

Regulatory Notice

11-05

Arbitration Panel Composition

Customer Option to Choose an All Public Arbitration Panel in All Cases

Effective Date: February 1, 2011

Executive Summary

Effective immediately, customers in FINRA arbitration have the option to choose an all public arbitration panel in all cases with three arbitrators.¹ FINRA amended the Code of Arbitration Procedure for Customer Disputes to allow customers with claims over \$100,000 to choose between two panel composition methods. The first method, called the composition rules **for majority-public panel**, is the composition method FINRA used prior to the rule amendments. It provides for a panel comprised of a chair-qualified public arbitrator, a public arbitrator and a non-public arbitrator.

The second method, called the composition rules for **optional all public panel**, allows any party to select an all public arbitration panel. FINRA believes that providing customers with the right to exclude a non-public arbitrator from the panel deciding their case will enhance customers' perception of the fairness of FINRA's rules and the securities arbitration process.

The amendments apply to all customer cases in which FINRA has not sent lists of arbitrators to the parties. The text of the amendments is available on our website at www.finra.org/notices/11-05.

Questions concerning this *Notice* should be directed to:

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Notice Type

- ▶ Rule Amendment

Suggested Routing

- ▶ Compliance
- ▶ Legal
- ▶ Registered Representatives
- ▶ Senior Management

Key Topics

- ▶ Arbitration
- ▶ Code of Arbitration Procedure
- ▶ Panel Composition

Referenced Rules & Notices

- ▶ FINRA Rule 12402
- ▶ FINRA Rule 12403
- ▶ FINRA Rule 12404
- ▶ FINRA Rule 12405
- ▶ FINRA Rule 12406
- ▶ FINRA Rule 12407
- ▶ FINRA Rule 12408
- ▶ FINRA Rule 12409
- ▶ FINRA Rule 12410
- ▶ FINRA Rule 12411
- ▶ FINRA Rule 12412
- ▶ FINRA Rule 12413
- ▶ FINRA Rule 12414



Financial Industry Regulatory Authority

Background & Discussion

Under FINRA rules, for claims up to \$100,000, the Code of Arbitration Procedure for Customer Disputes (Customer Code) provides, generally, for a single public arbitrator. Prior to the amendments, for all customer claims of more than \$100,000, the Customer Code provided for a three-arbitrator panel comprised of a chair-qualified public arbitrator, a public arbitrator and a non-public arbitrator. FINRA amended the Customer Code to give customers the option to choose between two panel selection methods for claims over \$100,000—the majority-public panel or the optional all public panel. The amendments provide that only customers (whether they are claimants or respondents in a case) may choose the panel-selection method; neither firms nor associated persons may choose. The majority-public panel option provides for a panel of one chair-qualified public arbitrator, one public arbitrator and one non-public arbitrator. And the optional all public panel provision, if chosen by the customer, allows any party to select an all public arbitration panel.

Parties in arbitration participate in selecting the arbitrators who serve on their cases. Under the rule amendments, for claims over \$100,000, FINRA will send parties three lists of 10 arbitrators randomly generated by the computerized Neutral List Selection System (NLSS)—10 chair-qualified public arbitrators, 10 public arbitrators and 10 non-public arbitrators. Under the majority-public panel method, each party may strike up to four arbitrators on each list; under the optional all public panel method, each party may strike up to four arbitrators on the chair-qualified public arbitrator list and on the public arbitrator list. However, under the optional all public panel method, each party may strike up to *all* of the arbitrators on the non-public arbitrator list. After striking arbitrators from the lists, the parties will rank the remaining arbitrators in order of preference and FINRA will appoint the panel from among the names remaining on the lists that the parties return. By striking all the arbitrators on the non-public list, any party may ensure that the panel will have three public arbitrators. The method for completing the panel is outlined in the description of new Rule 12403 below.

The amendments apply *only* to customer disputes; they do not apply to disputes involving only industry parties. FINRA believes giving customers the option of an all public panel will enhance confidence in and increase the perception of fairness in the FINRA arbitration process. Customers will have expanded power in choosing arbitration panels, and all customers will have the ability to exclude non-public arbitrators from their panels.

Details of the Customer Code Amendments

Prior to the amendments, FINRA Rule 12402 (Composition of Arbitration Panels) specified the panel composition for all customer cases.² And FINRA Rules 12403 (Generating and Sending Lists to the Parties),³ 12404 (Striking and Ranking Arbitrators),⁴ 12405 (Combining Lists),⁵ 12406 (Appointment of Arbitrators; Discretion to Appoint Arbitrators Not on List)⁶ and 12411 (Replacement of Arbitrators)⁷ enumerated the procedures for selecting, appointing and replacing arbitrators.

FINRA consolidated these rules into two new rules: FINRA Rule 12402 relating to customer cases with one arbitrator, and FINRA Rule 12403 relating to customer cases with three arbitrators. FINRA deleted Rules 12402, 12403, 12404, 12405, 12406, and 12411 in their entirety, and renumbered the remaining rules in the 12400 series so that the numbering would remain consecutive after the consolidation of these rules.

New Rule 12402—Cases With One Arbitrator

New Rule 12402 consolidates the content of old Rules 12402, 12403, 12404, 12405, 12406 and 12411, relating to single arbitrator cases. The rule also describes the procedures for selecting, appointing and replacing the arbitrator in a single-arbitrator case; FINRA did not make any substantive changes to these procedures.

New Rule 12403—Cases With Three Arbitrators

New Rule 12403 describes the two options that customers have for selecting panels in three-arbitrator cases, as explained above. The first option, the majority-public panel, ensures that FINRA will appoint one non-public arbitrator to a three-arbitrator panel. The second option, the optional all public panel, if selected by the customer, guarantees that any party may select an all public panel. As stated above, the amendments only allow customers to make the election between the two panel selection methods. The rule also includes the procedures for appointing and replacing arbitrators in a three-arbitrator case.

Except as outlined below, FINRA incorporated into new Rule 12403 the content of old Rules 12403, 12404, 12405, 12406 and 12411 as they relate to three-arbitrator cases. Under the amendments, the customer may elect in writing to proceed under either panel-selection method in the customer's Statement of Claim if the customer is a claimant, or at any time up to 35 days from service of the Statement of Claim, whether the customer is claimant or respondent. To ensure that the customer understands the options available, FINRA will notify the customer in writing that he or she has 35 days from service of the Statement of Claim to elect the optional all public panel method of panel composition.⁸ If the customer declines to make an affirmative election by the 35-day deadline, FINRA will apply the composition rule for a majority-public panel.

Under either panel-selection method, the parties will receive three lists—one with 10 chair-qualified public arbitrators, one with 10 public arbitrators and one with 10 non-public arbitrators. FINRA will permit each party to strike up to four arbitrators on the chair-qualified public and public lists, leaving at least six arbitrator names remaining on each party's list. However, the process for striking arbitrators on the non-public list will be different for each method, as detailed below.

In cases in which FINRA initially appointed a single chair-qualified public arbitrator (claim up to \$100,000), and the claim is subsequently amended to an amount over \$100,000, FINRA will notify the customer in writing that the panel size has changed to three arbitrators. The customer will then have 35 days to elect the majority-public panel method or the optional all public panel method to fill out the panel.

Striking Arbitrators on the Non-Public List

Majority-Public Panel—Under this method of panel composition:

- ▶ each separately represented party may strike up to four arbitrators on the non-public list;
- ▶ FINRA will appoint the highest-ranked available non-public arbitrator from the combined rankings; and
- ▶ in cases in which the parties strike all of the arbitrators appearing on the non-public list or when all remaining arbitrators on the non-public list are unable or unwilling to serve for any reason, FINRA will appoint a non-public arbitrator selected randomly by NLSS.

Optional All Public Panel—Under this method of panel composition:

- ▶ all parties have unlimited strikes with respect to the non-public list (meaning that any party may strike up to all names on the non-public list); and
- ▶ FINRA will not appoint a non-public arbitrator if the parties (individually or collectively) strike all the arbitrators appearing on the non-public list or if all remaining arbitrators on the non-public list are unable or unwilling to serve for any reason. In addition:
 - FINRA will return to the parties' lists and appoint the next highest-ranked public arbitrator to complete the panel;
 - if all public arbitrators are stricken or unavailable to serve, FINRA will appoint the next highest-ranked arbitrator on the public chair-qualified list; and
 - if all public chair-qualified arbitrators are stricken or unavailable to serve, FINRA will appoint a public arbitrator selected randomly by NLSS.

If a party fails to return a ranking list within the required timeframe, the Director of Arbitration will proceed as though the party did not want to strike any arbitrator or have any preferences among the listed arbitrators. This could result in the appointment of a non-public arbitrator if the other party or parties do not collectively strike all 10 names. Therefore, when sending the lists to the parties, FINRA will include a reminder alerting parties that a failure to comply with the required timeframe for returning lists to FINRA may result in the appointment of a panel consisting of two public arbitrators and one non-public arbitrator.

Public Arbitrator Pilot Program

In October 2008, FINRA launched a voluntary Public Arbitrator Pilot Program (Pilot), which allowed investors in cases with a three-person panel naming only a participating firm to have a panel consisting of three public arbitrators, instead of two public arbitrators and one non-public arbitrator.

Effective immediately, FINRA will not accept any new cases under the Pilot. In existing Pilot cases in which FINRA has *not* sent lists of arbitrators to the parties, FINRA will notify the parties that the case will proceed under the optional all public panel method of panel composition. If FINRA has sent lists of arbitrators to the parties, FINRA will administer the case under the Pilot procedures.

Effective Date

The amendments are effective immediately and apply to all customer cases in which FINRA has not sent lists of arbitrators to the parties.⁹

Endnotes

- 1 See Securities Exchange Act Rel. No. 63799 (January 31, 2011), (File No. SR-FINRA-2010-053).
- 2 Rule 12402 provided that a single arbitrator panel consisted of a chair-qualified public arbitrator, and that a three-arbitrator panel consisted of a chair-qualified public arbitrator, a public arbitrator and a non-public arbitrator.
- 3 Rule 12403 provided that if a panel consisted of one arbitrator, NLSS generated a list of 10 chair-qualified public arbitrators. If a panel consisted of three arbitrators, NLSS generated a list of 10 chair-qualified public arbitrators, 10 public arbitrators and 10 non-public arbitrators. The rule detailed how NLSS generated lists, and how FINRA sent lists to the parties and handled requests for additional information about arbitrators. NLSS excludes arbitrators from lists based on current known conflicts of interest identified in NLSS.
- 4 Rule 12404 stated that parties may strike up to four arbitrators from each list, leaving at least six arbitrator names remaining. It also explained the process for ranking arbitrator preferences and returning the lists to FINRA.
- 5 Rule 12405 explained how FINRA prepared combined ranked lists of arbitrators based on the parties' numerical rankings.
- 6 Rule 12406 explained that FINRA appoints the highest-ranked available arbitrator from each of the combined lists and described FINRA's procedures for appointing an arbitrator when the number of arbitrators available to serve from a combined list was not sufficient to fill the panel. The rule also provided that appointment occurred when FINRA sent notice to the parties of the names of the arbitrators on the panel and that arbitrators must execute FINRA's arbitrator oath or affirmation before making any decision as an arbitrator or attending a hearing.
- 7 Rule 12411 provided that if FINRA removed an arbitrator, or an arbitrator became otherwise unable or unwilling to serve, FINRA appointed as a replacement arbitrator the arbitrator who was the most highly ranked available arbitrator from the applicable combined list. It also stated the procedure for replacing an arbitrator if there weren't any arbitrators left on a combined list.
- 8 If the customer is a respondent, under Rule 12403(b), when FINRA serves the Statement of Claim on the customer, FINRA will notify the customer in writing that the customer may elect the composition rules for the optional all public panel within 35 days from service of the Statement of Claim.
- 9 FINRA stopped sending lists of arbitrators to parties in customer cases the day that the SEC approved the proposed rule change. FINRA will advise customers in cases that have not been sent lists that they have 35 days to elect the majority-public panel method or the optional all public panel method of panel composition.