

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-97291; File No. SR-FINRA-2022-033)

April 12, 2023

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of Amendment No. 1 and Order Instituting Proceedings to Determine Whether to Approve or Disapprove the Proposed Rule Change, as modified by Amendment No. 1, to Amend the Codes of Arbitration Procedure to Make Various Clarifying and Technical Changes to the Codes, Including in Response to Recommendations in the Report of Independent Counsel Lowenstein Sandler LLP

I. Introduction

On December 23, 2022, the Financial Industry Regulatory Authority, Inc. (“FINRA”) filed with the Securities and Exchange Commission (“Commission”) proposed rule change SR-FINRA-2022-033 pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Exchange Act”)¹ and Rule 19b-4² thereunder to amend the Code of Arbitration Procedure for Customer Disputes³ (“Customer Code”) and the Code of Arbitration Procedure for Industry Disputes⁴ (“Industry Code”) (together, “Codes”). The proposed rule change was published for public comment in the Federal Register on January 12, 2023.⁵ The Commission received five comment letters related to this filing.⁶ On February 14, 2023, FINRA consented to an extension

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See FINRA Rule 12000 Series (Code of Arbitration Procedure for Customer Disputes).

⁴ See FINRA Rule 13000 Series (Code of Arbitration Procedure for Industry Disputes).

⁵ See Exchange Act Release No. 96607 (Jan. 6, 2023), 88 FR 2144 (Jan. 12, 2023) (File No. SR-FINRA-2022-033) (hereinafter, the “Notice”).

⁶ The comment letters are available at <https://www.sec.gov/comments/sr-finra-2022-033/srfinra2022033.htm>.

of the time period in which the Commission must approve the proposed rule change, disapprove the proposed rule change, or institute proceedings to determine whether to approve or disapprove the proposed rule change to April 12, 2023.⁷ On April 11, 2023, FINRA responded to the comment letters received in response to the Notice and filed an amendment to modify the proposed rule change (“Amendment No. 1”).⁸

The Commission is publishing this order pursuant to Section 19(b)(2)(B) of the Exchange Act⁹ to solicit comments on the proposed rule change, as modified by Amendment No. 1, and to institute proceedings to determine whether to approve or disapprove the proposed rule change, as modified by Amendment No. 1.

II. Description of the Proposed Rule Change, as Modified by Amendment No. 1

A. Background

FINRA’s Dispute Resolution Services (“DRS”) provides an arbitration forum for disputes between customers, member firms, and associated persons of member firms.¹⁰ In general, FINRA arbitrators in this forum “read the pleadings filed by the parties, listen to the arguments,

⁷ See letter from Kristine Vo, Assistant General Counsel, Office of General Counsel, FINRA, to Lourdes Gonzalez, Assistant Chief Counsel, Division of Trading and Markets, U.S. Securities and Exchange Commission (Feb. 14, 2023), available at <https://www.finra.org/sites/default/files/2023-02/sr-finra-2022-033-extension-no-1.pdf>.

⁸ See letter from Kristine Vo, Assistant General Counsel, Office of General Counsel, FINRA, to Vanessa Countryman, Secretary, U.S. Securities and Exchange Commission (Apr. 11, 2023) (“FINRA Letter”), available at <https://www.sec.gov/comments/sr-finra-2022-033/srfinra2022033-20164047-333995.pdf>.

⁹ 15 U.S.C. 78s(b)(2)(B).

¹⁰ See FINRA Rules 12101(a) (Applicability of [Customer] Code), 13101(a) (Applicability of [Industry] Code).

study the documentary and/or testimonial evidence, and render a decision [on a claim].”¹¹ The Codes¹² govern all aspects of claim and case processing, including: initiating and responding to claims; appointment, disqualification, and authority of arbitrators; prehearing procedures and discovery; and hearings, evidence, and closing the record.¹³

Whatever the size of the claim or nature of the dispute, the arbitrator-selection process typically follows the same steps for each case: (1) the Neutral List Selection System (“NLSS”), a computerized list-selection algorithm, randomly generates a list (or lists) of arbitrators from FINRA’s rosters of eligible arbitrators for the selected hearing location for each proceeding;¹⁴ (2)

¹¹ FINRA, DISPUTE RESOLUTION SERVICES: LEARN ABOUT ARBITRATION, <https://www.finra.org/arbitration-mediation/learn-about-arbitration>.

¹² As stated above, FINRA has two Codes of Arbitration Procedure. The Customer Code governs a customer’s claim about the business activities of an individual or entity registered with FINRA (e.g., associated persons of member firms). See FINRA Rules 12101 (Customer Code applies to any dispute between a customer and a member or associated person filed under Rules 12200 or 12201), 12200 (parties must arbitrate disputes about the non-insurance business activity of a member or associated person if the customer requests arbitration or arbitration is required by written agreement), 12201 (permits arbitration of disputes about the non-insurance business activity of a member or associated person if the parties agree in writing to submit to arbitration). The Industry Code governs, for the most part, business disputes exclusively among associated persons and/or member firms. See FINRA Rules 13101 (Industry Code applies to dispute filed under Rules 13200, 13201, or 13202), 13200 (requires arbitration “if the dispute arises out of the business activities of a member or an associated person and is between or among” members and/or associated persons), 13201 (permits arbitration of employment discrimination, whistleblower, and sexual misconduct cases), 13202 (requires arbitration if the dispute involves the business activity of a registered clearing agency that has entered into an agreement to use FINRA’s arbitration forum).

¹³ See FINRA Customer Code (FINRA Rule 12000 Series), Parts III-VI; FINRA Industry Code (FINRA Rule 13000 Series), Parts III-VI.

¹⁴ See FINRA Rules 12402(b) (Generating Lists in Cases with One Arbitrator), 12403(a) (Generating Lists in Cases with Three Arbitrators), 13403(a) (Lists Generated in Disputes Between Members), 13403(b) (Lists Generated in Disputes Between Associated Persons

the Director of DRS (hereinafter, the “Director”) sends the list(s) to the parties;¹⁵ (3) the parties exercise limited strikes to eliminate candidates from the list(s);¹⁶ (4) the parties express preferences by ranking the remaining candidates on the list(s);¹⁷ and (5) the Director combines the strike and ranking lists to identify and appoint the arbitrator(s).¹⁸

B. The Proposed Rule Change

FINRA has proposed to amend the Codes to address the arbitrator list-selection process. Specifically, the proposed rule change would:

or Between or Among Members and Associated Persons); see also FINRA Rules 12400(a), 13400(a).

¹⁵ See FINRA Rules 12402(c), 12403(b), 13403(c).

¹⁶ See FINRA Rules 12402(d)(1) (Striking and Ranking Arbitrators in Cases with One Arbitrator), 12403(c)(1)(A) and (2)(A) (Striking and Ranking Arbitrators in Cases with Three Arbitrators), 13404(a) and (b) (Striking and Ranking Arbitrators in Industry Disputes).

¹⁷ See FINRA Rules 12402(d)(2), 12403(c)(1)(B) and (2)(B), 13404(c). Parties must deliver their ranked lists to the Director no more than 20 days after the date upon which the Director sent the lists to the parties. Except for certain individuals proceeding pro se, parties must complete and deliver their ranked lists via the DR Party Portal (“Portal”). See FINRA Rules 12402(d)(3), 12403(c)(3), 13404(d). The Portal permits arbitration case participants to, among other things, file an arbitration claim, view case documents, submit documents to FINRA and send documents to other Portal case participants, and schedule hearing dates. See FINRA, DISPUTE RESOLUTION SERVICES: DR PORTAL, <https://www.finra.org/arbitration-mediation/dr-portal>.

¹⁸ See FINRA Rules 12402(e) (Combining Lists in Cases with One Arbitrators), 12402(f) (Appointment of Arbitrators in Cases with One Arbitrator), 12403(d) (Combining Lists in Cases with Three Arbitrators), 12403(e) (Appointment of Arbitrators in Cases with Three Arbitrators), 13405 (Combining Lists in Industry Disputes), 13406 (Appointment of Arbitrators in Industry Disputes).

- (1) Codify current practice¹⁹ by: (a) requiring the Director to manually review the arbitrator list(s) generated by NLSS for any conflicts of interest; (b) authorizing the Director to remove an arbitrator for such a conflict; and (c) authorizing the Director to randomly generate a replacement arbitrator in the event an arbitrator is removed,²⁰
- (2) Codify current practice²¹ by requiring the Director to provide the parties with a written explanation of their decision “to grant or deny a party’s request to remove an arbitrator . . . ,”²² and
- (3) Expressly authorize the Director to remove an arbitrator for a conflict of interest or bias, either upon request of a party or on the Director’s own initiative, “[a]fter the Director sends the lists generated by the list selection algorithm to the parties, but before the first hearing session begins.”²³

The proposed rule change would also amend certain procedural rules governing FINRA arbitration cases. Specifically, the proposed rule change would:

¹⁹ See Notice at 2144 (describing current practice).

²⁰ Proposed Rules 12402(b)(3), 12403(a)(4), 13403(a)(5), 13403(b)(5).

²¹ See Notice at 2145 (describing current practice).

²² Proposed Rules 12407(c), 13410(c).

²³ Proposed Rules 12407(a), 13410(a).

- (1) Provide that “prehearing conferences” will generally be held by video and “hearings” on the merits will generally be held in person, unless “the parties agree to, or the panel grants a motion for, another type of hearing session,”²⁴
- (2) Provide that any abbreviated hearing (i.e., special proceeding)²⁵ in a simplified arbitration (i.e., a case involving \$50,000 or less, exclusive of interest and expenses)²⁶ will be held by video, unless: (a) the customer requests at least 60 days before the first scheduled hearing that it be held by telephone or (b) the parties agree to another format,²⁷
- (3) Require parties in simplified arbitrations to redact personal confidential information from documents filed with the Director,²⁸
- (4) Amend the definition of “hearing session” to indicate that, during a single day, “the next hearing session begins after four hours of hearing time has elapsed,”²⁹

²⁴ Proposed Rules 12500(b), 12501(c), 12504(a)(5), 13500(b), 13501(c), 13504(a), 12600(b), 13600(b).

²⁵ See FINRA Rules 12800(c)(3)(B), 13800(c)(3)(B) (describing special proceedings).

²⁶ See FINRA Rules 12401(a), 13401(a). Simplified Arbitrations are governed by FINRA Rule 12800 (Simplified Arbitration) or FINRA Rule 13800 (Simplified Arbitration), respectively.

²⁷ Proposed Rules 12800(c)(3)(B)(i), 13800(c)(3)(B)(i).

²⁸ Notice at 2146 & n.29 (explaining that FINRA Rules 1200(d)(1)(C) and 13300(d)(1)(C) would be deleted); proposed Rules 12300(d)(1), 13300(d)(1).

²⁹ Proposed Rules 12100(p), 13100(p). FINRA indicated that the Codes do not describe the method for determining the number of hearing sessions that occurred in a given day in order to calculate arbitrator compensation. See Notice at 2146 (indicating that the Codes “do not specify when the next hearing session begins”). FINRA stated that currently DRS calculates the total number of hearing hours, subtracts any time spent for lunch, and

- (5) Require a respondent filing an answer containing a third-party claim to: (a) execute a Submission Agreement³⁰ that lists the name of the third-party; and (b) file the updated Submission Agreement with the Director,³¹
- (6) Amend various aspects of the rules governing the filing of amended pleadings to, among other things, extend those rules to the filing of third-party claims,³²
- (7) Amend rules governing when an arbitration panel may decide a motion to combine separate but related claims or reconsider the Director's previous decision upon a party's motion,³³
- (8) Amend rules governing motions practice to, among other things, address the timing of the Director's delivery of pleadings to the arbitrator panel,³⁴
- (9) Expressly provide that any party generating a list of documents and other materials prior to the first scheduled hearing may provide that list to other parties,

divides the remainder by four (as in four hours) to identify the number of hearing sessions. See id.

³⁰ The Codes define the term "Submission Agreement" to mean the FINRA Submission Agreement "that parties must sign at the outset of an arbitration in which they agree to submit to arbitration under the Code." FINRA Rules 12100(dd), 13100(ee); see Notice at 2146 n.35.

³¹ Proposed Rules 12303(b), 13303(b).

³² Notice at 2147; see proposed Rules 12309, 13309.

³³ Proposed Rules 12314, 13314.

³⁴ Notice at 2148 (describing proposed changes); see proposed Rules 12503(d), 13503(d) (addressing timing of the Director's delivery of pleadings).

but must not combine it with a witness list in a single document filed with the Director,³⁵

- (10) Amend rules governing hearing records to: (a) identify which party must distribute transcripts of the official record;³⁶ and (b) codify that executive sessions (i.e., private discussions of the arbitrator panel) will not be recorded,³⁷
- (11) Codify current practice³⁸ by permitting a panel to dismiss a claim or arbitration without prejudice if it finds insufficient service upon a respondent,³⁹ and
- (12) Require a panel to issue an “award” (i.e., a document describing the final disposition of a case) if it grants a motion to dismiss all claims after a party’s case-in-chief.⁴⁰

Amendment No. 1 would modify proposed Rules 12314 and 13314 (“Combining Claims”). Under the Codes, a party may move to join multiple claims (i.e., separate but related claims) together in the same arbitration if: (1) the claims contain common questions of law or fact; and (2) either the claims assert any right to relief jointly and severally or the claims arise out of the same transaction or occurrence, or series of transactions or occurrences.⁴¹

³⁵ Proposed Rules 12514(a), 13514(a).

³⁶ Proposed Rules 12606(a)(2), 13606(a)(2), 12606(b)(2), 13606(b)(2).

³⁷ Proposed Rules 12606(a)(1), 13606(a)(1).

³⁸ Notice at 2149 (describing current practice).

³⁹ Proposed Rules 12700(c), 13700(c).

⁴⁰ Proposed Rules 12504(b), 13504(b).

⁴¹ See FINRA Rules 12312 (Multiple Claimants), 13312 (Multiple Claimants).

Before ranked arbitrator lists are due to the Director, the Codes permit the Director to combine separate but related claims into a single arbitration.⁴² Once a panel has been appointed, the Codes permit the panel to reconsider the Director’s decision upon a party’s motion.⁴³ But the Codes do not address whether a panel has independent authority to combine such claims.⁴⁴ Nor do the Codes specify which panel – if more than one has been appointed to hear the separate but related claims – may reconsider the Director’s previous decision.⁴⁵

Amendment No. 1 would modify the proposed rule change by amending proposed Rules 12314(b) and 13314(b) to provide that “[i]f a panel has been appointed to one or more cases, the panel appointed to the lowest numbered case⁴⁶ with a panel” may combine separate but related claims into one arbitration and reconsider the Director’s previous decision upon a party’s motion.⁴⁷

⁴² FINRA Rules 12314, 13314.

⁴³ Id.

⁴⁴ Notice at 2147.

⁴⁵ Id.

⁴⁶ Among cases with a panel, the lowest-numbered case would be “the case with the earliest filing date.” Amendment No. 1; FINRA Letter at 7-8.

⁴⁷ Proposed Rules 12314(b), 13314(b); see Amendment No. 1. Amendment No. 1 also deletes proposed Rules 12314(b)(2) and 13314(b)(2) from the original proposal because FINRA stated that those sub-sections are no longer necessary in light of the amendment. Id.; see FINRA Letter at 8. In light of that change, Amendment No. 1 has re-designated the sub-sections appearing under proposed Rules 12314(b) and 13314(b).

III. Proceedings to Determine Whether to Approve or Disapprove File No. SR-FINRA-2022-033 and Grounds for Disapproval Under Consideration

The Commission is instituting proceedings pursuant to Section 19(b)(2)(B) of the Exchange Act to determine whether the proposed rule change, as modified by Amendment No. 1, should be approved or disapproved.⁴⁸ Institution of proceedings is appropriate at this time in view of the legal and policy issues raised by the proposed rule change, as modified by Amendment No. 1. Institution of proceedings does not indicate that the Commission has reached any conclusions with respect to the proposed rule change, as modified by Amendment No. 1.

Pursuant to Section 19(b)(2)(B) of the Exchange Act, the Commission is providing notice of the grounds for disapproval under consideration.⁴⁹ The Commission is instituting proceedings to allow for additional analysis and input concerning whether the proposed rule change, as modified by Amendment No. 1, is consistent with the Exchange Act and the rules thereunder.

IV. Request for Written Comments

The Commission requests that interested persons provide written submissions of their views, data, and arguments with respect to the issues identified above, as well as any other concerns they may have with the proposed rule change, as modified by Amendment No. 1. In particular, the Commission invites the written views of interested persons concerning whether the proposed rule change, as modified by Amendment No. 1, is consistent with the Exchange Act and the rules thereunder.

⁴⁸ 15 U.S.C. 78s(b)(2)(B).

⁴⁹ Id.

Although there do not appear to be any issues relevant to approval or disapproval that would be facilitated by an oral presentation of views, data, and arguments, the Commission will consider, pursuant to Rule 19b-4, any request for an opportunity to make an oral presentation.⁵⁰

Interested persons are invited to submit written data, views, and arguments regarding whether the proposed rule change, as modified by Amendment No. 1, should be approved or disapproved by [insert date 21 days from publication in the Federal Register]. Any person who wishes to file a rebuttal to any other person's submission must file that rebuttal by [insert date 35 days from publication in the Federal Register].

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 email to rule-comments@sec.gov. Please include File No. SR-FINRA-2022-033 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 No. SR-FINRA-2022-033. This file number should be included on the subject line if email is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all

⁵⁰ Section 19(b)(2) of the Exchange Act, as amended by the Securities Acts Amendments of 1975, Pub. L. 94-29, 89 Stat. 97 (1975), grants the Commission flexibility to determine what type of proceeding – either oral or notice and opportunity for written comments – is appropriate for consideration of a particular proposal by a self-regulatory organization. See Securities Acts Amendments of 1975, Report of the Senate Committee on Banking, Housing and Urban Affairs to Accompany S. 249, S. Rep. No. 75, 94th Cong., 1st Sess. 30 (1975).

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, as modified by Amendment No. 1, that are filed with the Commission, and all written communications relating to the proposed rule change, as modified by Amendment No. 1, 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. If comments are received, any rebuttal comments should be submitted on or before [insert date 35 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.⁵¹

Sherry R. Haywood
Assistant Secretary

⁵¹ 17 CFR 200.30-3(a)(12); 17 CFR 200.30-3(a)(57).