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Ms. Vanessa Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090

RE: File No. SR-FINRA-2022-033 (Proposed Rule Change 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) – Response to Comments No. 2

Dear Ms. Countryman:

This letter is being submitted by the Financial Industry Regulatory Authority, Inc. (“FINRA”) in response to comments received by the Securities and Exchange Commission (“SEC” or “Commission”) regarding the above-referenced rule filing. The proposed rule change would amend the Code of Arbitration Procedure for Customer Disputes (“Customer Code”) and the Code of Arbitration Procedure for Industry Disputes (“Industry Code”) (together, “Codes”) to make changes to provisions relating to the arbitrator list selection process in response to recommendations in the report of independent counsel Lowenstein Sandler LLP.¹ The Proposal would also make clarifying and technical changes to requirements in the Codes for holding prehearing conferences and hearing sessions, initiating and responding to claims, motion practice, claim and case dismissals, and providing a hearing record.

The Commission published the Proposal for public comment in the Federal Register on January 12, 2023, and received five comments in response. On April 11, 2023, FINRA submitted a response to the comments and filed Partial Amendment No. 1 to the Proposal to propose amendments based on the comments received by the SEC.²

¹ See Securities Exchange Act Release No. 96607 (January 6, 2023), 88 FR 2144 (January 12, 2023) (Notice of Filing of File No. SR-FINRA-2022-033) (“Proposal”).

² See Letter from Kristine Vo, Assistant General Counsel, FINRA, to Vanessa Countryman, Secretary, SEC, dated April 11, 2023 (“Response Letter”) and Partial Amendment No. 1 to SR-FINRA-2022-033 filed on April 11, 2023 (“Partial Amendment No. 1”), <https://www.finra.org/rules-guidance/rule-filings/sr-finra-2022-033>.

The Commission published a notice and order in the Federal Register to solicit comments on the Proposal and to institute proceedings pursuant to Section 19(b)(2)(B) of the Securities Exchange Act of 1934 in the above-referenced rule filing to determine whether to approve or disapprove the Proposal.³ The SEC received one additional comment letter in response to the Order.⁴ Pickard supported some aspects of the Proposal, but opposed other aspects of the Proposal and suggested modifications.

FINRA submits this response to Pickard's material comments.

I. List Selection Process Amendments

A. Arbitrator Removal

In response to recommendations in the report of Lowenstein Sandler LLP relating to an independent review and analysis of the FINRA Dispute Resolution Services ("DRS") arbitrator list selection process ("Report"),⁵ the Proposal would codify current practice whereby the Director of DRS ("Director")⁶ excludes arbitrators from the arbitrator lists generated by the list selection algorithm based upon a manual review of current conflicts of interest not identified within the list selection algorithm.⁷ In addition, the Proposal would amend the Codes to require the Director to provide to the parties a written explanation of the Director's decision to grant or deny a party's request to remove an arbitrator pursuant to FINRA rules.⁸

³ See Securities Exchange Act Release No. 97291 (April 12, 2023), 88 FR 23720 (April 18, 2023) (Order Instituting Proceedings to Determine Whether to Approve or Disapprove File No. SR-FINRA-2022-033) ("Order").

⁴ See Letter from Aleaha Jones, Pickard Djinis and Pisarri LLP, to Vanessa Countryman, Secretary, SEC, dated May 9, 2023 ("Pickard").

⁵ See FINRA, The Report of the Independent Review of FINRA's Dispute Resolution Services – Arbitrator Selection Process, <https://www.finra.org/sites/default/files/2022-06/report-independent-review-drs-arbitrator-selection-process.pdf>; see also Proposal, *supra* note 1, 88 FR 2144, 2144.

⁶ The term "Director" means the Director of DRS. Unless the Codes provide that the Director may not delegate a specific function, the term includes FINRA staff to whom the Director has delegated authority. See FINRA Rules 12100(m) and 13100(m).

⁷ See proposed Rules 12402(b)(3), 12403(a)(4), 13403(a)(5) and 13403(b)(5).

⁸ See proposed Rules 12407(c) and 13410(c). See also *supra* note 1, 88 FR 2144, 2145. The Report recommended that DRS consider amending its policies to require a written explanation whenever a challenge to remove an arbitrator is granted or denied, if a written explanation is requested by either party. See Report, *supra* note 5. Effective September 1, 2022, DRS updated its policy to provide a written explanation whenever a party-initiated challenge to remove an arbitrator is granted or denied, regardless of whether an explanation is requested by either party.

Pickard stated that it did not object to these proposed amendments “provided that the screening by the Director is limited to conflicts of interest of the type screened out by the [list selection algorithm] and does not provide the Director with unlimited discretion to strike arbitrators for potential or suspected conflicts of interest or bias.”

As explained in the Report and on FINRA’s website, the Director’s manual review screens for conflicts of interest of the type that the list selection algorithm cannot accurately detect (e.g., familial relationships or unregistered financial affiliate conflicts).⁹ FINRA believes such obvious conflicts of interest should be addressed before panel appointment, by the Director, to prevent unnecessary challenges to arbitrators and the attendant disruption to the case that could ensue.

With respect to the scope of the Director’s discretion to remove arbitrators, the Codes provide that the Director will grant a party’s request to remove an arbitrator if it is reasonable to infer, based on information known at the time of the request, that the arbitrator is biased, lacks impartiality, or has a direct or indirect interest in the outcome of the arbitration.¹⁰ In addition, the interest or bias must be definite and capable of reasonable demonstration, rather than remote or speculative.¹¹ The Codes further provide that the Director must first notify the parties before removing an arbitrator on the Director’s own initiative, and that the Director may not remove the arbitrator if the parties agree in writing to retain the arbitrator within five days of receiving notice of the Director’s intent to remove the arbitrator.¹² Thus, the Director’s discretion to remove an arbitrator on the Director’s own initiative is not unlimited. These provisions of the Codes related to the scope of the Director’s authority to remove arbitrators would not change under the Proposal.

Pickard also expressed concern that the Proposal “fails to explain whether a request to strike a party must be supported in writing and whether it will be independently reviewed by the Director and granted immediately upon request.” Pickard opined that the Proposal would “allow parties to exert greater control over the arbitral selection process than they had under the previous rule set.” FINRA disagrees. FINRA is not proposing to amend the process related to a

⁹ See Report, supra note 5. See also FINRA, How Parties Select Arbitrators, <https://www.finra.org/arbitration-mediation/arbitrator-selection>. See also Securities Exchange Act Release No. 40261 (July 24, 1998), 63 FR 40761, 40769 (July 30, 1998) (Notice of Filing of File No. SR-NASD-98-48) (stating that DRS will perform a manual review for conflicts of interests between parties and potential arbitrators); Securities Exchange Act Release No. 40555 (October 21, 1998), 63 FR 56670, 56675 (October 22, 1998) (Order Approving File No. SR-NASD-98-48) (describing the manual review for conflicts of interests between parties and potential arbitrators).

¹⁰ See FINRA Rules 12407(a)(1) and 13410(a)(1).

¹¹ See FINRA Rules 12407(a)(1) and 13410(a)(1).

¹² See FINRA Rules 12407(a)(2) and 13410(a)(2).

party's ability to remove an arbitrator. Under the Codes, to challenge an arbitrator, a party must file a written motion with DRS and serve the motion on each party so that the motions are available to all parties. FINRA rules include detailed motion practice procedures.¹³ If a party challenges an arbitrator, all other parties are provided an opportunity to make their arguments prior to any decision by the Director.¹⁴

B. Definition of "Conflicts of Interest" and "Bias"

Pickard suggested that FINRA define the terms "conflicts of interest" and "bias" or that the term "bias" "be struck from the amendment to avoid inconsistent treatment of a broad term." As explained in the Proposal, a non-exhaustive list of potential conflicts and a description of the manual review process are published on FINRA's website.¹⁵ FINRA believes this information sufficiently explains to forum users what types of relationships or connections FINRA looks for to determine whether a conflict of interest exists.

In addition, FINRA declines to define the term "bias" or to strike it from FINRA rules. The Proposal would clarify the timeframe for when the Director may remove an arbitrator for conflicts of interest or bias, either upon request of a party or on the Director's own initiative. Thus, Pickard is mistaken in commenting that the proposal would change on what basis (*i.e.*, conflict of interest or bias) an arbitrator may be removed. That said, on a basic level, conflicts of interest focus on relationships that an arbitrator may have that may affect the arbitrator's impartiality; whereas bias involves a prejudice in favor of or against a person or group, usually in

¹³ See generally FINRA Rules 12503 and 13503.

¹⁴ Pickard also opined that "it is unclear[] if a party may review previous decisions by an arbitrator (all of which are made public in FINRA's Arbitration Awards Online database) to determine whether the arbitrator has, more often than not, ruled in favor of a customer or member firm, and submit a 'bias' complaint on this basis alone." As discussed above, the Director will make a determination following a review of all arguments provided by the parties.

¹⁵ See Proposal, *supra* note 1, 88 FR 2144, 2145. Potential conflicts include that: the arbitrator is employed by a party to the case; the arbitrator is an immediate family member or relative of a party to the case or a party's counsel; the arbitrator is employed at the same firm as a party to the case; the arbitrator is employed at the same law firm as counsel to a party to the case; the arbitrator is representing a party to the case as counsel; the arbitrator is an account holder with a party to the case; the arbitrator is employed by a member firm that clears through a clearing agent that is a party to the case; or the arbitrator is in litigation with or against a party to the case. DRS may also remove an arbitrator for other reasons affecting the arbitrator's ability to serve, such as if DRS learns the arbitrator has moved out of the hearing location. See also FINRA, How Parties Select Arbitrators, <https://www.finra.org/arbitration-mediation/arbitrator-selection>.

a manner considered to be unfair (e.g., ethnic favoritism).¹⁶ Accordingly, FINRA does not believe there is a risk that the terms would be conflated.

II. Procedural Amendments

A. Virtual Prehearing Conferences

Under the Proposal, FINRA would amend the Codes to provide that prehearing conferences will generally be held by video conference unless the parties agree to, or the panel grants a motion for, another type of hearing session.¹⁷ Pickard generally supported the proposed amendment for holding default virtual prehearing conferences, but suggested changes to provide that “another type of hearing session will be approved if agreed to by a majority of the parties.” FINRA believes the panel, once fully briefed, is in the best position to determine whether an alternative prehearing format is more suitable to the parties than the proposed default format of video conference. Therefore, FINRA declines to amend the Proposal to allow a majority of the parties to decide another type of hearing session.

B. Number of Hearing Sessions Per Day

The Proposal would codify DRS’s current practice of calculating the number of hearing sessions per day by amending the definition of “hearing session” to clarify that in one day, the next hearing session begins after four hours of hearing time has elapsed.¹⁸ Pickard expressed concern that “it was unclear from the Proposal whether fees for two full sessions will be assessed after four hours and one minute of hearing time have elapsed.” Under Pickard’s hypothetical, FINRA would pay arbitrators for a second hearing session to ensure that they are compensated for their time and service to the DRS forum.¹⁹ DRS plans to update arbitrator guidance to encourage arbitrators to be efficient in managing the time during hearings to minimize, whenever possible, the number of hearing sessions held.

¹⁶ See generally FINRA, How Parties Select Arbitrators, <https://www.finra.org/arbitration-mediation/arbitrator-selection>.

¹⁷ See proposed Rules 12500(b), 12501(c) and 12504(a)(5); see also proposed Rules 13500(b), 13501(c) and 13504(a)(5).

¹⁸ See FINRA, Honorarium, <https://www.finra.org/arbitration-mediation/honorarium>.

¹⁹ Under the Proposal and consistent with current FINRA rules, arbitrators are paid for each hearing session in which they participate. See generally FINRA Rules 12100(p), 12214, 13100(p), and 13214. See also supra note 1, 88 FR 2144, 2146; Volume 1 – 2017 of The Neutral Corner, Arbitrator Tip: Expediting the Hearing. FINRA notes that time spent in an executive session is not part of a hearing session, and therefore should not be included in the hearing session calculation. The Proposal would amend the Codes to provide that executive sessions are discussions among arbitrators outside the presence of the parties and their representatives, witnesses and stenographers and are not recorded as they are not part of the official record of the hearing. See supra note 1, 88 FR 2144, 2148.

C. Witness Lists Shall Not Be Combined with Document Lists

The Proposal would specify that if the parties create lists of documents and other materials in their possession or control that they intend to use at the hearing and have not already been produced, the parties may serve the lists on all other parties, but shall not combine the lists with the witness lists filed with the Director.²⁰ Pickard suggested that the proposed amendment to require that parties not file lists of documents and other materials with witness lists “appears to be a solution in search of a problem.” As explained in the Proposal, on occasion, the Director may inadvertently disseminate the list of documents and other materials to the arbitrators, which could reveal potentially prejudicial or inadmissible information to the arbitrators before the hearing.²¹ By requiring that the exhibit list and witness list be separately submitted, as applicable, FINRA believes the risk of inadvertently disseminating potentially prejudicial or inadmissible information would be significantly diminished.

D. Dismissal of Claimant’s Claims Requires Issuance of an Award

The Proposal would codify current practice to require the issuance of an award if a panel grants a motion to dismiss a claimant’s case at the conclusion of the case-in-chief.²² If a panel grants a motion to dismiss a claimant’s case at the conclusion of the case-in-chief,²³ such a dismissal of all a claimant’s claims would dispose of the case.²⁴ In this instance, FINRA issues an award because, under the Codes, an award is a document stating the disposition of a case,²⁵ is final and is not subject to review or appeal.²⁶ In addition, the Codes provide that an award shall be made publicly available.²⁷

²⁰ See proposed Rules 12514(a) and 13514(a).

²¹ See supra note 1, 88 FR 2144, 2148.

²² See proposed Rules 12504(b) and 13504(b). See also FINRA Rules 12904(e) and 13904(e). If the panel grants a motion to dismiss some but not all of the claimant’s claims, the hearing would proceed as to the remaining claims and at the conclusion of the hearing, the panel would issue an award that disposes of each claim. See FINRA, FINRA Dispute Resolution Services Arbitrator’s Guide, <https://www.finra.org/sites/default/files/arbitrators-ref-guide.pdf>.

²³ See FINRA Rules 12504(b) and 13504(b).

²⁴ In the circumstance described, if a case is dismissed after a claimant’s case-in-chief, this means a panel has determined that the claimant’s case did not establish a liability finding against the respondents.

²⁵ See FINRA Rules 12100(c) and 13100(c).

²⁶ See FINRA Rules 12904(b) and 13904(b).

²⁷ See FINRA Rules 12904(h) and 13904(h). See also FINRA, Arbitration Awards Online, <https://www.finra.org/arbitration-mediation/arbitration-awards>.

Pickard opposed the proposed amendment because “FINRA’s current rule set [] [requires] that all arbitration awards be made public in a permanent, unredacted database.” Pickard also expressed concerns that that an award issued after a claimant’s case-in-chief is dismissed “will not reflect any defense by Respondent(s).”

As stated above, when a claimant’s case is dismissed in this manner, it disposes of the case. Thus, in accordance with FINRA rules, FINRA issues an award that is made publicly available.²⁸ FINRA acknowledges that the award may not reflect any defense by respondents. The award may, however, include a rationale underlying the award.²⁹ In addition, after the panel dismisses the case at the conclusion of the case-in-chief, the firm must file an amended Uniform Application for Securities Industry Registration or Transfer (“Form U4”) for the associated person to report the final disposition of the case as dismissed.³⁰ FINRA requires that broker-dealer firms update an associated person’s Form U4 not later than 30 days after the case dismissal.³¹ Generally, this updated information is subsequently disclosed on the associated person’s BrokerCheck® report, which is publicly available to investors.³²

III. Comments That Are Outside the Scope

Pickard urged FINRA to make further amendments to the Codes relating to expungement of customer complaints and suggested modifications. These comments are outside the scope of the Proposal and, therefore, are not addressed herein.

Pickard also expressed concern about “FINRA’s current practice of selling licenses to third-party distributors, including major research distributors like LexisNexis, to republish details of arbitration awards through other public channels.” This comment is outside the

²⁸ See id.

²⁹ See FINRA Rules 12904(f) and 13904(f).

³⁰ Several questions on Form U4 require the disclosure of certain investment-related, customer-initiated arbitrations, civil litigations or customer complaints which allege sales practice violations. See Form U4, Question 14I, <https://www.finra.org/sites/default/files/form-u4.pdf>. Pursuant to FINRA Rule 1010, every initial or transfer Form U4 filing and, in general, any amendments to the disclosure information on Form U4 must be signed by the associated person. In addition, associated persons can provide a brief summary or add context on Form U4 regarding the circumstances leading to a customer arbitration, civil litigation or complaint, as well as the current status or final disposition. See Form U4, Question 14I and corresponding Disclosure Reporting Page, <https://www.finra.org/sites/default/files/form-u4.pdf>.

³¹ See FINRA By-Laws, Article V, Section 2(c). Associated persons share the responsibility to keep current information on their Form U4.

³² A detailed description of the information made available through BrokerCheck is available at <http://www.finra.org/investors/about-brokercheck>.

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scope of the proposal. However, FINRA notes that it does not license to third party distributors the rights to publish arbitration awards through other public channels.

Conclusion

FINRA believes that by codifying and clarifying the DRS forum practices and procedures regarding the list selection and other case administration processes, the Proposal will reduce uncertainty among forum users, provide greater transparency regarding these practices and procedures, and enhance the efficiency and timeliness of administering cases in the forum. Further, by aligning the forum's practices and procedures with the relevant rules of the Codes, the Proposal will help ensure that the rules are consistently applied.

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FINRA believes that the foregoing responds to the material comments raised by the commenter on the Proposal and that the Proposal should be approved. If you have any questions, please contact me on 212-858-4106, email: Kristine.Vo@finra.org.

Very truly yours,

/s/ Kristine Vo

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