id.

## 2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,<sup>8</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. Specifically, the proposed rule change would close the eligibility gap, simplify the non-public arbitrator definition, and provide greater choice for parties during the panel selection process.

### 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. A key focus of the 2015 amendments was the elimination of certain individuals from the public arbitrator roster. FINRA's intent was not to prevent these individuals from serving in any capacity. Hundreds of arbitrators or arbitrator applicants who formerly qualified to serve as public arbitrators are now unable to serve as arbitrators in the forum. As a result, the pool of eligible arbitrators has decreased, and FINRA is forced to turn away new candidates who would have been eligible to serve but for the recent amendments.

The proposed rule change would permit these previously eligible persons to serve as non-public arbitrators. While not changing the public arbitrator definition as approved by the SEC in 2015, the proposed rule change would expand the pool of candidates eligible to serve as non-public arbitrators. FINRA considered revising the public arbitrator definition to close the eligibility gap, but chose to maintain the recently approved criteria that exclude individuals who have any significant affiliation with the financial industry. Increasing the number of qualified

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<sup>8</sup> 15 U.S.C. 78q-3(b)(6).

arbitrators benefits all parties who come before the forum because it permits parties to consider additional arbitrators during panel selection and may reduce costs that arise due to an insufficient pool of qualified arbitrators such as the costs associated with arbitrators traveling from other hearing locations. Further, readmitting previously qualified persons increases the pool of experienced arbitrators, which strengthens the forum.

The proposal would impose no direct or indirect costs on persons previously eliminated from acting as arbitrators, new candidates for arbitrator, or parties accessing the forum.

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](mailto:rule-comments@sec.gov). Please include File Number SR-FINRA-2017-025 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-2017-025. 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 10:00 a.m. and 3:00 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-2017-025 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>9</sup>

Eduardo A. Aleman  
Assistant Secretary

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<sup>9</sup> 17 CFR 200.30-3(a)(12).