

May 14, 2018

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of a Proposed Rule Change Relating to Create a Fee and Honorarium for Late Cancellation of a Prehearing Conference

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 May 4, 2018, 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 amend FINRA Rules 12500 and 12501 of the Code of Arbitration Procedure for Customer Disputes (“Customer Code”) and FINRA Rules 13500 and 13501 of the Code of Arbitration Procedure for Industry Disputes (“Industry Code” and together, “Codes”), to charge a \$100 per-arbitrator fee to parties who request cancellation of a prehearing conference within three business days before a scheduled prehearing conference. The proposed rule change would also amend FINRA Rules 12214(a) and 13214(a) of the Codes to create a \$100 honorarium to pay each arbitrator scheduled to attend a prehearing conference that was cancelled within three business days of the prehearing conference.

¹ 15 U.S.C. 78s(b)(1).

² 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

Introduction

FINRA proposes to charge parties to an arbitration a \$100 per-arbitrator fee if a prehearing conference is cancelled³ at the request of one or more parties that was submitted within three business days before a scheduled prehearing conference ("late cancellation fee"). FINRA is also proposing to pay a \$100 honorarium to each arbitrator who was scheduled to attend the prehearing conference that was cancelled within three business days of the prehearing conference.

³ References to cancellations of prehearing conferences include postponements of such conferences.

Background

The Codes have several rules that address postponements and cancellations of hearings.⁴ FINRA Rules 12601(b)(1) and 13601(b)(1) provide that for each postponement agreed to by the parties, or granted upon request of one or more parties, FINRA assesses a postponement fee to the parties, equal to the applicable hearing session fee.⁵ In addition, under FINRA Rules 12601(b)(2) and 13601(b)(2), a party or parties that make postponement requests within 10 days before a scheduled hearing session are required to pay a \$600 per-arbitrator late cancellation fee.⁶ Finally, if a hearing is cancelled or postponed due to settlement or withdrawal of a claim, FINRA Rules 12902(d) and 13902(d) provide that if FINRA receives a settlement or withdrawal notice 10 days or fewer prior to the date that the hearing is scheduled to begin, parties that paid a filing fee will not be entitled to any refund of the filing fee.⁷

⁴ A hearing is a meeting between the arbitrators and parties to determine the merits of the arbitration. See FINRA Rules 12100(o) and 13100(o).

⁵ These rules also permit the panel to allocate the fee among the party or parties that agreed to or requested the postponement, to assess part or all of any postponement fees against a party that did not request the postponement if the panel determines that the non-requesting party caused or contributed to the need for the postponement, and to waive the fees. This fee is paid to FINRA and not passed through to the arbitrators.

⁶ These rules also permit the panel to allocate the \$600 per-arbitrator fee among the requesting parties if more than one party requests postponement, to allocate all or a portion of the \$600 per-arbitrator fee to the non-requesting party or parties if the arbitrators determine that the non-requesting party or parties caused or contributed to the need for the postponement, and to use its discretion to waive the fee in the event of an extraordinary circumstance, provided verification of such circumstance is received. See FINRA Rules 12601(b)(2) and 13601(b)(2).

⁷ Customers, associated persons, and other non-members who file a claim, counterclaim, cross claim or third party claim must pay a filing fee to initiate an arbitration, unless the fee is deferred. See FINRA Rule 12900(a)(1); see also FINRA Rule 13900(a)(1) (addressing filing fees for associated persons).

FINRA believes that it is appropriate to address late cancellations of prehearing conferences by charging a late cancellation fee to the parties. In addition, FINRA proposes to pay an honorarium in the same amount to those arbitrators who were scheduled to attend the prehearing conference.

Prehearing conferences are typically scheduled before the hearing on the merits begins.⁸ During these conferences, the arbitrator or panel meets with the parties, either in person or by telephone, to set discovery, briefing, and motions deadlines, to schedule subsequent hearing sessions, and to address other preliminary matters.⁹ A prehearing conference may also address other outstanding matters, such as discovery disputes or substantive motions (e.g., motions to dismiss or motions to amend).¹⁰

Prehearing conferences currently can be cancelled by the parties up to and including on the same day without penalty, unlike late postponement of arbitration hearings.¹¹ Considerable preparation by arbitrators and logistical work by FINRA staff is required prior to prehearing conferences. Late cancellations of prehearing conferences that occur within three or fewer business days of a scheduled prehearing conference typically cause the most problems for arbitrators. In FINRA's experience, these late cancellations often result in scheduling inconvenience for arbitrators, uncompensated work by arbitrators,¹² and an operational challenge

⁸ See FINRA Rules 12100(w) and 13100(w).

⁹ See FINRA Rules 12500(c) and 13500(c).

¹⁰ See FINRA Rules 12501(b) and 13501(b).

¹¹ See generally FINRA Rules 12601(b) and 13601(b).

¹² In the past, arbitrators have resigned from the roster because FINRA's dispute resolution forum does not provide a payment to arbitrators for cancellations of prehearing conferences. FINRA notes that one reason former arbitrators have given for their resignation is the lack of compensation for prehearing conferences that are cancelled on

for FINRA staff who must quickly notify other parties and the arbitrator or panel about the cancellation.

Proposed Rule Change

Late Cancellation Fee for Prehearing Conferences

FINRA is proposing to amend FINRA Rules 12500 and 12501 of the Customer Code and FINRA Rules 13500 and 13501 of the Industry Code,¹³ which govern prehearing conferences, to provide that if a cancellation request is agreed to by the parties or requested by one or more parties within three business days before a scheduled prehearing conference and granted, the party or parties shall be charged a fee of \$100 per arbitrator scheduled to attend the prehearing conference. If more than one party requests the cancellation, the arbitrator(s) may allocate the \$100 per-arbitrator fee between or among the requesting parties. If one party requests the cancellation, the arbitrator(s) shall allocate the fee to that party; provided, however, the arbitrator(s) may allocate all or a portion of the \$100 per-arbitrator fee to the non-requesting party or parties if the arbitrator(s) determine that the non-requesting party or parties caused or contributed to the need for the cancellation. In the event that an extraordinary circumstance prevents a party or parties from making a timely cancellation request, the arbitrator(s) may use their discretion to waive the fee, provided a written explanation of such circumstance is received.

Under the proposed rule change, if a party requests or the parties agree to cancel a prehearing conference within three business days of a scheduled prehearing conference, the \$100 per-arbitrator fee would be charged as a fee assessment at the time the case is closed. The date

short notice. FINRA has identified 17 separate complaints relating to 22 arbitrators with respect to the late cancellations of prehearing conferences.

¹³ To simplify this explanation, FINRA's discussion of the proposed changes focuses on changes to the Customer Code. However, the proposed changes also apply to the Industry Code.

of the party's or parties' cancellation request controls whether the fee is assessed, not the date of the arbitrators' decision on such a request, if a decision is required.¹⁴ For example, if a party requests cancellation of the prehearing conference five business days before the scheduled prehearing conference, but the arbitrators rule on the request two business days before the scheduled conference would be held, the party would not be assessed a late cancellation fee under the proposed rule. If the arbitrators cancel a prehearing conference on their own, the parties would not be charged.

In the event of a cancellation, a party or the parties would be charged only for those arbitrators who were scheduled to attend the prehearing conference. For example, after the parties complete the arbitrator selection process and a panel is appointed,¹⁵ the Director of the Office of Dispute Resolution¹⁶ ("Director") will schedule an Initial Prehearing Conference ("IPHC"),¹⁷ during which the parties and arbitrators meet initially, usually by telephone. If the amount of the claim is more than \$100,000, the panel must consist of three arbitrators,¹⁸ all of whom would participate in the IPHC. The Director will typically appoint the chairperson of the panel to preside over prehearing conferences to resolve discovery issues.¹⁹

¹⁴ A decision would be required if only one party requests that the prehearing conference be cancelled.

¹⁵ See generally Part IV (Appointment, Disqualification, and Authority of Arbitrators) of the FINRA Rule 12000 Series and the FINRA Rule 13000 Series.

¹⁶ The term "Director" means the Director of the Office of Dispute Resolution and includes FINRA staff to whom the Director has delegated authority, unless the Code provides that the Director may not delegate a specific function. See FINRA Rule 12100(m); see also FINRA Rule 13100(m).

¹⁷ See FINRA Rule 12500; see also FINRA Rule 13500.

¹⁸ See FINRA Rule 12401; see also FINRA Rule 13401.

¹⁹ See FINRA Rule 12501(a); see also FINRA Rule 13501(a).

If more than one party cancels a prehearing conference under the proposed rule, the arbitrators would have the authority to allocate the fee in the award. The most common allocation would be between or among the parties making the request. However, depending on the facts and circumstances of the request, the arbitrators could assess the fee to one party or to a non-requesting party or parties if the arbitrators determine that these parties caused or contributed to the need for the cancellation. This authority is granted to the arbitrators under the Codes²⁰ and is consistent with other fee provisions in the Codes.²¹

If an extraordinary circumstance prevents a party from making a timely cancellation request, the arbitrators have the discretion to waive the late cancellation fee, provided they receive a written explanation of the circumstance. FINRA would notify parties and arbitrators that the prehearing conference was cancelled and remind parties to provide an explanation, if applicable, before the close of the arbitration case. If the fee is waived, the party's or parties' obligation to pay the fee would be eliminated. FINRA, however, would pay the \$100 per-arbitrator honorarium to the arbitrator(s) scheduled to attend the prehearing conference.

The following example illustrates how the rule would work. A claimant files a claim for \$150,000 against a firm. The parties select their arbitrators, the panel is appointed, the Director schedules an IPHC for Wednesday, August 15, 2018, and the three arbitrators are scheduled to attend. The parties meet independently and finish addressing the preliminary matters a week before the IPHC is scheduled. If the parties notify the Director of their agreement to cancel the IPHC²² on Thursday, August 9, 2018, they would not be charged because they provided notice

²⁰ See, e.g., FINRA Rules 12904(e)(8) and 13904(e)(8).

²¹ See generally FINRA Rules 12601(b) and 13601(b).

²² Parties may agree to forego the IPHC provided certain conditions are met. See FINRA Rule 12500(c); see also FINRA Rule 13500(c).

four business days before the scheduled prehearing conference.²³ If the parties notify the Director of the cancellation on Friday, August 10, 2018, they would be assessed a \$100 per-arbitrator fee (or \$300), because they would have provided the cancellation notice within three business days before the scheduled prehearing conference. In the example, if one party requested cancellation of the IPHC by August 10 but an extraordinary circumstance (e.g., a serious car accident) prevented timely notice, the party could provide a written explanation before the case closes for the arbitrators to consider waiving the fee. If the arbitrators waive the fee, FINRA would still pay the \$100 per-arbitrator honorarium to those arbitrators scheduled to attend the conference.

Finally, FINRA recognizes that customers could experience an increase in costs under the proposed rule change if they are assessed a part of or the entire late cancellation fee. FINRA notes that there are some mitigation strategies that parties could employ to avoid incurring these fees. As the objective of the proposed rule change is to encourage parties to address preliminary matters further in advance of a prehearing conference; if they do so, then they could provide notice of cancellation more than three business days prior to the scheduled prehearing conference to avoid the fee entirely. Further, if the parties agree to cancel a scheduled prehearing conference three business days or fewer before the scheduled conference, they can negotiate responsibility for the fee. In addition, the rules permit the arbitrator or panel to allocate the fee to the non-requesting party or parties if the arbitrator(s) determine that the non-requesting party or parties caused or contributed to the need for the cancellation.

²³ If August 9, 2018 were a FINRA holiday, the deadline would be extended until the next business day. See FINRA Rule 12100(l); see also FINRA Rule 13100(l). In this scenario, therefore, if the latest date to avoid a fee falls on a holiday, parties would not be assessed the late cancellation fee if they notify FINRA on the next business day following the holiday.

Arbitrator Honorarium for Late Cancellation of Prehearing Conferences

The proposed rule change would pay arbitrators who were scheduled to attend the prehearing conference that was cancelled an honorarium for late cancellations of prehearing conferences by amending FINRA Rule 12214(a)²⁴ to provide that FINRA would pay an honorarium of \$100 to each arbitrator scheduled to attend a prehearing conference that was cancelled within three business days of the prehearing conference by agreement of the parties or was requested by one or more parties within three business days of the prehearing conference and granted.

If the arbitrators waive the fee, the obligation to pay the fee would be eliminated, but FINRA would still pay the \$100 per-arbitrator honorarium to the arbitrator(s) scheduled to attend the prehearing conference.

Nonsubstantive changes

In addition to amending FINRA Rules 12500 and 12501²⁵ to establish a per-arbitrator fee for late cancellations of prehearing conferences and FINRA Rule 12214(a)²⁶ to create a corresponding honorarium, the proposed rule change would also make a few nonsubstantive changes to these rules.

As noted in Item 2 of this filing, if the Commission approves the proposed rule change, FINRA will announce the effective date of the proposed rule change in a Regulatory Notice to be published no later than 60 days following Commission approval. The effective date will be no

²⁴ FINRA Rule 13214(a) would also be amended. See supra note 13.

²⁵ See also FINRA Rules 13500 and 13501.

²⁶ See also FINRA Rule 13214(a).

later than 30 days following publication of the Regulatory Notice announcing Commission approval.

2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,²⁷ 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, and Section 15A(b)(5) of the Act,²⁸ which requires, among other things, that FINRA rules provide for the equitable allocation of reasonable dues, fees and other charges among members and issuers and other persons using any facility or system that FINRA operates or controls.

FINRA believes that the proposed rule change would allocate equitably the proposed late cancellation fee among those parties that cancel such conferences on short notice. The proposed fee would be paid by the parties, and passed through to the arbitrators to provide them with some compensation for the preparation time expended and for their inconvenience when a prehearing conference is cancelled on short notice. While arbitrators would typically allocate the fee to the requesting party or parties, FINRA rules permit the arbitrators to allocate all, or a portion of the fee, to the non-requesting party or parties if the arbitrators determine that the non-requesting party caused or contributed to the late cancellation. Moreover, the fee can be avoided altogether if the parties provide three business days' notice of such a cancellation. For these reasons, FINRA believes that the proposed fee is an equitable allocation of a reasonable fee to use the forum.

²⁷ 15 U.S.C. 78o-3(b)(6).

²⁸ 15 U.S.C. 78o-3(b)(5).

Moreover, FINRA believes that the proposed rule change would protect investors and the public interest by improving FINRA's ability to retain qualified arbitrators willing to devote the time and effort necessary to consider thoroughly all prehearing issues presented, which is an essential element for FINRA to operate an effective arbitration forum for the purposes of investor protection and market integrity.

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 discussion of the economic impacts of the proposed amendments follows.

(a) Need for the Rule

Unlike hearing sessions, parties can currently cancel prehearing conferences up to and including the same day of the conference without penalty.²⁹ Late cancellations of prehearing conferences are costly to arbitrators and can negatively impact their incentive to participate in the forum. They also pose an operational challenge for FINRA staff. The proposal would create incentives for parties to address preliminary matters further in advance of a prehearing conference by charging a late cancellation fee. The proposal would also compensate arbitrators for their costs in the event of a late cancellation.

(b) Economic Baseline

The economic baseline for the proposal is the current rules under the Codes that address the postponements and cancellations of hearings. The proposal is expected to affect the parties to an arbitration including customers, member firms, and associated persons. The proposal is also expected to affect FINRA arbitrators.

²⁹ Unless otherwise noted, consistent with the rest of the document, references to cancellations include postponements.

Arbitrators often spend considerable time and effort preparing for prehearing conferences. Currently, parties that cancel a prehearing conference do not incur a penalty, and arbitrators do not receive compensation for their time and effort spent preparing if a prehearing conference is cancelled (and not postponed until a later date). Late cancellations of prehearing conferences can also result in scheduling inconveniences. These factors can reduce the incentives of arbitrators to participate in the forum and the ability of FINRA to retain experienced arbitrators on the roster.³⁰ The loss of experienced arbitrators reduces the efficacy of the forum and the protections it affords to investors and other industry participants from wrongdoing.

FINRA has collected information detailing the frequency of late cancellations of prehearing conferences, from January 2018 to March 2018. FINRA is able to identify 182 instances of late cancellations of prehearing conferences, or approximately ten percent of the 1,904 scheduled prehearing conferences. Among these late cancellations, there were 474 arbitrators that could have been affected. This sample, from one calendar quarter, suggests that late cancellations of prehearing conferences could affect approximately one-quarter of arbitrators annually.³¹

(c) Economic Impact

The proposal would charge parties a fee if a prehearing conference is cancelled within three business days. A benefit of the proposal is an increase in the incentives of arbitrators to participate in the forum. Arbitrators would receive at least nominal compensation for their time and effort preparing for a prehearing conference, and in particular when the cancellation is closer

³⁰ See supra note 12.

³¹ There were a total of 7,364 registered FINRA arbitrators as of January 2018.

to the conference date and arbitrators have likely spent more time and effort to prepare. Arbitrators would also be less likely to experience scheduling inconveniences if the fee deters late cancellations of prehearing conferences. The removal of a disincentive for arbitrators to participate in the forum would reduce the likelihood that they resign from the forum. Retaining more experienced arbitrators could improve the efficacy of the forum and increase the protections it affords.

Parties would incur a \$100 fee for each arbitrator scheduled to attend a prehearing conference in the event of a late cancellation.³² The late cancellation fee would increase the forum costs of parties that cancel a prehearing conference or that are responsible for the cancellation. FINRA does not expect, however, that the late cancellation fee would reduce the incentives of parties to file claims. The fee should encourage parties to be more effective in managing their schedules and calendars to avoid late cancellations and to provide appropriate notice when seeking to cancel prehearing conferences. Arbitrators also have discretion to waive the late cancellation fee in the event of an extraordinary circumstance provided that the parties give a written explanation.

Parties would be able to cancel a prehearing without penalty if the cancellation is more than three business days in advance. In the event that a prehearing conference is cancelled more than three business days in advance, arbitrators would not receive compensation for any time and effort in their preparation. FINRA believes, however, that arbitrators are likely to put in more time and effort to prepare for a prehearing conference closer to the scheduled date. Earlier cancellations, therefore, are less likely to result in costs to the arbitrators and, therefore, would lessen the negative impact on the incentives to participate in the forum.

³² FINRA believes that the amount of the honorarium is reasonable given its understanding of the time and effort arbitrators expend when preparing for prehearing conferences.

(d) Alternatives Considered

Alternatives to the proposed amendments include applying the same parameters as scheduled hearing sessions to prehearing conferences: the number of days (10) prior to a scheduled hearing session for parties to cancel without incurring a late cancellation fee and the fee amount (\$600 per arbitrator) if parties cancel late. FINRA believes that arbitrators' costs for a late cancellation are less for a prehearing conference, which is often by phone, than for a scheduled hearing session, which is typically in person. Accordingly, FINRA believes that less advance notice and a lower fee are appropriate for cancellation of a prehearing conference. FINRA believes that the proposed amendments would incentivize parties to avoid late cancellations, while at the same time compensating arbitrators in the event of a late cancellation that is commensurate with their costs.

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-2018-019 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-2018-019. 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. Persons

submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-FINRA-2018-019 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.³³

Eduardo A. Aleman
Assistant Secretary

³³ 17 CFR 200.30-3(a)(12).