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FINRA Seeks SEC Approval For Proposed Amendments To Customer And Industry Code Definitions Of Non-Public Arbitrator And Public Arbitrator

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Introduction

FINRA Dispute Resolution has filed with the Securities and Exchange Commission ("SEC") proposed amendments to the definitions of non-public arbitrator and public arbitrator contained in subsections (p) and (u) of Rule 12100 of the FINRA Code of Arbitration Procedure for Customer Disputes (the "Customer Code") as well as the parallel definitions contained in subsections (p) and (u) of Rule 13100 of the FINRA Code of Arbitration Procedure for Industry Disputes (the "Industry Code"). If approved, the proposed amendments would result in numerous changes to how non-public and public arbitrators are classified. Among the key proposed changes are the following: (i) a person who was associated with a securities broker-dealer at any point during their career would always be classified as a non-public arbitrator, without exception; (ii) a person who is or was associated with a mutual fund or hedge fund would be eligible to serve as a non-public arbitrator, but could never be classified as a public arbitrator, as is the case currently once such person ends her affiliation; (iii) a person who was employed by a bank or other financial institution who effects securities transactions or supervises or monitors the compliance of such employees would have to wait five years after ending such activities before they can be classified as a public arbitrator (the "cooling off period") instead of becoming immediately eligible to serve as a public arbitrator upon terminating her affiliation, except that any such person who was employed in such capacity for a total of 15 years or more would be permanently disqualified from serving as a public arbitrator instead of the current 20 year period; (iv) an attorney, accountant or other professional who has devoted 20% or more of their professional time in a single calendar year to representing or providing services to securities broker-dealer clients would be subject to a five year cooling off period before they can be classified as a public arbitrator instead of the current two year period; (v) an attorney, accountant, expert witness or other professional who has devoted 20% or more of her professional time in a single calendar year to representing or providing services to investors in securities cases or associated persons in employment cases would likewise be subject to a five year cooling off period before they can be classified as a public arbitrator; (vi) an attorney, accountant or other professional who has devoted 20% of their time annually to representing or providing services to securities broker-dealers would be permanently disqualified from serving as a public arbitrator where such person provided such services for a period of 15 years instead of the current 20 year period; and (vii) an attorney, accountant, expert witness or other professional who has devoted 20% of their time annually to representing or providing services to investors in securities cases or associated persons in employment cases would similarly be permanently disqualified from serving as a public arbitrator where such person provided such services for a period of 15 years.

In SR-FINRA-2014-028, FINRA Dispute Resolution states that it is seeking to once again amend the public and non-public arbitrator definitions in order to "address the concerns about arbitrator neutrality that were raised by the commenters on the 2013 amendments."

FINRA Dispute Resolution's rule filing (File No. SR-FINRA-2014-028), including the proposed amendments, can be found on FINRA's website at http://www.finra.org/web/groups/industry/@ip/@reg/@rulfil/documents/rulefilings/p532202.pdf.

Background to the Proposed Amendments

On June 18, 2014, FINRA Dispute Resolution filed with the SEC proposed amendments to the definitions of non-public arbitrator and public arbitrator that are contained in Rule 12100(p) and (u) of the Customer Code and Rule 13100(p) and (u) of the Industry Code respectively. The SEC issued Release No. 34-72491 on June 27, 2014 in connection with FINRA Dispute Resolution's rule filing. *See* http://www.sec.gov/rules/sro/finra/2014/34-72491.pdf.

The SEC has approved proposed amendments to the definitions of non-public arbitrator and public arbitrator submitted by FINRA Dispute Resolution on a number of prior occasions, most recently in 2013. Following the SEC's approval of the 2013 amendments, FINRA Dispute Resolution staff conducted discussions with the National Arbitration and Mediation Committee as well as other interested groups in connection with the 2013 amendments. SEC Release No. 34-72491 at 3-4 (June 27, 2014). In SR-FINRA-2014-028, FINRA Dispute Resolution states that it is seeking to once again amend the public and non-public arbitrator definitions in order to "address the concerns about arbitrator neutrality that were raised by the commenters on the 2013 amendments." SEC Release No. 34-72491 at 4. Those concerns "related to the cooling off periods, the categories of individuals whom FINRA disqualifies from serving as public arbitrators, and the categories of individuals whom FINRA classifies as non-public arbitrators." *Id*.

The Proposed Amendments

While SR-FINRA-2014-028 contains numerous proposed amendments to the non-public arbitrator and public arbitrator definitions contained in Rules 12100(p) and (u), this Alert will just highlight some of the key proposed changes. As the proposed amendments to the parallel definitions of non-public and public arbitrators contained in Rules 13100(p) and (u) are identical to the proposed amendments to Rules 12100(p) and (u), the former will not be separately discussed.

Among the more significant proposed amendments to Rule 12100(p) and (u) are the following:

- Rule 12100(p)(1)(A) and (2) and 12100(u)(1) and (2) currently permit a person who was associated with a securities broker-dealer to be classified as a public arbitrator where more than five years has elapsed since such person ended her affiliation with the securities industry, except that a person who is retired from or spent a substantial part of her career with a broker-dealer or who was associated with a broker-dealer for a total of 20 years or more is always classified as a non-public arbitrator. Under proposed amended Rule 12100(p)(1)(A) and 12100(u)(1)(A), a person who is, or was, affiliated with a securities broker-dealer at any point in her career would be permanently disqualified from serving as a public arbitrator. SEC

Release No. 34-72491 at 6. Thus, "[o]nce FINRA classifies an arbitrator as non-public, FINRA would never reclassify the arbitrator as public" and "under the proposed rule change, there would be no exceptions to this provision." *Id*. at 6-7.

- Rule 12100(p) at present does not permit a person who is associated with a mutual fund or hedge fund to serve as a non-public arbitrator, although such person may serve as a public arbitrator following a two year cooling off period. SEC Release No. 34-72491 at 7. New proposed Rule 12100(p)(1)(D) would allow such person to serve as a non-public arbitrator. *Id*. Just like a person associated with a broker-dealer, however, a person associated with a mutual fund or hedge fund would be permanently disqualified from serving as a public arbitrator. *Id*.

- Currently, a person who is employed by a bank or other financial institution who affects transactions in securities or supervises or monitors the compliance of such employees may be classified as a public arbitrators immediately upon the termination of her affiliation under Rule 12100(p)(4), except that such person is permanently disqualified from serving as a public arbitrator where such person was employed in such capacity for 20 years or more pursuant to Rule 12100(u)(2). Thus, such a person is not currently subject to any cooling off period (assuming she was employed for less than 20 years). SEC Release No. 34-72491 at 10-11. Under proposed amended Rule 12100(p)(4) and 12100(u)(4), such person would be subject to a five year cooling off period before she could be classified as a public arbitrator, and the total amount of time employed in such capacity before such person would be permanently disqualified from serving as a public arbitrator would be reduced to a total of 15 years. *Id*.

- Under current Rule 12100(p)(3) and 12100(u)(2), an attorney, accountant or other professional who has devoted 20% or more of her professional time in the previous two years to representing or providing services to securities broker-dealer clients is eligible to become classified as a public arbitrator following a two year cooling off period, except that such person is always considered to be a non-public arbitrator if she provided such services to securities industry clients for 20 years or more. Under proposed amended Rule 12100(p)(2) and 12100(u)(2), the cooling off period for such a person would be increased to five years and the total amount of time before the permanent disqualification would apply would be reduced to 15 years. SEC Release No. 34-72491 at 9.

- At present, FINRA Dispute Resolution allows an attorney, accountant, expert witness or other professional who represents or provides services to investors in securities cases to serve as a public arbitrator. SEC Release No. 34-72491 at 9. In response to concerns raised by securities industry representatives regarding the neutrality of such an individual, new proposed Rule 12100(p)(3) would require that an attorney, accountant, expert witness or other professional who has within the past five years devoted 20% or more of her professional time in a single calendar year to representing or providing services to investors in securities disputes

Thus, "[o]nce FINRA classifies an arbitrator as non-public, FINRA would never reclassify the arbitrator as public" and "under the proposed rule change, there would be no exceptions to this provision.

or registered representatives in employment disputes be classified as a non-public arbitrator. SEC Release No. 34-72491 at 10. While such person would be eligible to become a public arbitrator after the five year cooling off period, such person would be permanently disqualified from serving as a public arbitrator under new proposed Rule 12100(u)(3) if she "accumulate[s] 15 calendar years of providing the qualifying services over the course of a career...." *Id.*

Conclusion

The proposed amendments to the definitions of non-public arbitrator and public arbitrator will now be subject to the comment period under Section 19(b)(1) of the Securities Exchange Act of 1934. The SEC will either by order approve or disapprove the proposed amendments or institute proceedings to determine whether the proposed rule changes should be disapproved within 45 days of the date of publication of the Release or up to 90 days if the SEC determines such longer period to be appropriate. ■

For more information about any of the topics covered in this issue of the Securities Law Alert, please contact:

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