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SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-68142; File No. SR-FINRA-2012-040)

November 2, 2012

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Order Approving Proposed Rule Change to Amend the By-Laws of FINRA Dispute Resolution, Inc. to Clarify that Services Provided by Mediators Should Not Cause Them to be Classified as Industry Members under the By-Laws

## I. Introduction

On August 23, 2012 the Financial Industry Regulatory Authority, Inc. ("FINRA") filed with the Securities and Exchange Commission ("SEC" or "Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Exchange Act" or "Act")[1] and Rule 19b-4 thereunder,[2] a proposed rule change to amend the By-Laws of FINRA Dispute Resolution, Inc. ("By-Laws") to clarify that services provided by mediators, when acting in such capacity and not representing parties in mediation, should not cause the individuals to be classified as Industry Members under the By-Laws. Specifically, the proposed rule change would amend the definitions of Industry Members[3] and Public Members[4] in the By-Laws to except any services provided in the capacity as a mediator of disputes involving a broker or dealer and not representing any party in such mediations from being considered professional services provided to brokers or dealers. The amended definitions would allow mediators who are otherwise qualified to be eligible to become Public Members of the National Arbitration and Mediation Committee ("NAMC"), a committee appointed by the Board of Directors of FINRA Dispute

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

2 17 CFR 240.19b-4.

3 See Dispute Resolution By-Laws, Article I(s) (Definitions – Industry Member).

4 See Dispute Resolution By-Laws, Article I(x) (Definitions – Public Member).

Resolution, Inc. ("DR Board"). The proposed rule change was published for comment in the Federal Register on September 11, 2012.[5] The Commission received one comment letter, from an anonymous commenter on the proposed rule change.[6] The text of the proposed rule change is available on FINRA's website at http://www.finra.org, at the principal office of FINRA, on the Commission's website at http://www.sec.gov, and at the Commission's Public Reference Room.

This order approves the proposed rule change.

## II. Description of the Proposal

The proposed rule change would amend the By-Laws to clarify that services provided by mediators when acting in such capacity and not representing parties in mediation should not cause the individuals to be classified as Industry Members under the By-Laws. Consequently, mediators who were otherwise qualified would be eligible to become Public Members of the NAMC would not be excluded because of the mediation activity excepted by the proposed rule. Currently, those mediators cannot become members of the NAMC because of the definitions of Industry Member and Public Member in the By-Laws.

In a FINRA mediation, all parties agree on the selection of a mediator, agree on the compensation of the mediator, and agree on how to allocate the mediator's compensation among the parties; the mediator receives part of the compensation in each case from an industry party. However, for mediations to which investors are parties, mediators represent neither the investors nor the FINRA-registered individuals or entities. Similarly, for mediations involving industry parties only, mediators represent neither the FINRA-registered individuals nor entities.

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[5] See Exchange Act Release No. 67784 (Sept. 5, 2012), 77 FR 55885 (Sept. 11, 2012). ("Notice"). The comment period closed on October 2, 2012.

[6] See Letter from anonymous commenter, dated October 2, 2012 ("Comment Letter").

Pursuant to the Plan of Allocation and Delegation of Functions by FINRA to Subsidiaries ("Delegation Plan"), the NAMC has the power and authority pursuant to FINRA's Rules to advise the FINRA DR Board on the development and maintenance of an equitable and efficient system of dispute resolution that will equally serve the needs of public investors and FINRA members, to monitor rules and procedures governing the conduct of dispute resolution, and to have such other powers and authority as is necessary to effectuate the purposes of FINRA's Rules.[7] The Delegation Plan provides that the FINRA DR Board must appoint the NAMC, whose membership must consist of a majority of Public Members.[8]

Currently, under the By-Laws, a mediator could be classified as an Industry Member rather than a Public Member for purposes of Committee participation because of the services provided by a mediator to an industry party. In FINRA's mediation forum, mediators are retained only by agreement of all parties to a dispute rather than by any one party and the parties compensate mediators jointly pursuant to that agreement. While mediators derive some of their revenue from brokers or dealers, FINRA has indicated that it does not believe the compensation earned in the capacity as a mediator compromises the mediator's neutrality.

The proposed rule change would amend the definitions of Industry Members and Public Members in the By-Laws to except any services provided in the capacity as a mediator of disputes involving a broker or dealer and not representing any party in such mediations from being considered professional services provided to brokers or dealers.

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[7] See Plan of Allocation and Delegation of Functions by FINRA to Subsidiaries – NASD Dispute Resolution, §III(C)(1)(b).

[8] Id. See also Rules 12102(a) and 12102(a)(1) of the Code of Arbitration Procedure for Customer Disputes and Rules 13102(a) and 13102(a)(1) of the Code of Arbitration Procedure for Industry Disputes.

As explained in the Notice, FINRA believes that the proposed rule change is consistent with the provisions of Section 15A of the Act, including Section 15A(b)(2) of the Act,[9] in that it provides for the organization of FINRA and FINRA Dispute Resolution in a manner that will permit FINRA to carry out the purposes of the Act, to comply with the Act, and to enforce compliance by FINRA members and persons associated with FINRA members with the Act, the rules and regulations thereunder, FINRA rules and other federal securities laws. FINRA also believes that the proposed rule change is consistent with Section 15A(b)(4) of the Act,[10] which requires, among other things, that FINRA's rules assure a fair representation of its members in the selection of its directors and administration of its affairs and provide that one or more directors shall be representative of issuers and investors and not be associated with a member of FINRA, broker or dealer. FINRA believes that the proposal would assure fair administration of its Dispute Resolution affairs by providing another source of qualified and experienced candidates from which to select public members for the NAMC.

III. Discussion of Comment Letters

The Commission received one comment letter on the proposed rule change in response to the Notice.[11] The Comment Letter states that "the purpose of mediating or having a mediator is to forego the formalness. An industry member would have an upper-hand and expert knowledge. [T]hen the situation could be deemed a legal case." The Commission believes that the commenter is suggesting that members with industry experience would introduce formality into

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[9] 15 U.S.C. 78o–3(b)(2).

[10] 15 U.S.C. 78o–3(b)(4).

[11] Supra note 6.

what is supposed to be an informal process.[12] Notwithstanding its interpretation or the merit of the statement underlying its interpretation, the Commission believes that the proposed rule change simply prevents mediation activity from automatically qualifying the mediator as an Industry Member. It does not shield the mediator from being classified as an Industry Member for other activities that would otherwise cause the mediator to be considered an Industry Member.[13]

## IV. Discussion and Commission's Findings

The Commission has carefully reviewed the proposed rule change and the comment received. Based on its review, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities association. In particular, the Commission finds that the proposed rule change is consistent with the provisions of Section 15A of the Act, including Section 15A(b)(2) of the Act, in that it facilitates the organization of FINRA and FINRA Dispute Resolution in a manner that will permit FINRA to carry out the purposes of the Act, to comply with the Act, and to enforce compliance by FINRA members and persons associated with FINRA members with the Act, the rules and regulations thereunder, FINRA rules and other federal securities laws. The Commission also finds that the proposed rule change is consistent with Section 15A(b)(4) of the Act, which requires, among other things, that FINRA's rules assure a fair representation of its members in the selection of its directors and administration of its affairs and provide that one or

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[12] Because the commenter submitted the Comment Letter anonymously, neither the Commission not FINRA is able to seek clarification of the subject matter of the letter.

[13] In a telephone call with Mignon McLemore of FINRA on October 12, 2012, she stated that FINRA believes the Comment Letter is unclear and could not be clarified due to the anonymity of its author. Accordingly, FINRA believes that it could not respond to the letter.

more directors shall be representative of issuers and investors and not be associated with a member of FINRA, broker or dealer.

More specifically, the Commission finds that by enlarging the pool from which to draw Public Members for the NAMC, the proposed rule change facilitates the organization of FINRA and FINRA Dispute Resolution in a manner consistent with Section 15A(b)(2) of the Act; the Commission also finds that enlarging the pool from which to draw Public Members for the NAMC facilitates compliance with and thus is consistent with the provision of Section 15A(b)(4) of the Act to provide that one or more of FINRA's directors shall be representative of issuers and investors and not be associated with a member of FINRA, broker-dealer.

The Commission appreciates the commenter's letter about members with industry experience acting as mediators. However, the Commission believes that the proposed rule change simply prevents mediation activity from automatically qualifying the mediator as an Industry Member. It does not shield the mediator from being classified as an Industry Member for other activities that would otherwise cause the mediator to be considered an Industry Member.

The Commission has reviewed the record for the proposed rule change and believes that the record does not contain any information to indicate that the proposed rule would have a significant effect on efficiency, competition, or capital formation. In light of the record, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation and has concluded that the proposed rule is unlikely to have any significant effect.[14]

For the reasons stated above, the Commission finds that the rule change is consistent with the Act and the rules and regulations thereunder.

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[14] See 15 U.S.C. 78c(f).

V. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,[15] that the proposed rule change (SR-FINRA-2012-040) be, and it hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[16]

Kevin M. O'Neill
Deputy Secretary

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

16 17 CFR 200.30-3(a)(12).