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Mr. Brent J. Fields  
Secretary  
U.S. Securities and Exchange Commission  
100 F Street, N.E.  
Washington, DC 20549-1090

**Re: File No. SR-FINRA-2015-034 – Response to Comments**

Dear Mr. Fields:

This letter responds to comments received by the Securities and Exchange Commission (“SEC” or “Commission”) to the above-referenced rule filing, FINRA’s proposal to merge its dispute resolution subsidiary, FINRA Dispute Resolution, Inc., into and with its regulatory subsidiary, FINRA Regulation Inc. To implement the merger, the proposed rule change would make conforming amendments to the Plan of Allocation and Delegation of Functions by NASD to Subsidiaries; amend the FINRA Regulation By-Laws to make relevant conforming amendments and to incorporate substantive provisions from the Dispute Resolution By-Laws that apply to the dispute resolution forum only; delete the FINRA Dispute Resolution By-Laws in their entirety; and make conforming amendments to FINRA rules. The proposed rule change also would amend the FINRA Regulation By-Laws to increase the total number of directors who could serve on the FINRA Regulation board.

The Commission published the proposed rule change for public comment in the Federal Register on October 13, 2015.<sup>1</sup> The Commission received five comment letters in response to the proposed rule change.<sup>2</sup> Four commenters opposed the

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<sup>1</sup> See Securities Exchange Act Release No. 76082 (October 6, 2015), 80 FR 61545 (October 13, 2015).

<sup>2</sup> See Letter from Hugh D. Berkson, President, Public Investors Arbitration Bar Association, Nov. 3, 2015 (“PIABA”); Letter from Ron A. Rhoades, JD, CFP®, Asst. Professor of Finance, W. Ky. Univ., Nov. 3, 2015 (“Rhoades”); Letter from Jill Gross, Professor of Law, Pace Law School, Nov. 3, 2015 (“Gross”); Letter from Larry A. Tawwater, President, American Association for Justice, Nov. 3, 2015 (“AAJ”); and Letter from William A. Jacobson, Clinical Professor of Law, Cornell Law School, and Director, Cornell Sec. Law Clinic, Nov. 4, 2015 (“Jacobson”).

proposal,<sup>3</sup> and one commenter, AAJ, neither opposed nor supported the proposal. The following are FINRA's responses, by topic, to the commenters' material concerns.<sup>4</sup>

PIABA, Gross and Jacobson generally questioned the rationale for the proposed rule change, raising concerns regarding whether the proposed rule change is consistent with FINRA's stated purpose in establishing FINRA Dispute Resolution as a separate entity, *i.e.*, to strengthen the independence and credibility of the dispute resolution program. The commenters also generally questioned FINRA's statement that the proposed merger would align the corporate structure with the public's perception of FINRA as a single organization, with PIABA suggesting that FINRA better educate investors as to the distinct nature of the various corporate entities. The commenters also raised concerns regarding the impact of the proposed merger on FINRA's ability to provide a fair and neutral forum. AAJ generally questioned whether the proposed rule change represents a policy shift with respect to the operation of FINRA's dispute resolution forum.

FINRA disagrees that the proposed rule change would in any way impact the continued operation of its dispute resolution forum as a fair, efficient and economical alternative to costly and complex litigation to resolve monetary and business disputes between and among investors, brokerage firms and individual brokers. As discussed in the proposed rule change, and in more detail below, the existing separate corporate structure has not contributed to the benefits or perception of fairness of the forum. Accordingly – and importantly – the proposed rule change would not affect the numerous services and benefits provided by the forum or the cost to any party to use it. Furthermore, the proposed rule change would have no practical impact on the current corporate governance or oversight that ensures the forum's fairness and effectiveness.

The purpose of the proposed rule change is to reduce the considerable administrative duplication associated with maintaining FINRA Regulation and FINRA Dispute Resolution as distinct corporate entities, thus achieving organizational operational efficiencies consistent with investor protection. The merger would allow FINRA to lower its operating expenses and more efficiently use staff resources. For example, by merging the two corporate entities, FINRA would eliminate the need to file numerous tax filings each year, including multiple state tax and information returns, sales tax returns, property tax returns, as well as many state registrations and annual reports. Merging the two entities also would eliminate a separate payroll entity, removing the need for separate compensation and accounting protocols.

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<sup>3</sup> PIABA, Rhoades, Gross, Jacobson.

<sup>4</sup> Rhoades suggested that, in lieu of approving the proposed rule change, the Commission should remove arbitration from FINRA and use an alternative dispute resolution forum unaffiliated with FINRA. FINRA considers the comment to be outside the scope of the proposed rule change.

Impact of Corporate Structure on Public Perception and Maintaining a Fair and Neutral Dispute Resolution Forum

*FINRA Corporate Structure and Operations*

In 1999, FINRA moved NASD's Office of Dispute Resolution into a separate subsidiary, NASD Dispute Resolution (now FINRA Dispute Resolution). At the time, FINRA believed the separation would further strengthen the independence and credibility of the arbitration and mediation functions. FINRA however does not need to maintain separate corporate entities in order to provide a fair, neutral and efficient dispute resolution forum. FINRA, FINRA Regulation and FINRA Dispute Resolution largely function as a single organization today and the significant commonalities and shared resources between the corporate entities serve to benefit the dispute resolution forum and its users. To avoid duplication and manage related costs, the entities currently share many administrative and support functions, including, for example, Corporate Communications and Government Relations, Corporate Real Estate and Corporate Security, Finance and Purchasing, Human Resources, Internal Audit, Legal, Meetings and Travel, Office of the Corporate Secretary, Office of the Ombudsman and Technology. FINRA Dispute Resolution remains financially dependent on the FINRA enterprise, as fees received from parties who use the arbitration and mediation programs are not sufficient to fund the forum's arbitration and mediation activities at current cost levels. Following the merger, FINRA would continue to supplement the fees collected from users, as necessary, to maintain a cost effective forum – an approach consistent with PIABA's past assertions that FINRA or its member firms should bear various expenses related to the dispute resolution program to keep the forum affordable for investors.<sup>5</sup>

FINRA also operates as one entity insofar as FINRA rules and administrative processes are integrated in furthering the mission of protecting investors, under the leadership of FINRA's Chairman and CEO (who also serves as President of both FINRA Regulation and FINRA Dispute Resolution), FINRA executive management and FINRA's Board. For example, Dispute Resolution staff works closely with the Department of Enforcement and FINRA's operating departments to identify misconduct by individuals or firms involved in arbitration cases that might merit further investigation or action to ensure the protection of the investing public. FINRA's procedural rules also specifically provide that if a FINRA arbitration panel issues an award in favor of the claimant, and the member firm or associated person fails to comply with the award or related settlement, FINRA has the authority to

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<sup>5</sup> See, e.g., Letter from Joseph C. Peiffer, President, PIABA, dated March 9, 2015, relating to late cancellation fees (Securities Exchange Act Release No. 75036 (May 22, 2015), 80 FR 30740 (May 29, 2015); SR-FINRA-2015-003); Letter from Jason Doss, President, PIABA, dated July 22, 2014, relating to arbitrator honoraria (Securities Exchange Act Release No. 73245 (Sept. 29, 2014), 79 FR 59876 (Oct. 3, 2014); SR-FINRA-2014-026).

suspend or cancel the membership of the firm or suspend the associated person for such non-compliance.<sup>6</sup>

At the same time, the proposed rule change would retain and incorporate into FINRA Regulation's operations, as the merged entity, the unique elements of the dispute resolution program that strengthen its operations and enhance the fairness and neutrality of the forum.<sup>7</sup> For example, FINRA would maintain the National Arbitration and Mediation Committee ("NAMC"), an advisory committee on arbitration matters that includes representatives from the public, the securities industry and arbitrators and mediators serving the forum.<sup>8</sup> Under the Codes of Arbitration Procedure ("Codes"),<sup>9</sup> the NAMC can recommend rules, regulations, procedures and amendments relating to arbitration, mediation and other dispute resolution matters to the FINRA Board.<sup>10</sup> The NAMC also has the major responsibility to establish and maintain rosters of neutrals composed of persons from within and outside of the securities industry.<sup>11</sup> As such, the NAMC is a key component to maintaining a fair and efficient forum. Under the proposed rule change, the NAMC would continue in both its current form (including the requirement that non-industry members compose at least 50 percent of the NAMC) and function (providing input that would shape the forum's rules, policies and procedures).

With respect to governance of the dispute resolution program, members of the FINRA Board's Regulatory Policy Committee, who currently serve as the directors of the boards of both FINRA Regulation and FINRA Dispute Resolution,<sup>12</sup> would continue to serve as directors of the board of the merged entity, thereby ensuring fair representation of FINRA's constituents in the administration of the dispute resolution

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<sup>6</sup> See By-Laws of the Corporation, Article VI, Section 3, and FINRA Rule 9554.

<sup>7</sup> See Securities Exchange Act Release No. 76082, 80 FR 61545, 61546 (October 13, 2015) (Notice of Filing File No. SR-FINRA-2015-034).

<sup>8</sup> See Securities Exchange Act Release No. 76082, 80 FR 61545, 61548 (October 13, 2015) (Notice of Filing File No. SR-FINRA-2015-034).

<sup>9</sup> See Rule 12000 and 13000 Series.

<sup>10</sup> See Rules 12102 and 13102.

<sup>11</sup> See Rules 12102 and 13102.

<sup>12</sup> See Securities Exchange Act Release No. 76082, 80 FR 61545, 61549 (October 13, 2015) (Notice of Filing File No. SR-FINRA-2015-034).

program.<sup>13</sup> Accordingly, the proposed rule change would not have a practical impact on corporate governance involving FINRA Dispute Resolution. In addition, the governance structure would continue to consist of a majority of public board members,<sup>14</sup> which helps to ensure that FINRA receives input on the forum's proposed rules, policies and procedures from those whose backgrounds and affiliations are not connected to the industry. In response to PIABA's suggestion that FINRA's boards have somehow been improperly "cross-pollinated,"<sup>15</sup> FINRA notes that overlapping board membership was contemplated at the time it sought to create the dispute resolution subsidiary as a way to provide stability and uniformity among the corporate entities.<sup>16</sup>

As an operational matter, FINRA's dispute resolution program would continue to function as a separate department within FINRA Regulation. As such, the Director of the Office of Dispute Resolution would oversee the dispute resolution programs<sup>17</sup> and would have the responsibility for managing its day-to-day operations, including, for example, deciding issues involving case administration and arbitrator training.<sup>18</sup>

In addition, under the proposed merger, the dispute resolution forum would continue to be subject to its current regulatory oversight. This robust regulatory framework serves to ensure that FINRA manages and administers the forum in a manner that is fair and protects investors and the public interest. For example, the arbitration program and services would continue to be governed by the Codes of Arbitration Procedure,<sup>19</sup> and the mediation program and services by the Code of

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<sup>13</sup> The proposed rule change would amend the FINRA Regulation corporate governance structure to add two board seats, which would provide FINRA with additional flexibility to manage its board committee assignments and meet the compositional requirements under the FINRA Regulation By-Laws. See Securities Exchange Act Release No. 76082, 80 FR 61545, 61549 (October 13, 2015) (Notice of Filing File No. SR-FINRA-2015-034).

<sup>14</sup> See Securities Exchange Act Release No. 76082, 80 FR 61545, 61549 (October 13, 2015) (Notice of Filing File No. SR-FINRA-2015-034).

<sup>15</sup> PIABA at 5.

<sup>16</sup> See Securities Exchange Act Release No. 41510, 64 FR 32575, 32586 (June 17, 1999) (Notice of Filing File No. SR-NASD-99-21).

<sup>17</sup> See Securities Exchange Act Release No. 76082, 80 FR 61545, 61550 (October 13, 2015) (Notice of Filing File No. SR-FINRA-2015-034).

<sup>18</sup> Unless the Codes provide that the Director may not delegate a specific function, the term Director of the Office of Dispute Resolution would include FINRA staff to whom the Director has delegated authority. See Proposed Amended Rules 12100(k) and 13100(k).

<sup>19</sup> See Rule 12000 and 13000 Series.

Mediation Procedure,<sup>20</sup> and any proposed rule changes would be filed with the Commission. Further, the forum would continue to be subject to oversight inspections by the SEC.

### *Public Perception*

For many of the reasons noted above, from the public perspective, FINRA, FINRA Regulation and FINRA Dispute Resolution today have the appearance of a single organization. This public perception is furthered by FINRA's consolidated annual report and its public communications. Taken together with the fact that the merger would not affect the services and benefits provided by – or the costs to use – the dispute resolution forum, or its corporate governance or oversight, FINRA does not believe that the merger would impact public perception of fairness of the forum. Since maintaining a separate corporate entity does not contribute to the fairness or efficiency of operating the forum, FINRA does not believe it would be relevant or helpful, as PIABA suggests, for FINRA to engage in educational efforts regarding the existing corporate distinction between FINRA, FINRA Regulation and FINRA Dispute Resolution.

On the other hand, FINRA continuously engages in efforts to educate the investing public about the services and benefits of its dispute resolution forum, including the fairness and neutrality of the forum. For example, there is a section on FINRA's website dedicated to arbitration and mediation, which contains valuable information describing how the arbitration and mediation processes work, how an investor can initiate a claim using either process, and the rules and regulations that govern these processes.<sup>21</sup> Further, FINRA provides information on its website on law schools' securities arbitration clinics that represent parties with smaller claims in arbitration or mediation proceedings.<sup>22</sup> In addition, FINRA provides reference guides<sup>23</sup> and instructional videos for parties on the dispute resolution process.<sup>24</sup> These resources are readily and continuously available to the public at no charge and would remain so following the proposed merger.

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<sup>20</sup> See Rule 14000 Series.

<sup>21</sup> See FINRA, Arbitration and Mediation, available at <http://www.finra.org/arbitration-and-mediation>.

<sup>22</sup> See generally, FINRA, Arbitration and Mediation, *Options for Investors, How to Find an Attorney*, available at <http://www.finra.org/arbitration-and-mediation/how-find-attorney>.

<sup>23</sup> See FINRA Investor Education and Pace Law School Investor Rights Clinic, *Investor's Guide to Securities Industry Disputes*, available at <http://www.finra.org/sites/default/files/Investors%20Guide%20to%20Securities%20Industry%20Disputes.pdf>.

<sup>24</sup> See, e.g., FINRA, Arbitration and Mediation, *What to Expect - Videos and Guides*, available at <http://www.finra.org/arbitration-and-mediation/what-expect>.

FINRA also has made many enhancements to the dispute resolution program since the establishment of FINRA Dispute Resolution that are wholly unrelated to its corporate structure. Among other key changes, investors now have the ability to have an all-public arbitration panel, which increases public confidence in the fairness of FINRA's dispute resolution process. Last year, FINRA formed the Dispute Resolution Task Force to consider possible enhancements to the forum to improve the effectiveness, transparency, impartiality and efficiency of FINRA's securities arbitration forum for all participants.<sup>25</sup> The Task Force is composed of a diverse group of leading investor advocates, academics, regulators, and industry representatives to help ensure that FINRA's arbitration and mediation processes continue to serve the needs of the investing public. In short, FINRA is continuously looking at ways to strengthen the dispute resolution process and would continue to work closely with investors, members, and other interested parties in such efforts, irrespective of FINRA's corporate structure.

#### Impact of Department of Enforcement's Determinations on Arbitration Matters

PIABA raised the concern of "unintended repercussions" of the merger, specifically questioning whether a decision by FINRA Enforcement to decline to take action against a member for conduct that is subject of a pending arbitration could be used as defensive evidence in an arbitration proceeding. This issue exists irrespective of the proposed merger, and FINRA has previously stated that its determination not to take enforcement action against a member has no evidentiary weight in a subsequent proceeding, such as mediation, arbitration or a judicial action.<sup>26</sup> FINRA's decision to close an investigation without further action can result from many factors unrelated to the merits of a complaint, such as jurisdictional limitations or the existence of an ongoing or completed enforcement action by another law enforcement or regulatory agency.<sup>27</sup> Furthermore, FINRA considers it unethical and potentially misleading to suggest to an adjudicator or mediator that FINRA's determination is probative evidence in a dispute on the merits of a related claim.<sup>28</sup>

#### Cost-Benefit Analysis

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<sup>25</sup> See generally, FINRA, Arbitration and Mediation, *FINRA Dispute Resolution Task Force*, available at <http://www.finra.org/arbitration-and-mediation/finra-dispute-resolution-task-force>.

<sup>26</sup> See Notice to Members 02-53 at 509 (August 2002) (NASD Files Proposal to Amend Rule 3070 to Require Filing of Criminal and Civil Complaints and Arbitration Claims with NASD; Revises Letters Sent When Determination Made to Close an Investigation Without Further Action).

<sup>27</sup> See id.

<sup>28</sup> See id.

PIABA suggested that FINRA provide a cost-benefit analysis or otherwise quantify the savings from the reduced administrative burdens that would result under the proposed rule change and state how such savings would be allocated to investors, the dispute resolution forum or otherwise. As discussed above and in the rule filing, the purpose of the proposed rule change is to reduce unnecessary administrative burdens required to maintain FINRA Dispute Resolution as a separate legal entity without any degradation to the fairness and neutrality of the Dispute Resolution program. FINRA currently achieves operational efficiencies by leveraging the administrative resources noted above. The proposed rule change, however, would allow for more efficient use of FINRA's administrative resources resulting from the elimination of numerous tax and other regulatory filings each year. These cost savings, while prudent from an operational standpoint, are not expected to materially impact FINRA's budget or the costs of forum-related services. Nevertheless, the proposed rule change would allow FINRA to streamline its operational procedures and re-allocate staff involved in such processes to other matters, thereby enhancing the efficient operation of the corporation, which in turn benefits all who are served by FINRA's mission.

#### Duration of Comment Period

Finally, PIABA and AAJ contended that the comment period provided by the Commission is too short to allow interested parties to fully evaluate the proposed rule change and offer their views. In this regard, Section 19 of the Securities Exchange Act of 1934 sets forth the procedures for SEC approval of proposed rule changes by securities self-regulatory organizations ("SROs"), including FINRA. FINRA followed its standard rulemaking processes with respect to the proposed rule change, and understands that the SEC adhered to its standard procedures with respect to the proposal, allowing 21 days for comment from the date of publication of the proposed rule change in the Federal Register.<sup>29</sup> FINRA believes that the SEC provided interested parties with sufficient time to consider the proposed merger and does not believe that any extension to these standard times is warranted.

FINRA believes that the foregoing responds to the issues raised by the commenters. If you have any questions, please contact me at 202-728-8018.

Sincerely,

/s/ Meredith Cordisco

Meredith Cordisco  
Assistant General Counsel

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<sup>29</sup> See e.g., FINRA Rulemaking Process, SEC Notice of the Proposal in the Federal Register, available at <http://www.finra.org/industry/finra-rulemaking-process>.