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SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-74289; File No. SR-FINRA-2015-003)

FEBRUARY 18, 2015

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of a Proposed Rule Change to Amend the Codes of Arbitration Procedure to Increase the Late Cancellation Fee

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on February 5, 2015, Financial Industry Regulatory Authority, Inc. (“FINRA”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been substantially prepared by FINRA. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

FINRA is proposing to amend Rules 12214 and 12601 of the Code of Arbitration Procedure for Customer Disputes (“Customer Code”) and Rules 13214 and 13601 of the Code of Arbitration Procedure for Industry Disputes (“Industry Code”) (together, “Codes”) to require that parties give more advance notice before cancelling or postponing a hearing, or be assessed a higher late cancellation fee if such notice is not provided. The text of the proposed rule change is available at the principal office of FINRA, on FINRA’s website at <http://www.finra.org>, and at the Commission’s Public Reference Room.

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

II. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, FINRA included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. FINRA has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

*Introduction*

Under current Rules 12601(b)(2) and 13601(b)(2) of the Codes, each arbitrator selected for a case receives a \$100 honorarium when a hearing is postponed or cancelled<sup>3</sup> within three business days of the scheduled date. However, if the postponement or cancellation occurs more than three business days in advance of the scheduled hearing, the arbitrators do not receive an honorarium.<sup>4</sup>

FINRA is proposing to amend Rules 12601(b)(2) and 13601(b)(2)<sup>5</sup> to require that if a postponement or cancellation request is made by one or more parties within ten calendar days

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<sup>3</sup> If the parties settle an arbitration case, hearings that were scheduled to occur after settlement are cancelled, and depending on the timing of the cancellation, could result in the assessment of a cancellation fee. See Rules 12902(d) and 13902(d). These rules incorporate the fees and costs incurred under Rules 12601 and 13601, and, therefore, would incorporate the proposed rule change to the late cancellation fee.

<sup>4</sup> For each postponement agreed to by the parties, or granted upon request of one or more parties, FINRA assesses a postponement fee to the parties, equal to the applicable hearing session fee (“Postponement Fee”). See Rules 12601(b)(1) and 13601(b)(1). This fee is paid to FINRA and not passed through to the arbitrators.

<sup>5</sup> FINRA would also amend the Late Cancellation Fee reference (defined infra) in Rules 12214(a) and 13214(a).

before a scheduled hearing session and granted, the party or parties making the request would pay a fee of \$600 per arbitrator (“Late Cancellation Fee”). Under the proposed rule change, therefore, the Late Cancellation Fee for a three-person arbitration panel would be \$1,800, instead of \$300 under the current rules.<sup>6</sup> The primary purpose of the proposed rule change is to encourage parties to provide more advance notice of postponements and cancellations, or, in the alternative, to compensate arbitrators more than they are currently paid for lost time and opportunities in the event of a late postponement or cancellation.

Under the proposed rule change, the Late Cancellation Fee would be assessed if a hearing is postponed or cancelled within ten calendar days before a scheduled hearing session. To simplify the discussion, the following explanation will use the term “cancellation” or a variation thereof to describe either scenario.

#### *Background*

In FINRA arbitration, once the parties select arbitrators, they hold an initial pre-hearing conference with the parties, usually over the telephone, to discuss procedural issues, the mediation alternative, discovery, and scheduling of hearings.<sup>7</sup> In many cases, the hearing dates are selected months in advance, thus requiring arbitrators to reserve these dates and forego other opportunities that would result in a conflict with the scheduled dates. FINRA has received many complaints from arbitrators concerning the current late cancellation rule (“Late Cancellation

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<sup>6</sup> Pursuant to an analysis of FINRA’s data, for the period from September 1, 2013 to August 31, 2014, approximately 80 percent of arbitration cases were heard by a three-person panel. The number of arbitrators that the parties may select for a case typically depends on the amount of the claim. See Rules 12401 and 13401 (describing, among other things, the parameters for when panels may consist of three arbitrators).

<sup>7</sup> A hearing is a meeting between the parties and the arbitrators of four hours or less to determine the merits of the arbitration. See Rules 12100(m) and 13100(m); see also Rules 12100(n) and 13100(n). A typical day in an arbitration case has two hearing sessions.

Rule”),<sup>8</sup> which applies when parties postpone, settle in advance of, or otherwise cancel a scheduled hearing session within three business days of its start date. It is the most frequent complaint Dispute Resolution staff receives from arbitrators.

In fact, when FINRA formed the Dispute Resolution Task Force (“Task Force”) in 2014 to consider possible enhancements to its arbitration and mediation forum, the majority of arbitrator responses to the Task Force’s request for comments suggested that FINRA should address the issue of late hearing cancellation requests.<sup>9</sup> According to feedback received by FINRA, the current rule is inadequate because the three-business-day cancellation window does not provide arbitrators, who have committed to dates to hear a case, with enough time to schedule other income-generating opportunities. Moreover, the \$100 honorarium for these late cancellations does not adequately compensate arbitrators for the preparation time expended and the income that would have been earned from conducting a hearing. FINRA has learned that the lack of sufficient notice and compensation is frustrating for arbitrators and is a reason some arbitrators leave FINRA’s roster.

*Proposal to Increase Late Cancellation Fees and Cancellation Timeframe*

FINRA is proposing, therefore, to amend the Codes<sup>10</sup> to require that parties give more advance notice before cancelling a hearing, or be assessed a higher Late Cancellation Fee if such

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<sup>8</sup> See Rules 12601(b)(2) and 13601(b)(2).

<sup>9</sup> The Task Force comprises individuals from the public and industry sectors, who work together to suggest strategies to enhance the transparency, impartiality, and efficiency of FINRA’s securities dispute resolution forum for all participants. See FINRA Dispute Resolution Task Force, available at <http://www.finra.org/ArbitrationAndMediation/FINRADisputeResolution/MoreonFINRADisputeResolution/P600966>.

<sup>10</sup> FINRA is proposing to amend Rules 12601 and 12214 of the Customer Code and Rules 13601 and 13214 of the Industry Code. To simplify the explanation, FINRA’s discussion of the proposed rule changes focuses on changes to the Customer Code rules. However, the proposed rule changes, and, thus, the discussion also apply to the Industry Code rules.

notice is not provided. Specifically, FINRA would amend Rule 12601(b)(2) to require that if a cancellation request is made by one or more parties within ten calendar days before a scheduled hearing session and granted, the party or parties making the request shall pay a fee of \$600 per arbitrator in addition to the Postponement Fee.

First, the proposed rule change would move from three business days to ten calendar days the timeframe within which parties must cancel hearings to avoid incurring the proposed Late Cancellation Fee.<sup>11</sup> This change would provide arbitrators with more advance notice than they currently receive, which could give them an opportunity to secure other income-generating opportunities. Further, it could help them minimize the time lost in preparing for their assigned arbitration hearings, which, depending on the number of parties involved and the complexity of the case, could involve many hours of reviewing materials. For example, parties sometimes submit detailed exhibits and legal briefs to support their positions and theories of the case for arbitrators to review in advance of the hearings. Other than the honoraria funded by the Late Cancellation Fee, FINRA does not compensate arbitrators for their preparation time in the event the hearings are cancelled.

Second, the proposed rule change would increase the honorarium for late cancellations from \$100 to \$600 per arbitrator. The proposal would make the honorarium equal to that which arbitrators would have received for one typical day of hearings,<sup>12</sup> no matter how many

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<sup>11</sup> The proposed rule change would make the calculation of deadlines consistent under the Codes. Under the Codes, “day” is defined as a calendar day, not a business day. See Rules 12100(j) and 13100(j).

<sup>12</sup> An arbitrator receives an honorarium payment for each hearing session in which the arbitrator participates. If two hearing sessions are conducted in one day, an arbitrator would receive \$300 for each session or a total of \$600 for the day. See supra note 7. On September 29, 2014, the SEC approved a proposal to increase the amount of honoraria paid to an arbitrator for participation in a hearing session to \$300 per session; the \$300 rate became effective on December 15, 2014 for all cases filed on or after the approval

consecutive days are cancelled.<sup>13</sup> The Late Cancellation Fee would be charged to the party or parties making the request.<sup>14</sup> However, Rule 12601(b)(2) provides that the arbitrators may allocate all or a portion of the fee to the non-requesting party if the arbitrators determine that the non-requesting party caused or contributed to the cancellation. If an extraordinary circumstance prevents a party or parties from making a timely cancellation request, arbitrators may use their discretion to waive the fee.

FINRA notes that there are some mitigation strategies that parties could employ to avoid incurring a Late Cancellation Fee. As the objective of the proposal is to encourage parties to address issues earlier in their cases, parties could provide notice of a cancellation ten or more calendar days prior to the first scheduled hearing session. Further, if the parties agree to cancel the hearing inside the ten-day window, then they could negotiate which party pays this fee or a percentage of the fee. In addition the rules permit the panel to waive the fees, and they may do so, if the circumstances warrant, like a sudden illness or accident.

Third, the proposed rule change would shift the phrase “and granted” to the end of the first dependent clause in Rule 12601(b)(2) to clarify that the timing of the parties’ cancellation request controls whether the fee is assessed, not the timing of the arbitrators’ decision on such request, if a decision is required. For example, the parties may jointly request cancellation of a hearing. A joint request means that the parties to the arbitration agree to cancel the hearing and,

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date. See Securities Exchange Act Release No. 73245 (Sept. 29, 2014), 79 FR 59876 (Oct. 3, 2014) (Order Approving File No. SR-FINRA-2014-026) (“Honoraria Increase Proposal”).

<sup>13</sup> See Notice to Members 04-53 (Arbitrator Hearing Adjournments), July 2004, available at <http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p006140.pdf>.

<sup>14</sup> If the parties cannot agree on the allocation, the arbitrators typically split the fee among the parties.

thus, the arbitrator or panel is not required to decide the request. Under the proposed rule change, if the parties make such a request ten calendar days or more before a scheduled hearing, they would not be assessed a Late Cancellation Fee.<sup>15</sup> Further, one party may make a cancellation request without the agreement of other parties to the arbitration; in such a case, the arbitrator or panel would be required to decide the party's motion. Under the proposed rule change, if the party makes such a motion ten calendar days or more before a scheduled hearing, the party would not be assessed a Late Cancellation Fee, regardless of when the arbitrators act on the request.

Fourth, FINRA notes that the Late Cancellation Fee is revenue-neutral to FINRA; it is currently passed through to the arbitrators. This practice would not change under the proposed rule change.

Last, FINRA is proposing to make conforming changes to Rule 12214(a), by amending the reference to the Late Cancellation Fee in Rule 12214(a).

The proposed rule change would address further a concern raised by many FINRA arbitrators – that the forum's honoraria are too low. FINRA began the process of increasing arbitrator honoraria by filing the Honoraria Increase Proposal with the SEC in June 2014, which proposed increasing the amount that arbitrators receive for one hearing session, among other things. On September 29, 2014, the SEC approved FINRA's proposal.<sup>16</sup> While approval of the honoraria increases was an important step, FINRA also believes that changes are needed to the Late Cancellation Rule to further compensate arbitrators for lost opportunity costs as well as time spent in preparing for arbitration hearings that do not take place. Given arbitrators' numerous responsibilities in preparing for, managing, and conducting arbitrations, FINRA believes the

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<sup>15</sup> See Rules 12601(a)(1) and 13601(a)(1).

<sup>16</sup> See supra note 12,

proposed changes to the Late Cancellation Rule as well as the other recently-implemented honoraria increases would better compensate the arbitrators for their time commitments and their service to the forum.

FINRA acknowledges that customers are likely to pay at least some of the increased Late Cancellation Fee under the proposed rule change. As a result, the proposed rule change might have an effect on settlement negotiations, especially if the potential settlement amount is small compared to the Late Cancellation Fee. For example, in cases where negotiations extend past the ten-calendar-day deadline, the increased cost of cancellation, under the proposed rule change, may affect the amount agreed upon in settlement or even the probability of settlement. FINRA notes that the forum's rules are designed to help parties resolve their disputes fairly and efficiently. Parties pursue settlement when they believe it is in their financial interest to do so. The proposed fee increase would be another factor that parties would weigh in determining when or whether to settle or to proceed to hearing.

FINRA believes, however, that the proposed changes would result in fewer late cancellations by the parties, as the higher Late Cancellation Fee would provide parties with an incentive to consider and begin settlement negotiations earlier in the process, if such an approach is in their interests. In addition, FINRA believes that the proposed rule change could help it minimize arbitrator turnover by addressing arbitrators' concerns that the current honoraria funded by the Late Cancellation Fee does not adequately compensate them for time spent and opportunities lost.

## 2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section

15A(b)(6) of the Act,<sup>17</sup> which requires, among other things, that FINRA rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. FINRA also believes that the proposed rule change is consistent with the provisions of Section 15A(b)(5) of the Act,<sup>18</sup> which requires, among other things, that FINRA rules provide for the equitable allocation of reasonable dues, fees, and other charges among members and issuers and other persons using any facility or system that FINRA operates or controls. FINRA believes that the proposed rule change appropriately allocates the proposed fee increase among those parties that cancel hearings on short notice. The Late Cancellation Fee would be paid by the parties, and passed through to the arbitrators to provide them with more compensation for preparation time expended and lost opportunities in the event of a cancellation on short notice. FINRA believes, therefore, that the proposed Late Cancellation Rule represents an equitable allocation of a reasonable fee to use the forum. While arbitrators would typically allocate the Late Cancellation Fee to the requesting party or parties, FINRA rules permit the arbitrators to allocate all, or a portion of the fee, to the non-requesting party, if the arbitrators determine that the non-requesting party caused or contributed to the late cancellation. Moreover, the Late Cancellation Fee can be avoided altogether if the parties provide ten or more calendar days advance notice of such a cancellation.

Finally, FINRA believes that the proposed rule change will protect investors and the public interest by improving FINRA's ability to retain qualified arbitrators willing to devote the time and effort necessary to consider thoroughly all arbitration issues presented, which, FINRA believes, is an essential element for FINRA to achieve its mission of investor protection and

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<sup>17</sup> 15 U.S.C. § 78o-3(b)(6).

<sup>18</sup> 15 U.S.C. § 78o-3(b)(5).

market integrity.

B. Self-Regulatory Organization's Statement on Burden on Competition

FINRA does not believe that the proposed rule change would result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

Written comments on the proposed rule change were neither solicited nor received.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) by order approve or disapprove such proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or  
Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-FINRA-2015-003 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Brent J. Fields, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-FINRA-2015-003. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filing also will be available for inspection and copying at the principal office of FINRA. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

All submissions should refer to File Number SR-FINRA-2015-003 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>19</sup>

Brent J. Fields  
Secretary

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<sup>19</sup> 17 CFR 200.30-3(a)(12).