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SECURITIES AND EXCHANGE COMMISSION
[Release No. 34-81572; File No. SR-FINRA-2017-025]

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Order Approving a Proposed Rule Change Relating to the Definition of Non-public Arbitrator
September 11, 2017.

I. Introduction

On July 10, 2017, Financial Industry Regulatory Authority, Inc. ("FINRA") filed with the Securities and Exchange Commission ("Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Exchange Act")[1] and Rule 19b-4 thereunder,[2] a proposed rule change 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 with the Customer Code, "Codes"). The proposed rule change would permit any person who is disqualified from service as a public arbitrator, but otherwise qualified to serve as an arbitrator, to serve as a non-public arbitrator.

The proposed rule change was published for comment in the Federal Register on July 28, 2017.[3] The public comment period closed on August 18, 2017. The Commission received four comment letters in response to the Notice, all of which supported the proposed rule change.[4] On

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1 15 U.S.C. 78s(b)(1).

2 17 CFR 240.19b-4.

3 See Exchange Act Release No. 81196 (July 24, 2017), 82 FR 35248 (July 28, 2017) (File No. SR-FINRA-2017-025) ("Notice").

4 See Letters from Steven B. Caruso, Maddox Hargett Caruso, P.C., dated July 24, 2017 ("Caruso Letter"); Glenn S. Gitomer, McCausland Keen + Buckman, dated August 14, 2017 ("Gitomer Letter"); Jill Gross, Professor of Law and Former Director, and Elissa Germaine, Supervising Attorney, Adjunct Professor of Law, and Director, Pace Law School's Investor Rights Clinic, dated August 17, 2017 ("Pace Letter"); Marnie C. Lambert, President, Public Investors Arbitration Bar Association ("PIABA"), dated August 18, 2017 ("PIABA Letter"). Comment letters are available at https://www.sec.gov.

August 30, 2017, FINRA responded to the comment letters received in response to the Notice.[5] This order approves the proposed rule change.

II. Description of the Proposed Rule Change[6]

FINRA classifies arbitrators under the Codes as either "non-public" or "public." The non-public arbitrator definition lists affiliations that might qualify a person to serve as a non-public arbitrator at the forum.[7] Conversely, the public arbitrator definition describes criteria that disqualify an applicant from inclusion on the public arbitrator roster.[8]

In 2015, the Commission approved amendments to the definitions of non-public arbitrator and public arbitrator in the Codes ("2015 amendments").[9] Among other things, the 2015 amendments: (i) provided that persons who worked in the financial industry for any duration during their careers would always be classified as non-public arbitrators; (ii) 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; and (iii) broadened the disqualifications to the public arbitrator definition based on the activities or affiliations of an arbitrator's family members.[10]

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5 See Letter from Margo A. Hassan, Associate Chief Counsel, FINRA, to Brent J. Fields, Secretary, U.S. Securities and Exchange the Commission, dated August 30, 2017 ("FINRA Letter"). The FINRA Letter is available on FINRA's website at http://www.finra.org, at the principal office of FINRA, at the Commission's website at https://www.sec.gov, and at the Commission's Public Reference Room.

6 The subsequent description of the proposed rule change is substantially excerpted from FINRA's description in the Notice. See Notice, 82 FR at 35249.

7 See FINRA Rules 12100(r) and 13100(r).

8 See FINRA Rules 12100(y) and 13100(x).

9 See Exchange Act Rel. No. 74383 (Feb. 26, 2015), 80 FR 11695 (Mar. 4, 2015) (File No. SR-FINRA-2014-028) ("2015 Order").

10 See id. (stating that "the intent of the proposed rule change was to address concerns about arbitrator neutrality raised by forum users").

Under the definitions as revised by the 2015 amendments, 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. The public arbitrators have never been employed by the financial industry, do not provide services to the financial industry or to parties engaged in securities arbitration and litigation, and do not have immediate family members or co-workers who do so.[11]

However, FINRA believes that the 2015 amendments to the arbitrator definitions also created an "eligibility gap" whereby certain otherwise qualified arbitrators[12] could not serve in any capacity. For example, FINRA states that over 800 public arbitrators were disqualified from the public arbitrator roster under the revised public arbitrator definition. 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. Accordingly, FINRA completely removed them from its arbitrator rosters.[13] In addition, FINRA stated that due to the 2015 amendments it had to reject over 140 arbitrator applicants in 2016 who otherwise met FINRA's minimum arbitrator qualifications.[14]

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11 See 2015 Order.

12 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. See Notice, 82 FR at note 6.

13 See Notice, 82 FR at 35249.

14 Id.

Therefore, FINRA is proposing to amend Rules 12100(r) in the Customer Code and 13100(r) in the Industry Code to delete the specific criteria for inclusion on the non-public arbitrator roster. Specifically, the proposed rule 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. Accordingly, the proposed rule change would allow FINRA to appoint individuals who cannot be classified as public arbitrators to the non-public arbitrator roster if they meet FINRA's general arbitrator qualification criteria.[15]

III. Comment Summary

As noted above, the Commission received four comment letters on the proposed rule change, all of which supported the proposal.[16] All four commenters believe that the proposal would expand the pool of arbitrators and provide greater choice of non-public arbitrators for parties during the panel selection process.[17] One commenter stated that the proposal represents "a fair, equitable and reasonable approach that would facilitate the fairness and efficiency of the participant experience in the FINRA arbitration forum."[18] Another commenter stated that expanding the pool of available arbitrators "translates to greater party control over the process, [which] increases parties[']' perceptions of the fairness of the forum."[19] Similarly, another commenter stated that "having as many qualified, fair, and neutral arbitrators as possible will help advance the integrity of the arbitration process."[20]

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15 Id.

16 See supra note 4.

17 Id.

18 Caruso Letter.

19 Pace Letter.

20 PIABA Letter.

In addition to supporting the proposed rule change, two of these commenters also recommended additional changes to the FINRA arbitration forum designed to "ensure a fair and efficient arbitration pool."[21]

One commenter recommended that FINRA consider simplifying the definition of "public arbitrator"[22] in the Codes, which the commenter thinks is "also too complicated."[23] In its response, FINRA stated that in 2016 it did reconsider its definition of "public arbitrator" in the Codes but determined not to change it.[24]

The second commenter recommended that FINRA amend its policies to lower or eliminate certain educational requirements for individuals to become arbitrators.[25] Currently, unless waived, by FINRA, arbitrators must have at least two years of college-level credits in order to become an arbitrator.[26] The commenter believes that "[w]hether someone has taken college-level courses does not necessarily mean that such person cannot grasp the concepts being discussed and considered during the arbitration process."[27] Alternatively, the commenter thinks that one's ability to understand and pass FINRA's arbitrator training course is sufficient to

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21 PIABA Letter; see also Pace Letter.

22 See supra note 8.

23 Pace Letter.

24 See FINRA Letter; see also Notice at 82 FR 35249 (stating that the intent of the proposed rule change was to address concerns about arbitrator neutrality raised by forum users. 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").

25 See PIABA Letter.

26 See supra note 12.

27 PIABA Letter.

qualify as an arbitrator.[28] In its response, FINRA highlighted that it has authority to waive the educational requirement in light of, for example, a candidate's number of years of employment and type of employment (e.g., his or her field of employment and his or her positions held). Notwithstanding its discretion to waive the education requirement, FINRA consulted the subcommittee responsible for reviewing the arbitrator application[29] on the commenter's recommendation for its input.[30] Based on these factors, FINRA did not agree to revise the proposal at this time.[31]

The second commenter also recommended that FINRA continue its efforts to address arbitrator demographic issues.[32] In particular, the commenter recommended that FINRA continue recruiting new arbitrators to "help increase the diversity of the pool."[33] Similarly, this commenter recommended that FINRA continue recruiting public arbitrators in small and mid-sized cities in order to expand the pool of public arbitrators from which parties in these areas of the country can make their selections.[34] The commenter stated that "many constituents of FINRA arbitration . . . have had concerns about the number of . . . arbitrators who are selected to serve in the arbitrator pool outside of their nearest arbitrator site[.]"[35] The commenter claims

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28 See id.

29 The Neutral Roster Subcommittee of the National Arbitration and Mediation Committee.

30 See FINRA Letter.

31 Id.

32 See PIABA Letter.

33 PIABA Letter.

34 See PIABA Letter.

35 PIABA Letter.

that these "traveling arbitrators" create scheduling issues that delay the arbitration process and "may not understand a neighboring state's laws and procedures as much as a local arbitrator."[36]

In its response, FINRA stated that it "has been actively recruiting new arbitrators, [especially in] locations with the greatest need."[37] FINRA also agreed, however, that it should "continue [its efforts] to increase its public arbitrator pool."[38] In this regard, FINRA identified its recruiting methods, including, among other things, starting a program in which current FINRA arbitrators actively recruit arbitrator candidates, hiring national recruiters, utilizing social media platforms to circulate formal recruitment videos, focusing recruitment efforts in locations where public arbitrators are most needed, and targeting organizations to improve the diversity of its pool, such as women-focused groups and LGBTQ communities.[39] As a result of these methods, FINRA identified the improvements in recruiting that it has made since the 2015 amendment, including increasing the total number of public arbitrators and increasing both the percentage of new arbitrators who are women and the percentage of new applicants who are African-American.[40]

FINRA also stated, however, that notwithstanding its efforts to minimize the commenter's concerns about "traveling arbitrators," FINRA uses arbitrators in neighboring

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36 Id.

37 FINRA Letter.

38 Id.

39 See FINRA Letter.

40 See FINRA Letter (stating that "[FINRA r]ecruitment efforts since July 2015 added approximately 596 arbitrators to the public arbitrator roster. . .. FINRA's latest arbitrator demographic survey . . . showed that FINRA had particular success in adding women and African-Americans to the roster. In 2016, 33 percent of the arbitrators added were women and 14 percent were African-American. This represents an important improvement from the 2015 survey results which showed that 26 percent of arbitrators added were women and four percent were African-American").

hearing locations to expand arbitrator pools in other locations, as needed. FINRA believes that this option is necessary to "ensure an effective ratio of available arbitrators to open cases in each location."[41]

IV. Discussion and Commission Findings

After careful review of the proposed rule change, the comment letters, and FINRA's response, the Commission finds that the proposal is consistent with the requirements of the Exchange Act and the rules and regulations thereunder that are applicable to a national securities association.[42] Specifically, the Commission finds that the proposed rule change is consistent with Section 15A(b)(6) of the Exchange Act,[43] which requires, among other things, that FINRA rules 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.

The Commission agrees with FINRA that amending the definition of public arbitrator as proposed would provide greater choice for parties to an arbitration to choose a panel. As stated in the Notice, the 2015 amendments to the definitions of public and non-public arbitrators disqualified over 100 existing arbitrators from service at the FINRA forum and caused FINRA to reject over 140 prospective arbitrators in 2016.[44] FINRA stated that the disqualified arbitrators and rejected applicants would otherwise have met FINRA's minimum arbitrator qualifications.[45] The Commission agrees with FINRA and the commenters that the proposal amending the

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41 FINRA Letter at note 2.

42 In approving this rule change, the Commission has considered the rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

43 15 U.S.C. 78o-3(b)(6).

44 See supra notes 13 and 14.

45 Id.

definition of non-public arbitrator would permit FINRA to admit these otherwise qualified individuals to its roster of arbitrators thus expanding parties' choice or arbitrators.[46]

In addition, the Commission agrees with FINRA that the proposed rule change will not result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Exchange Act. In the Notice, FINRA stated that it proposed the 2015 amendments to remove certain individuals from the public arbitrator roster and not to prevent these individuals from serving in any capacity. As stated above, however, the 2015 amendments resulted in the exclusion of formerly qualified arbitrators and prospective arbitrators from the FINRA roster entirely. The proposed rule change would permit these previously eligible persons to again serve as non-public arbitrators. The Commission agrees with FINRA's conclusion that increasing the number of qualified arbitrators benefits all parties who come before the forum because it "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."[47] The Commission also believes that "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"[48] because previously eliminated arbitrators will be reinstated[49] and any prospective applicant must invest the same cost to apply to be an arbitrator notwithstanding the definitions of public and non-public arbitrator.

To note, the Commission additionally recognizes that the FINRA Dispute Resolution

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46 See Caruso Letter, Gitomer Letter, Pace Letter, PIABA Letter, and FINRA Letter.

47 Notice, 82 FR at 35249-35250; see Caruso Letter, Gitomer Letter, Pace Letter, and PIABA Letter.

48 Notice, 82 FR at 35250.

49 Telephone conversation between Kenneth L. Andrichik, Senior Vice President, FINRA Office of Dispute Resolution, and Daniel Fisher, Branch Chief, Division of Trading and Markets, Commission, on September 8, 2017.

Task Force ("Task Force") recommended that FINRA "monitor the application of the [2015 amended definitions of public and non-public arbitrators] in light of concerns that individuals with substantial process and subject matter expertise are stricken from the list of public arbitrators."[50] The proposed rule change responds to the Task Force's concerns.[51]

The Commission also acknowledges that the commenters' unanimously supported the proposal[52] and recognizes commenters' recommendations to make additional changes to the FINRA arbitration forum designed to "ensure a fair and efficient arbitration pool."[53] However, those recommendations are outside the scope of this proposal.

With regard to one commenter's suggestion that FINRA also simplify the definition of public arbitrator,[54] the Commission acknowledges FINRA's response that it weighed, and decided against, amending the public arbitrator definition so soon after amending it in 2015.[55]

With regard to another commenter's recommendations to amend FINRA policies to lower or eliminate its educational requirements for individuals to become arbitrators, the Commission acknowledges an individual's educational history is not necessarily determinative

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50 FINRA Dispute Resolution Task Force, Final Report and Recommendations of the FINRA Dispute Resolution Task Force (dated December 16, 2015) at page 17, available at http://www.finra.org/sites/default/files/Final-DR-task-force-report.pdf ("Task Force Report").

In July 2014, FINRA formed the Task Force to "suggest strategies to enhance the transparency, impartiality, and efficiency of FINRA's securities dispute resolution forum for all participants." FINRA News Release, FINRA Announces Arbitration Task Force (dated July 17, 2014), available at http://www.finra.org/newsroom/2014/finra-announces-arbitration-task-force.

51 See Status Report on FINRA Dispute Resolution Task Force Recommendations (dated February 8, 2017) at page 2, available at https://www.finra.org/sites/default/files/DR_task_report_status_020817.pdf.

52 See supra note 4.

53 PIABA Letter; see Pace Letter.

54 See Pace Letter.

55 See FINRA Letter.

of his or her ability to serve as an arbitrator.[56] However, the Commission also acknowledges that while the existing educational requirement sets a presumptive minimum threshold that may exclude otherwise appropriate candidates, FINRA has the authority to waive the requirement based on a candidate's overall experience.[57] The Commission believes that FINRA's policies setting the minimum credentials for its arbitrators along with FINRA's authority to waive those minimums appropriately balance FINRA's interest in recruiting arbitrators while maintaining the integrity of its arbitration forum.

The Commission also acknowledges this commenter's request for FINRA to recruit new arbitrators to expand the pool of public arbitrators in small and mid-sized cities from which parties can make their selections.[58] In particular, the Commission acknowledges the commenter's concern that selecting arbitrators to serve in an arbitrator pool outside of their nearest arbitrator site can create scheduling issues that delay the arbitration process.[59] The Commission also acknowledges, however, the ongoing recruitment efforts that FINRA has established and continues to employ in order to achieve this goal. In particular, the Commission notes FINRA's efforts to actively recruit new arbitrators in "locations with the greatest need."[60] For example, FINRA cites its 2017 recruitment efforts in Birmingham, Phoenix, Orlando, Las Vegas, Portland, Philadelphia, and Dallas – "smaller locations where public arbitrators are most needed."[61]

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56 See PIABA Letter.

57 See supra note 12; see also FINRA Letter.

58 See PIABA Letter.

59 Id.

60 FINRA Letter.

61 Id.

In addition, the Commission acknowledges the commenter's recommendation that FINRA continue its efforts to recruit new arbitrators in general to create a more diverse overall pool of arbitrators.[62] The Commission also acknowledges the steps that FINRA has taken to help meet this goal. For instance, FINRA stated that it has started a program in which current FINRA arbitrators actively recruit arbitrator candidates, hired national recruiters, and utilized social media platforms to circulate formal recruitment videos.[63] In addition, FINRA stated that it has focused its recruitment efforts on demographics that are less represented in the current arbitrator pool, targeting women-focused groups and LGBTQ communities.[64] Moreover, the Commission acknowledges the advances that FINRA has made in improving the diversity of its arbitrator pool.[65] In its response, FINRA identified the improvements in recruiting that it has made since the 2015 amendments, including increasing the total number of public arbitrators and increasing the percentage of new arbitrators who are women and the percentage of new arbitrators who are African-Americans.[66]

Taking into consideration the comments and FINRA's responses, the Commission believes that the proposal is consistent with the Exchange Act. The Commission believes that the proposal will help protect investors and the public interest by, among other things, increasing the size and diversity of the FINRA arbitrator pool from which parties can select a panel. The Commission believes that expanding investor choice in the arbitrator selection process improves efficiency and enhances the integrity of the forum. In addition, the Commission believes that

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62 See PIABA Letter.

63 See FINRA Letter.

64 Id.

65 Id.

66 Id.

FINRA's response to commenters, as discussed in more detail above, appropriately addressed their concerns and adequately explained FINRA's reasons for declining to modify its proposal. Accordingly, the Commission believes that the approach proposed by FINRA is appropriate and designed to protect investors and the public interest, consistent with Section 15A(b)(6) of the Exchange Act and the rules and regulations thereunder.

V. Conclusion

IT IS THEREFORE ORDERED pursuant to Section 19(b)(2) of the Exchange Act[67] that the proposal (SR-FINRA-2017-025), be and hereby is approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[68]

Eduardo A. Aleman
Assistant Secretary

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67 15 U.S.C. 78s(b)(2).

68 17 CFR 200.30-3(a)(12).

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