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SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-74383; File No. SR-FINRA-2014-028)
Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Order Approving a Proposed Rule Change Relating to Revisions to the Definitions of Non-Public Arbitrator and Public Arbitrator

February 26, 2015

I. Introduction

On June 17, 2014, 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 ("Act")[1] and Rule 19b-4 thereunder,[2] a proposed rule change to amend FINRA Rule 12100(p) of the Code of Arbitration Procedure for Customer Disputes ("Customer Code") and FINRA Rule 13100(p) of the Code of Arbitration Procedure for Industry Disputes ("Industry Code") (collectively, "Codes"), defining the term "non-public arbitrator;" and FINRA Rule 12100(u) of the Customer Code and Rule 13100(u) of the Industry Code, defining the term "public arbitrator."

The proposed rule change was published for comment in the Federal Register on July 3, 2014.[3] On August 4, 2014, FINRA extended the time period in which the Commission must approve the proposed rule change, disapprove the proposed rule change, or institute proceedings to determine whether to approve or disapprove the proposed rule change to October 1, 2014. The Commission received three hundred sixteen (316) comment letters in response to the Notice

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

2 17 CFR 240.19b-4.

3 Exchange Act Release No. 72491 (Jun. 27, 2014), 79 FR 38080 (Jul. 3, 2014) (Notice of Filing of Proposed Rule Change Relating to Revisions to the Definitions of Non-Public Arbitrator and Public Arbitrator) ("Notice of Filing"). The comment period closed on July 24, 2014.

of Filing.[4] On September 30, 2014, the Commission received a letter from FINRA responding to the comment letters.[5] On October 1, 2014, the Commission issued an order to institute proceedings pursuant to section 19(b)(2)(B) of the Act[6] to determine whether to approve or disapprove the proposed rule change. The order was published for comment in the Federal

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4 Of the 316 letters, 21 were unique letters, and 295 of the letters followed a form designated as the "Type A" letter, submitted by self-identified independent financial advisors ("independent financial advisors") ("Type A Letter"). The unique letters were submitted by: Philip M. Aidikoff, Aidikoff, Uhl & Bakhtiari, dated July 1, 2014 ("Aidikoff Letter"); Steven B. Caruso, Esq., Maddox Hargett & Caruso, P.C., dated July 1, 2014 ("Caruso July Letter"); Ryan K. Bakhtiari, Aidikoff, Uhl & Bakhtiari, dated July 2, 2014 ("Bakhtiari July Letter"); Richard A. Stephens, Attorney at Law, dated July 6, 2014 ("Stephens Letter"); Daniel E. Bacine, Barrack, Rodos & Bacine, dated July 18, 2014 ("Bacine Letter"); Blossom Nicinski, dated July 20, 2014 ("Nicinski Letter"); Christopher L. Mass, dated July 21, 2014 ("Mass Letter"); Glenn S. Gitomer, McCausland Keen and Buckman, dated July 23, 2014 ("Gitomer July Letter"); David T. Bellaire, Esq., Executive Vice President & General Counsel, Financial Services Institute, dated July 24, 2014 ("FSI Letter"); Thomas J. Berthel, CEO, Berthel Fisher & Company, dated July 24, 2014 ("Berthel Letter"); Kevin M. Carroll, Managing Director and Associate General Counsel, Securities Industry and Financial Markets Association, dated July 24, 2014 ("SIFMA July Letter"); CJ Croll, Student Intern, Elissa Germaine, Supervising Attorney, and Jill I. Gross, Director, Investor Rights Clinic at Pace Law School, dated July 24, 2014 ("PIRC July Letter"); Jason Doss, President, Public Investors Arbitration Bar Association, dated July 24, 2014 ("PIABA Letter"); George H. Friedman, Esq., George H. Friedman Consulting, LLC, dated July 24, 2014 ("Friedman July Letter"); Gary N. Hardiman, dated July 24,2014 ("Hardiman Letter"); J. Burton LeBlanc, President, American Association for Justice, dated July 24, 2014 ("AAJ Letter"); Richard P. Ryder, Esq., President, Securities Arbitration Commentator, Inc., dated July 24, 2014 ("SAC July Letter"); Andrea Seidt, President, North American Securities Administrators Association, and Ohio Securities Commissioner, dated July 24, 2014 ("NASAA July Letter"); Robert Getman, dated July 28, 2014 ("Getman Letter"); Barry D. Estell, Attorney at Law (retired), dated August 13, 2014 ("Estell Letter"); and Walter N. Vernon III, Esq., dated August 21, 2014 ("Vernon Letter"). Comment letters are available at www.sec.gov.

The Commission discussed these comments in the Proceedings Order. See infra note 7.

5 Letter from Margo A. Hassan, Assistant Chief Counsel, FINRA Dispute Resolution, to Brent J. Fields, Secretary, SEC, dated September 30, 2014 ("FINRA September Letter"). The FINRA September Letter is available at www.sec.gov.

6 15 U.S.C. 78s(b)(2)(B).

Register on October 7, 2014.[7] The Commission received fourteen (14) comment letters in response to the Proceedings Order.[8] On November 24, 2014, the Commission received a letter

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[7] Exchange Act Release No. 73277 (Oct. 1, 2014), 79 FR 60556 (Oct. 7, 2014) (Order Instituting Proceedings To Determine Whether To Approve or Disapprove Proposed Rule Change Relating to Revisions to the Definitions of Non-Public Arbitrator and Public Arbitrator) ("Proceedings Order"). The comment period closed on November 6, 2014.

[8] The comment letters were submitted by: John A. Bender, Esq., Member, Ryan Swanson Cleveland, dated October 10, 2014 ("Bender Letter"); George H. Friedman, Esquire, George H. Friedman Consulting, LLC, dated October 20, 2014 ("Friedman October Letter"); Richard P. Ryder, Esq., President, Securities Arbitration Commentator, Inc., dated October 26, 2014 ("SAC October Letter"); Steven B. Caruso, Esq., Maddox Hargett & Caruso, P.C., dated October 29, 2014 ("Caruso October Letter"); Ryan K. Bakhtiari, Aidikoff, Uhl & Bakhtiari, dated October 30, 2014 ("Bakhtiari October Letter"); Glenn S. Gitomer, McCausland Keen and Buckman, dated November 5, 2014 ("Gitomer November Letter"); William Beatty, President, North American Securities Administrators Association and Washington Securities Administrator, dated November 6, 2014 ("NASAA November Letter"); Kevin M. Carroll, Managing Director and Associate General Counsel, Securities Industry and Financial Markets Association, dated November 6, 2014 ("SIFMA November Letter"); Ryan Corbin, Kori Eskridge, and Kristina Ludwig, Student Interns, and Nicole Iannarone, Assistant Clinical Professor, Georgia State University College of Law Investor Advocacy Clinic, dated November 6, 2014 ("GSU Letter"); CJ Croll and Jeffrey Valacer, Student Interns, Elissa Germaine, Supervising Attorney, and Jill I. Gross, Director, Investor Rights Clinic at Pace Law School, dated November 6, 2014 ("PIRC First November Letter"); Greg Curley, Senior Litigation Counsel, American International Group, Inc., AIG Advisor Group, Inc., dated November 6, 2014 ("AIG Letter"); William A. Jacobson, Esq., Clinical Professor of Law and Director, and Nathan F. Baum, Student, Cornell University Law School Securities Law Clinic, dated November 6, 2014 ("CSLC Letter"); Daniel Wolfe, Legal Intern, and Teresa Verges, Director, University of Miami Investor Rights Clinic, dated November 6, 2014 ("UMIRC Letter"); and CJ Croll and Jeffrey Valacer, Student Interns, Elissa Germaine, Supervising Attorney, and Jill I. Gross, Director, Investor Rights Clinic at Pace Law School, dated November 21, 2014 ("PIRC Second November Letter"). Comment letters are available at www.sec.gov.

from FINRA responding to the comment letters.[9] On December 11, 2014, the Commission received a letter from FINRA supplementing the FINRA November Letter.[10]

This order approves the proposed rule change.

II. Description of the Proposed Rule Change

In general, FINRA classifies arbitrators as "non-public" or "public" based on their professional and personal affiliations. Currently, FINRA Rule 12100(p) of the Customer Code and FINRA Rule 13100(p) of the Industry Code (defining the term "non-public arbitrator") list financial industry affiliations that might qualify a person to serve as a non-public arbitrator in the FINRA arbitration forum. Conversely, FINRA Rule 12100(u) of the Customer Code and FINRA Rule 13100(u) of the Industry Code (defining the term "public arbitrator") list affiliations that disqualify a person from serving as a public arbitrator in the FINRA arbitration forum. FINRA is proposing to delete the definitions in their entirety, and replace them with new definitions. The proposed amendments are described below.

A. Non-Public Arbitrator Definition

1. Proposed New Rule 12100(p)(1)[11]

Under the current non-public arbitrator definition, if a person is currently, or was within the past five years, affiliated with a financial industry entity specified in the rule (a "specified

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9 Letter from Margo A. Hassan, Assistant Chief Counsel, FINRA Dispute Resolution, to Brent J. Fields, Secretary, SEC, dated November 24, 2014 ("FINRA November Letter"). The FINRA November Letter is available at www.sec.gov.

10 Letter from Margo A. Hassan, Assistant Chief Counsel, FINRA Dispute Resolution, to Brent J. Fields, Secretary, SEC, dated December 11, 2014 ("FINRA December Letter"). The FINRA December Letter is available at www.sec.gov.

11 Where this order refers only to rules in the Customer Code, the changes and discussions also apply to the corresponding rules in the Industry Code.

financial industry entity"), the person is classified as a non-public arbitrator.[12] The rule permits these individuals to be reclassified as public arbitrators five years after ending all financial industry affiliations unless (i) they retired from, or spent a substantial part of their career with, a specified financial industry entity[13] or (ii) they were affiliated for 20 years or more with a specified financial industry entity.[14] The individuals subject to these exceptions remain classified as non-public arbitrators.

New Rule 12100(p)(1) would eliminate the five-year cooling-off provision for persons who work in the financial industry by permanently classifying persons who are, or were, affiliated with a specified financial industry entity at any point in their careers, for any duration, as non-public arbitrators. New Rule 12100(p)(1) would also add two new categories of financial industry professionals who would be permanently classified as non-public arbitrators: (i) persons associated with, including registered through, a mutual fund or hedge fund, and (ii) persons associated with, including registered through, an investment adviser.[15]

In addition, new Rule 12100(p)(1) would clarify certain references made in the current rule. For instance, the new rule would replace "[a person] registered under the Commodity

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12 See current Rule 12100(p)(1). This provision applies to a person who is, or was within the past five years: (1) associated with, including registered through, a broker or dealer (including a government securities broker or dealer or a municipal securities dealer); (2) registered under the Commodities Exchange Act; (3) a member of a commodities exchange or a registered futures association; or (4) associated with a person or firm registered under the Commodities Exchange Act.

13 See current Rule 12100(p)(2).

14 See current Rule 12100(u)(2).

15 Currently, FINRA Rules preclude these individuals from serving as arbitrators in any capacity. See current Rule 12100(p) and (u). If, however, they end their affiliation they may serve as public arbitrators after a two-year cooling-off period. These individuals may serve as non-public arbitrators if they are qualified to serve under another provision (e.g., dually registered as an investment adviser and an associated person of a FINRA member).

Exchange Act; a member of a commodities exchange . . ., or associated with a person or firm registered under the Commodity Exchange Act,"[16] with "a person who is, or was, associated with, including registered through, under, or with (as applicable), . . . the Commodity Exchange Act or the Commodities Futures Trading Commission[.]" Also, instead of referring to "a member . . . of a registered futures association,"[17] new Rule 12100(p)(1)(B) would identify the association as the National Futures Association. Moreover, new Rule 12100(p)(1)(B) would include a reference to "[a person] who is, or was, associated with, including registered through, under, or with (as applicable), . . . the Municipal Securities Rulemaking Board." In addition, new Rule 12100(p)(1)(C) would include a provision to cover any entity "organized under or registered pursuant to the Securities Exchange Act of 1934, Investment Company Act of 1940, or the Investment Advisers Act of 1940." This provision would cover financial industry affiliated persons not otherwise specified in the rule and potential categories of financial industry professionals that may be created in the future.

2. **Proposed New Rule 12100(p)(2)**

Under current Rule 12100(p)(3), attorneys, accountants, and other professionals who devoted 20 percent or more of their professional work in the last two years to serving specified financial industry entities and/or employees, are classified as non-public arbitrators.[18] Rule 12100(p)(3) permits these individuals to be reclassified as public arbitrators two years after they stopped providing services to specified financial industry entities, with one exception. A person

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16 See current FINRA Rule 12100(p)(1)(B)-(D).

17 See current FINRA Rule 12100(p)(1)(C).

18 The rule applies to the persons and entities listed in current Rule 12100(p)(1).

who provided services for 20 calendar years or more over the course of his or her career is permanently disqualified from serving as a public arbitrator.[19]

Proposed new Rule 12100(p)(2) would broaden the application of current Rule 12100(p)(3) in three ways: (i) it would increase the look-back period from two years to five years, (ii) it would apply to not only services provided to specified financial industry entities but also to services provided to any persons or entities associated with those specified financial industry entities, and (iii) it would permanently disqualify from serving as public arbitrators persons who provided the specified services for 15 calendar years or more over the course of their careers (in contrast to the current 20 year provision).[20]

In addition, the proposal would replace the phrase "professional work" with "professional time."

3. Proposed New Rule 12100(p)(3)

Currently, FINRA rules permit individuals who represent or provide professional services to investors in securities disputes to serve as public arbitrators.[21]

Under proposed new Rule 12100(p)(3), attorneys, accountants, and other professionals who devoted 20 percent or more of their professional time, within the past five years, to serving parties in investment or financial industry employment disputes would be classified as non-public arbitrators. However, Rule 12100(p)(3) would permit these individuals to serve as public arbitrators five years after they stopped devoting 20 percent or more of their professional time to

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19 See current Rule 12100(u)(2).

20 See proposed new Rule 12100(u)(2). The 15 years are a total number of years – they would not have to be consecutive years.

21 Currently, these individuals are not qualified under the non-public arbitrator definition to serve as non-public arbitrators, nor are they disqualified from serving as public arbitrators under the public arbitration definition.

serving parties in investment or financial industry employment disputes with one exception. A person who provided services for 15 calendar years or more over the course of his or her career would be permanently disqualified from serving as a public arbitrator.[22]

4. Proposed New Rule 12100(p)(4)

Under current Rule 12100(p)(4), any person who is an employee of a bank or other financial institution who (i) effects transactions in securities, including government or municipal securities, and commodities, futures, or options, or (ii) supervises or monitors the compliance with the securities and commodities laws of employees who engage in such activities is classified as a non-public arbitrator. When these individuals end their affiliation, they are immediately reclassified as public arbitrators unless they have engaged in this type of work for 20 years or more over the course of their careers.[23]

Proposed new Rule 12100(p)(4) would add a five-year look-back period to this provision. Specifically, under proposed new Rule 12100(p)(4), any person who, within the last five calendar years, was an employee of a bank or other financial institution who (i) effects transactions in securities, including government or municipal securities, commodities, futures, or options, or (ii) supervises or monitors the compliance with the securities and commodities laws of employees who engage in such activities would be classified as a non-public arbitrator. However, proposed new Rule 12100(p)(4) would permit these individuals to serve as public arbitrators five years after they ended their industry affiliation unless they provided these

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[22] See proposed new Rule 12100(u)(3). The 15 years are a total number of years – they would not have to be consecutive years.

[23] See current Rule 12100(u)(2).

services for 15 years or more.[24] After 15 years of service, the proposed rules would permanently classify such individuals as non-public arbitrators.[25]

B. **Public Arbitrator Definition**

1. Proposed New Rule 12100(u)(1)

Current Rules 12100(u)(1) and 12100(u)(3) identify the types of financial industry employment that disqualify a person from serving as a public arbitrator by cross-referencing those activities listed in current Rule 12100(p) (defining "non-public arbitrators"). Consequently, these otherwise qualified individuals are classified as non-public arbitrators. Proposed new Rule 12100(u)(1) would retain the types of financial industry employment that would disqualify a person from serving as a public arbitrator with revisions identical to those in proposed new Rule 12100(p)(1). Specifically: (i) instead of referring to "[a person] registered under the Commodity Exchange Act; a member of a commodities exchange . . ., or associated with a person or firm registered under the Commodity Exchange Act," proposed new Rule 12100(u)(1)(B) would refer to "a person who is, or was, associated with, including registered through, under, or with (as applicable), . . . the Commodity Exchange Act or the Commodities Futures Trading Commission;" (ii) instead of referring to "a member . . . of a registered futures association," proposed new Rule 12100(u)(1)(B) would identify the association as the National Futures Association; (iii) proposed new Rule 12100(u)(1)(B) would add a reference to "[a person] who is, or was, associated with, including registered through, under, or with (as applicable), . . . the Municipal Securities Rulemaking Board;" and (iv) proposed new Rule 12100(p)(1)(C) would include a provision to cover any entity "organized under or registered

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[24] See proposed new Rule 12100(u)(4). The 15 years are a total number of years – they would not have to be consecutive years.

[25] See proposed new Rule 12100(u)(4).

pursuant to the Securities Exchange Act of 1934, Investment Company Act of 1940, or the Investment Advisers Act of 1940." This provision would cover financial industry affiliated persons not otherwise specified in the rule and potential categories of financial industry professionals that may be created in the future.

As stated above, current FINRA Rule 12100 (p)(1) generally permits individuals classified as non-public arbitrators to become reclassified as public arbitrators five years after ending their affiliations (subject to specified exceptions).[26] As explained in the above discussion on proposed new Rule 12100(p)(1), the proposal would eliminate the five-year cooling-off period[27] resulting in the permanent classification of these individuals as non-public arbitrators pursuant to new Rule 12100(u)(1).

2. **Proposed New Rules 12100(u)(2) and 12100(u)(6)[28]**

Under current Rule 12100(u)(1), attorneys, accountants, and other professionals who devoted 20 percent or more of their professional work in the last two years to serving specified financial industry entities and/or employees listed in current Rule 12100(p)(1), may not be classified as public arbitrators. However, current Rule 12100(u)(1) permits these individuals to be reclassified as public arbitrators two years after they stopped providing those services, with

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26 See supra notes 12, 12, and 13 and their accompanying text.

27 Current Rule 12100(u)(3) subjects investment advisers and persons associated with, including registered through, a mutual fund or hedge fund to a two-year cooling-off period after ending the affiliation. Under proposed new Rule 12100(u)(1), these individuals would also be subject to permanent classification as non-public arbitrators.

28 Although the descriptions of the disqualifications in proposed new Rules 12100(u)(2) and 12100(u)(6) are almost identical, FINRA believes it would add clarity to the definition to distinguish when the provisions would result in a permanent classification, and when they would result in a temporary classification. See Notice of Filing, 79 FR 38080, 38084 (Jul. 3, 2014).

one exception.[29] A person who provided services for 20 calendar years or more over the course of his or her career is permanently disqualified from serving as a public arbitrator.[30]

Proposed new Rules 12100(u)(2) and 12100(u)(6) would broaden the provisions of current Rule 12100(u)(1) in three ways: (i) it would apply to not only services provided to specified financial industry entities but also to services provided to any persons or entities associated with those specified financial industry entities;[31] (ii) new Rule 12100(u)(2) would decrease the number of years for a permanent disqualification from 20 years to 15 years;[32] and (iii) new Rule 12100(u)(6) would increase the cooling-off period from two years to five years.[33] In sum, the proposal would permanently disqualify from serving as public arbitrators persons who provided the specified services for 15 calendar years or more over the course of their careers.

3. Proposed New Rules 12100(u)(3) and 12100(u)(7)

Under proposed new Rules 12100(u)(3) and 12100(u)(7) attorneys, accountants, expert witnesses, and other professionals who devote 20 percent or more of their professional time annually to representing or providing services to parties in disputes concerning investment accounts or transactions, or employment relationships within the financial industry generally

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29 See current Rule 12100(u)(1) (incorporating, among other things, current Rule 12100(p)(3)).

30 See current Rule 12100(u)(2) (referencing the 20-year time period).

31 Cf. current Rule 12100(p)(3) to illustrate the scope of coverage to be expanded by proposed new Rule 12100(u)(2).

32 The 15 years are a total number of years – they would not have to be consecutive years.

33 Substantively, proposed new Rules 12100(u)(2) and 12100(u)(6) are analogous to proposed new Rule 12100(p)(2).

would be classified as non-public arbitrators.[34] New Rule 12100(u)(7), however, would permit these individuals to be reclassified as public arbitrators five years after the final calendar year in which they devoted 20 percent or more of their professional time providing those services with one exception. A person who provided services for 15 calendar years or more over the course of his or her career would be permanently disqualified from serving as a public arbitrator.[35]

4. **Proposed New Rules 12100(u)(4) and 12100(u)(8)[36]**

Under current Rule 12100(u)(1), any person who is an employee of a bank or other financial institution and (i) effects transactions in securities, including government or municipal securities, and commodities, futures, or options, or (ii) supervises or monitors the compliance with the securities and commodities laws of employees who engage in such activities is classified as a non-public arbitrator.[37] When these individuals end their affiliation, they may immediately be reclassified as public arbitrators unless they have engaged in this type of work for 20 years or more over the course of their careers.[38]

Proposed new Rules 12100(u)(4) and 12100(u)(8) would broaden the application of provisions of current Rule 12100(u)(1) in two ways: (i) proposed new Rule 12100(u)(8) would

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34 The substance of proposed new Rules 12100(u)(3) and 12100(u)(7) corresponds to the substance of proposed new Rule 12100(p)(3).

35 See proposed new Rule 12100(u)(3). The 15 years are a total number of years – they would not have to be consecutive years.

36 Although the descriptions of the disqualifications in proposed new Rules 12100(u)(4) and 12100(u)(8) are almost identical, FINRA believes it would add clarity to the definition to distinguish when the provisions would result in a permanent classification, and when they would result in a temporary classification. See Notice of Filing, 79 FR 38080, 38084 (Jul. 3, 2014).

37 See current Rule 12100(u)(1), which cross-references current Rule 12100(p)(4), among other provisions.

38 See current Rule 12100(u)(2).

permit these individuals to be reclassified as public arbitrators five years after they ended their affiliation, and (ii) proposed new Rule 12100(u)(4) would decrease the number of years required for a permanent classification as a non-public arbitrator from 20 years to 15 years.[39]

5. Proposed New Rule 12100(u)(5)

Under current Rules 12100(u)(6) and 12100(u)(7), individuals who are employed by,[40] or who are directors or officers of,[41] an entity that directly or indirectly controls, is controlled by, or is under common control with, any partnership, corporation, or other organization that is engaged in the securities business are classified as non-public arbitrators.[42] These persons may become public arbitrators two years after ending their affiliation.[43]

Proposed new Rule 12100(u)(5) would broaden the provisions of current Rules 12100(u)(6) and 12100(u)(7) in two ways: (i) it would expand the scope of the classification by replacing the phrase "securities business" with "financial industry," and (ii) it would increase the cooling-off period from two years to five years.[44]

6. Proposed New Rule 12100(u)(9)

Under current Rule 12100(u)(4), an attorney, accountant, or other professional whose firm derived 10 percent or more of its annual revenue in the past two years from providing

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39 The 15 years are a total number of years – they would not have to be consecutive years.

40 See current Rule 12100(u)(6).

41 See current Rule 12100(u)(7).

42 Under current Rules 12100(u)(6) and 12100(u)(7), a spouse or immediate family member of such individuals would also be classified as a non-public arbitrator.

43 See current Rule 12100(u); see also infra note 49 and accompanying text.

44 Current Rule 12100(u) subjects individuals covered by current Rules 12100(u)(6) and 12100(u)(7) to a two-year cooling-off period after ending the affiliation. The disqualification for spouses and immediate family members is addressed in proposed new Rule 12100(u)(11), which retains a two-year cooling-off period after ending the affiliation or relationship (discussed below).

services to specified financial industry entities is classified as a non-public arbitrator. Similarly, under current Rule 12100(u)(5), any attorney, accountant, or other professional whose firm derived $50,000 or more in annual revenue in the past two years from providing professional services to any specified financial industry entity relating to any customer dispute concerning an investment account or transaction is also classified as a non-public arbitrator. In both instances, however, current Rule 12100(u) permits such individuals to be reclassified as public arbitrators two years after they ended their affiliation with the firm or two years after the firm no longer derived annual revenue from specified financial industry entities that exceeding those thresholds.[45]

Proposed new Rule 12100(u)(9) would: (i) merge current Rules 12100(u)(4) and 12100(u)(5), and (ii) remove the requirement that the $50,000 in revenue relate to customer disputes concerning an investment account or transaction. Specifically, under proposed new Rule 12100(u)(9) any person who is an attorney, accountant, or other professional whose firm derived $50,000 or more, or at least 10 percent of its annual revenue, in any single calendar year during the past two calendar years, from (i) the entities listed in proposed new Rule 12100(u)(1) and/or from any persons or entities associated with such listed entities, or (ii) a bank or other financial institution where persons effect transactions in securities including government or municipal securities, commodities, futures, or options would be classified as a non-public arbitrator. Proposed new Rule 12100(u)(9) would, however, permit such individuals to be reclassified as public arbitrators two calendar years after ending their employment with the employing firm.

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[45] Current Rule 12100(u) subjects individuals covered by current Rules 12100(u)(4) and 12100(u)(5) to a two-year cooling-off period after ending the affiliation.

7. **Proposed New Rule 12100(u)(10)**

Under proposed new Rule 12100(u)(10), attorneys, accountants, and other professionals whose firm derived $50,000 or more, or at least 10 percent of its annual revenue, in any single calendar year during the past two calendar years, from individual and/or institutional investors relating to securities matters generally would be classified as non-public arbitrators. Proposed new Rule 12100(u)(10) would, however, permit such individuals to be reclassified as public arbitrators two calendar years after ending their employment with the employing firm or two years after the firm no longer derived annual revenue from individual and/or institutional investors relating to securities matters that exceeding those thresholds.

8. **Proposed New Rule 12100(u)(11)**

Under current Rules 12100(u)(6) and 12100(u)(7), an individual whose spouse or immediate family member is employed by,[46] or is a director or officer of,[47] an entity that directly or indirectly controls, is controlled by, or is under common control with, any partnership, corporation, or other organization that is engaged in the securities business is classified as a non-public arbitrator. These persons may become public arbitrators two years after ending their affiliation.[48]

In addition, under current Rule 12100(u)(8), an individual whose spouse or immediate family member is engaged in the conduct or activities described in current Rule 12100(p)(1)-(4)

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46 See current Rule 12100(u)(6).

47 See current Rule 12100(u)(7).

48 See current Rule 12100(u).

(i.e., is employed by a specified financial entity or provides services to such an entity and/or the entity's employees) is classified as a non-public arbitrator.[49]

Proposed new Rule 12100(u)(11) would: (i) merge current Rules 12100(u)(6), 12100(7), and 12100(u)(8), and (ii) add a two year cooling-off period. Specifically, under new Rule 12100(u)(11) a person whose immediate family member is an individual whom FINRA would disqualify from serving on the public arbitrator roster would be classified as a non-public arbitrator. However, if the person's immediate family member ends the disqualifying affiliation, or the person ends the relationship with the individual so that the individual is no longer the person's immediate family member, the person would be able to be reclassified as a public arbitrator after two calendar years had passed from the end of the affiliation or relationship.

9. Definition of "Immediate Family Member"

Current Rule 12100(u) defines the term "immediate family member" to include a person's parent, stepparent, child, stepchild, member of a person's household, an individual to whom a person provides financial support of more than 50 percent of his or her annual income, or a person who is claimed as a dependent for federal income tax purposes. Current Rule 12100(u) does not define the term "spouse."

Proposed new Rule 12100(u) would amend the definition of "immediate family member" to add as immediate family members a person's spouse, partner in a civil union, and domestic partner.

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[49] While current Rule 12100(u) does not include a cooling-off period for this classification, FINRA stated that it has been its practice to make these individuals wait for five years after their spouse or immediate family member ends the disqualifying affiliation before the individuals may be reclassified public arbitrators. See Notice of Filing, 79 FR 38080, 38085 (Jul. 3, 2014).

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. A more detailed description of the proposed rule changes is contained in the Notice of Filing and the Proceedings Order.[50]

III. Comment Summary[51]

In response to the Notice of Filing, the Commission received 316 comment letters (including 295 copies of substantially the same letter submitted by self-identified independent financial advisors). Five of the commenters expressed support for the proposed rule change in its entirety.[52] Two commenters opposed the proposed rule change in its entirety.[53] The other commenters (including the independent financial advisors) generally supported the proposed rule change in part, but raised concerns about various aspects of the proposal.

In response to the Proceedings Order, the Commission received fourteen comments.[54] Of these comments, four supported the proposal,[55] three opposed the proposal,[56] and the remainder partially supported or opposed aspects of the proposal.[57]

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50 See supra notes 3 and 7.

51 Some provisions of the proposed rule change would result in a similar outcome – the permanent classification of certain individuals as non-public arbitrators. Accordingly, where the discussion of comments references specific provisions of the proposal, that discussion may also apply to other provisions in the proposal that would result in similar outcomes.

52 See Aidikoff Letter, Bakhtiari July Letter, Caruso July Letter, Gitomer July Letter, and SIFMA July Letter.

53 See SAC July Letter (stating that the proposed rule change should be disapproved until a cost-benefit analysis is provided) and Friedman July Letter (stating that FINRA should "go back to the drawing board").

54 See supra note 8.

55 See Caruso October Letter, Bakhtiari October Letter, Gitomer November Letter, and SIFMA November Letter.

A. Permanent Classification of Industry Employees as Non-Public Arbitrators

In general, the proposal would result in the permanent classification (or reclassification of current public arbitrators) of individuals who worked in the financial industry (a) in any capacity, (b) at any point, and (c) for any duration, ("Industry Affiliates") as non-public arbitrators. Many commenters opposed the permanent classification of Industry Affiliates as non-public arbitrators for varying reasons.[58]

1. Elimination of the Cooling-Off Period

In general, the proposal would result in the classification (or reclassification of current public arbitrators) of individuals as non-public arbitrators who otherwise would have been classified as public arbitrators. Specifically, individuals who worked in the financial industry for any duration would be permanently classified as non-public arbitrators (effectively eliminating the five-year cooling-off period).[59]

Several commenters supported this provision as providing a workable "bright-line" test that would address criticism regarding bias (perceived or actual) in favor of the financial industry,[60] including one that stated that eliminating the five-year cooling-off period would eliminate industry-side potential and perceived bias.[61]

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56 See Bender Letter, Friedman October Letter, and SAC October Letter.

57 See UMIRC Letter, GSU Letter, AIG Letter, CSLC Letter, NASAA November Letter, PIRC First November Letter, and PIRC Second November Letter.

58 See, e.g., Type A Letter, FSI Letter, Getman Letter, and Vernon Letter.

59 See proposed new Rules 12100(p)(1) and (u)(1).

60 See Aidikoff Letter; see also Caruso October Letter, Bakhtiari October Letter, Gitomer November Letter, SIFMA November Letter, CSLC Letter Bakhtiari July Letter, SIFMA July Letter, NASAA July Letter, PIABA Letter, and AAJ Letter.

61 See SIFMA November Letter.

Many commenters opposed eliminating the five-year cooling-off period for Industry Affiliates.[62] Some of these commenters expressed concern that eliminating the cooling-off period could exclude arbitrators with industry experience who could be useful on a panel to, among other things, educate the other panelists on industry practice.[63] Another commenter suggested that FINRA classify Industry Affiliates as neither public nor non-public arbitrators for a set number of years following the date they end their affiliation with the financial industry.[64] This commenter also opposed categorizing any industry employee, regardless of capacity, as a non-public arbitrator. For example, this commenter suggested that industry employees who are clerical should be classified as neither public nor non-public arbitrators.[65]

In its response, FINRA disagreed with the opposing commenters, stating that its constituents agreed that any cooling off period for financial industry employees would "leave a perception of unfairness for some advocates."[66] In addition, FINRA stated that investor advocates have a stated preference for using expert witnesses and making their own arguments rather than relying on members of the arbitration panel that have industry experience to explain and influence matters.[67] FINRA also stated, however, that former industry employees have valuable knowledge and experience, and that completely removing them from arbitrator service

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62 See Bender Letter, Friedman October Letter, SAC October Letter, Type A Letter, FSI Letter, Getman Letter, Berthel Letter, and Vernon Letter.

63 See Type A Letter and Berthel Letter; see also FSI Letter.

64 See Friedman October Letter; see also PIRC July Letter and FSI Letter (suggesting that FINRA should adopt a cooling-off period for industry employees that would be proportional to the number of years they were Industry Affiliates).

65 See Friedman October Letter.

66 See FINRA September Letter.

67 Id.

would negatively impact the forum.[68] Similarly, FINRA stated that if an Industry Affiliate meets FINRA's qualifications for service as an arbitrator (regardless of the capacity in which she or he served the financial industry), she or he should be classified as a non-public arbitrator.[69] FINRA stated that parties to an arbitration would continue to have the authority to strike any or all arbitrators on the non-public list.[70]

Ultimately, FINRA stated that it believes that it is more workable to use a bright-line test than a pro rata cooling-off period for financial industry employees.[71] Accordingly, FINRA declined to amend the proposed rule change.[72]

2. All Employees, Regardless of Capacity, to be Classified as Non-Public Arbitrators

Four commenters stated that, as proposed, the rule would improperly characterize certain individuals without true financial industry experience as non-public arbitrators.[73] One of these commenters expressed concern that individuals performing solely clerical or ministerial functions for a financial industry firm would be classified as non-public arbitrators because they would be considered "associated persons" as defined by Rule 12100(p).[74] Accordingly, this commenter suggested FINRA amend the definition of the term "associated person" in the proposal to track the definition of the term "associated person" in section 3(a)(18) of the Act, which excludes individuals performing solely clerical or ministerial functions. Another

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68 See FINRA November Letter; see also FINRA September Letter.

69 See FINRA November Letter; see also FINRA September Letter.

70 See FINRA November Letter; see also FINRA September Letter.

71 See FINRA September Letter.

72 See FINRA September Letter and FINRA November Letter.

73 See Stephens Letter, FSI Letter, Getman Letter, and Vernon Letter.

74 See Stephens Letter.

commenter suggested that the proposal should only classify individuals who "worked for [a financial industry firm] in a capacity for which testing and registration is required" as non-public arbitrators to address this concern.[75]

In its response, FINRA stated that its staff believes that "investor concerns about the neutrality of the public roster apply to all industry employees, including those who serve in clerical or ministerial positions."[76] In addition, FINRA stated that it believes that if a financial industry affiliate meets FINRA's qualifications for service as an arbitrator, FINRA should appoint the person to the non-public arbitrator roster.[77] Accordingly, FINRA declined to amend the proposed rule change.[78]

B. Classification of Professionals

1. Classifying Investor Advocates as Non-Public Arbitrators

In general, the proposed rule change would classify attorneys, accountants, expert witnesses, or other professionals who (a) devote 20 percent or more of their professional time (b) in any single calendar year within the past five calendar years (c) to representing or providing services to parties in disputes concerning investment accounts or transactions, or employment relationships within the industry ("Investor Advocates") as non-public arbitrators.[79] Currently, individuals meeting this description are classified as public arbitrators.

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75 See Vernon Letter (expressing concern that under the proposal [the commenter] could be characterized as a non-public arbitrator based solely on his capacity as a "trainee" for Merrill Lynch in 1983).

76 See FINRA September Letter.

77 See FINRA November Letter.

78 See FINRA September Letter and FINRA November Letter.

79 See proposed new Rule 12100(p)(3).

Several commenters supported this provision,[80] including two commenters that indicated that this provision is necessary to eliminate potential and perceived investor-side bias.[81] Specifically, one of these commenters stated that the rationale for eliminating perceived bias is the same for both public and non-public arbitrators.[82] Another commenter stated that eliminating perceived investor-side bias is necessary in light of the implementation of the all-public-panel rule.[83] Similarly, one commenter noted that the historical distinction of classifying arbitrators as pubic arbitrators based on their financial industry experience was compelling when FINRA required the presence of someone with financial industry experience on all panels, but is no longer necessary with the advent of the all-public-panel rule.[84]

Several commenters also opposed the classification of Investor Advocates as non-public arbitrators,[85] including some commenters who supported the classification of industry-affiliated persons as non-public arbitrators.[86] Many of these commenters stated that including investor

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80 See Caruso October Letter, Bakhtiari October Letter, Gitomer November Letter, SIFMA November Letter, AIG Letter, FSI Letter, Bethel Letter, and SIFMA July Letter. The commenters who used the Type A Letter also supported this provision.

81 See SIFMA November Letter and AIG Letter.

82 See SIFMA November Letter; see also SIFMA July Letter (stating that the proposal "strike[s] an appropriate balance in the interests of fairness, perceptions of fairness, and arbitrator neutrality for all parties").

83 See AIG Letter.

84 See SIFMA November Letter.

85 See Bender Letter, Friedman October Letter, SAC October Letter, UMIRC Letter, GSU Letter, CSLC Letter, NASAA November Letter, PIRC Second November Letter, NASAA July Letter, PIABA Letter, Stephens Letter, PIRC July Letter, Bacine Letter, Mass Letter, Hardiman Letter, and Friedman July Letter.

86 See, e.g., CSLC Letter and NASAA November Letter; see also NASAA July Letter (arguing that FINRA should classify as non-public arbitrators only persons "representing or providing services to non-retail parties in disputes concerning investment accounts or transactions, or employment relationships within the financial industry"), Stephens Letter (arguing that FINRA should only classify as non-public arbitrators persons ". . .

representatives in the public arbitrator pool counteracts some of the existing perceived bias in favor of the financial industry in the FINRA arbitration forum.[87] One commenter stated that "[he could not] fathom how this [provision] would further investor protection."[88] Two other commenters stated that there is no evidence supporting the assumption that professionals who serve the investing public have any bias either for or against the financial industry.[89] Another commenter stated that it believes that the classification of Investor Advocates as non-public arbitrators is inconsistent with the concept of a "public" arbitrator.[90] Two commenters argued that there is a perception that the arbitration system is unfair or always "stacked against" investors and that "any proposal to change the definitions of public and non-public arbitrator should be focused on mitigating the investing public's perception of bias, not the industry's perception of bias."[91] Another commenter asserted that the "public" and "non-public" labels were never intended to account for biases in favor of the investing public but rather to eliminate arbitrators' perceived and actual bias against customers who are compelled to participate in this

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representing or providing services to parties in disputes [other than customers] concerning investment accounts …"), and Bacine Letter (arguing that the distinction between public and non-public arbitrators has always been based on whether the arbitrators had industry experience and argued for keeping this distinction).

87 See, e.g., CSLC Letter, NASAA July Letter, and PIABA Letter.

88 See Friedman October Letter.

89 See GSU Letter and PIABA Letter.

90 See NASAA November Letter; see also Mass Letter (asserting that lawyers who represent investors or claimants are public arbitrators because they work on behalf of the public at large against the financial industry), and Hardiman Letter (stating that classifying Investor Advocates as non-public arbitrators would be "burying professionals who represent the investing public in the industry non-public side").

91 See CSLC Letter (citing the NASAA July Letter and PIABA Letter) and PIRC Second November Letter.

forum by the financial industry.[92] This commenter also argued that the proposed new classifications would cause confusion because Investor Advocates generally represent the public and would naturally be considered to be associated with the "public" pool.[93]

In the Notice of Filing, FINRA stated that it proposed the reclassification of arbitrator categories in response to concerns regarding the neutrality of the public arbitrator roster raised by both investor representatives and industry representatives.[94] Similarly, in its response FINRA stated that addressing both investor and industry perceptions of bias in the public arbitrator roster would better safeguard the integrity of its arbitration forum.[95] FINRA also stated that parties would continue to receive extensive disclosure statements on each proposed arbitrator that describe in detail that arbitrator's background. Accordingly, FINRA believes that under the proposal parties in customer cases would be able to address their own perceptions of bias that may arise under the proposal through the use of their unlimited strikes on the list of non-public arbitrators.[96] Thus, FINRA declined to amend the proposed rule change.[97]

2. Five-year Cooling-Off Period for Professionals Representing Industry

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92 See UMIRC Letter.

93 See UMIRC Letter; see also, e.g., Stephens Letter, NASAA July Letter, PIABA Letter, PIRC July Letter, Bacine Letter (stating that the proposal would create confusion since the U.S. courts, the American Arbitration Association, and the general public generally view professionals who represent investors to be "public arbitrators"), and PIRC July Letter (stating that past NASD response letters, as well as the FINRA website, also make the distinction that professionals who represent investors are typically public arbitrators).

94 See Notice of Filing, 79 FR 38080, 38081 (Jul. 3, 2014); see also FINRA September Letter (stating that industry constituents have expressed concern about the neutrality of the public arbitrator roster because of the presence on the roster of Investor Advocates).

95 See FINRA November Letter.

96 Id.

97 See FINRA September Letter and FINRA November Letter.

In general, the proposed rule change would extend the cooling-off period from two years to five years for attorneys, accountants, expert witnesses, or other professionals who (a) devote 20 percent or more of their professional time (b) in any single calendar year within the past five calendar years (c) to representing or providing services to financial industry firms ("Industry Advocates").

Three commenters generally supported this provision as fair and acknowledged the consistency of approach towards professionals representing investors and those representing industry.[98] Another commenter generally supported removing Industry Advocates from the public arbitrator roster, but believed that they should be permanently classified as non-public arbitrators like financial industry employees (i.e., the commenter suggested that FINRA eliminate the cooling-off period rather than extend it).[99]

In its response, FINRA stated that it has drawn a distinction between individuals who work in the financial industry and individuals who provide services to the financial industry. FINRA also stated its belief that to help ensure fairness to all forum users, it needed to take a consistent approach to cooling-off periods for service providers to both investors and the financial industry.[100] Accordingly, FINRA declined to amend the proposed rule change.[101]

3. Using Professional Time to Quantify Professional Work

As stated above, the proposal would classify attorneys, accountants, expert witnesses, or other professionals as either public arbitrators or non-public arbitrators depending on, among other things, the percentage of time those individuals devoted to representing either the financial

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98 See SIFMA July Letter, PIABA Letter, and Berthel Letter.

99 See NASAA July Letter.

100 See FINRA September Letter.

101 Id.

industry or investors.[102] Some commenters questioned the appropriateness of classifying individuals as public or non-public arbitrators based on the "amount of time" an individual devotes to a client.[103] Alternatively, commenters suggested using revenue instead of professional time as the metric to quantify professional work.[104] One of these commenters suggested that revenue is a better measurement since not all professionals track their work in terms of time, but all professionals would have a record of revenue.[105] Another one of these commenters stated that using professional time as the metric would categorize professors and supervisors in investor advocacy clinics as non-public arbitrators, even though the clinic does not earn any revenues and the primary function of the clinic is educational.[106]

In its response, FINRA stated that given the purpose of the proposal is to address the perception that professionals who regularly provide services to investors might be biased in favor of investors, it does not believe that it would be appropriate to make an exception for employees of law school investor advocacy clinics.[107] FINRA also stated that the proposed rule change regarding "professional time" was specifically discussed by its National Arbitration and Mediation Committee ("NAMC")[108] and it agreed that the change "added clarity to the rule text,

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102 See proposed new Rule 12100(p)(3).

103 See UMIRC Letter and PIRC July Letter.

104 See UMIRC Letter and PIRC July Letter.

105 See PIRC July Letter.

106 See UMIRC Letter.

107 See FINRA November Letter.

108 NAMC provides policy guidance to FINRA Dispute Resolution staff. Its members include investors, securities industry professionals, and FINRA arbitrators and mediators. A majority of NAMC's members and its chair are non-industry representatives. See FINRA Advisory Committees, National Arbitration and Mediation Committee, available at http://www.finra.org/aboutfinra/leadership/committees/p197363.

was simpler to apply, and would result in more accurate calculations by arbitrator applicants and arbitrators reviewing their business mix."[109] Accordingly, FINRA declined to amend the proposed rule change.[110]

4. Impact to the Pool of Public Arbitrators

a. Number of Available Public Arbitrators

Since February 1, 2011, customers have been able to choose an arbitration panel composed entirely of public arbitrators (i.e., an "all-public panel").[111] One commenter cited statistics that indicated that customers in approximately three-quarters of eligible cases choose an all-public panel.[112] Another commenter estimated that public arbitrators account for approximately 85% of those that serve.[113] Consequently, several commenters expressed concern that the proposed rule change would negatively impact the number of public arbitrators available to serve in FINRA's arbitration forum.[114] Similarly, some commenters suggested that under the

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109 See FINRA September Letter and FINRA November Letter.

110 See FINRA September Letter and FINRA November Letter.

111 See Exchange Act Release No. 70442 (Sept. 18, 2013), 78 FR 58580 (Sept. 24, 2013) (order approving a proposed rule change to, among other things, permit all parties to select an all-public panel) and Exchange Act Release No. 63799 (Jan. 31, 2011), 76 FR 6500 (Feb. 4, 2011) (order approving a proposed rule change to provide customers with the option to choose an all-public panel in all cases).

112 See UMIRC Letter (citing Exchange Act Release No. 69762 (Jun. 13, 2013), 78 FR 37267, 37268 (Jun. 20, 2013) (Notice of Filing of Proposed Rule Change Relating to Amendments to the Code of Arbitration Procedure for Customer Disputes Concerning Panel Composition)).

113 See SAC October Letter.

114 See, e.g., Bender Letter, PIRC First November Letter, GSU Letter, SAC October Letter, Friedman October Letter, UMIRC Letter, Friedman July Letter, SAC July Letter, NASAA July Letter, and FSI Letter.

proposed rule change FINRA would need to devote resources to recruit additional public arbitrators.[115]

Several commenters questioned FINRA's estimate that the total number of arbitrators that would be reclassified from public arbitrators to non-public arbitrators would be approximately 474[116] out of 3,567 current public arbitrators (approximately 13.3%).[117] A number of commenters stated that they believe that FINRA severely underestimated the number of arbitrators that would be reclassified.[118] Some commenters estimated that the number of public arbitrators that would be reclassified is approximately one-fourth or 25% of the current public arbitrator pool.[119] Consequently, commenters expressed concern that the proposal would result in delays in arbitration proceedings due to an insufficient number of arbitrators.[120] Two commenters cited the recent stay in arbitration proceedings in Puerto Rico as an example of the possible outcome if the pool of public arbitrators is drastically reduced in some geographic areas.[121]

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115 See SAC July Letter and NASAA July Letter.

116 In the FINRA September Letter, FINRA estimated that 374 arbitrators would be reclassified from public to non-public arbitrators as a result of having had a Central Registration Depository ("CRD") number at some point in their careers or having had an affiliation with a firm with a CRD number. In addition, FINRA estimated that approximately 100 arbitrators would be reclassified from public to non-public as a result of having identified an affiliation with PIABA; see also FINRA November Letter.

117 See FINRA November Letter (basing its estimate on a survey of databases to which FINRA has access); see also FINRA September Letter.

118 See Bender Letter, SAC October Letter, UMIRC Letter, PIRC November Letter, and GSU Letter.

119 See Bender Letter and SAC October Letter.

120 See SAC October Letter and UMIRC Letter; see also FSI Letter.

121 See SAC October Letter and UMIRC Letter; see also SAC July Letter (suggesting that the potential shortage of public arbitrators may be more concentrated in some locations than others).

In its response, FINRA acknowledged commenters' concerns about reducing the number of public arbitrators currently on the public arbitrator roster. FINRA also stated, however, that it believes that addressing users' perceptions of the neutrality of its public arbitrators outweighs those concerns.[122] In addition, FINRA stated that it intends to address commenters' concerns as well, stating its commitment to aggressively recruiting arbitrators to help ensure that "the forum has a sufficient number of public arbitrators to serve the needs of forum users in each of its hearing locations."[123] Specifically, FINRA illustrated its ongoing efforts to recruit public arbitrators since the adoption of the all-public panel rule.[124] In addition, FINRA expressed its commitment to arbitrator retention, citing its recent rule proposal to increase the amount of honoraria arbitrators receive in connection with serving on a panel.[125] In its response, FINRA concluded that despite the temporary decrease in the number of public arbitrators resulting from the proposed rule change, the FINRA forum will have a sufficient number of public arbitrators to serve the immediate needs of forum users.[126] In addition, FINRA stated that if the proposal was approved it would focus its recruiting efforts on the hearing locations most impacted by the rule

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122 See FINRA November Letter.

123 See FINRA November Letter and FINRA December Letter; see also FINRA September Letter.

124 See FINRA November Letter and FINRA December Letter (collectively citing, for example, the Puerto Rico bond fund disputes for which FINRA stated that its staff conducted recruitment activities in Puerto Rico and asked arbitrators in hearing locations in the Southeast Region and Texas if they would be willing to serve in Puerto Rico. FINRA stated that its recruitment efforts have resulted in almost 200 applications from Puerto Rico residents to serve on its roster, and approximately 800 arbitrators currently on its roster who have agreed to hear cases in Puerto Rico).

125 See Exchange Act Release No. 73245 (Sept. 29, 2014), 79 FR 58976 (Oct. 3, 2014) (Order Approving Proposed Rule Change to Amend the Code of Arbitration Procedure for Customer Disputes and the Code of Arbitration Procedure for Industry Disputes to Increase Arbitrator Honoraria and Increase Certain Arbitration Fees and Surcharges).

126 See FINRA September Letter, FINRA November Letter, and FINRA December Letter.

change and that it would assign additional staff to recruitment as necessary.[127] Accordingly, FINRA declined to amend the proposed rule change.[128]

b. Quality of Public Arbitrator Pool

Several commenters expressed concern that the proposed rule change would negatively impact the quality of public arbitrators available to serve in FINRA's arbitration forum.[129] In particular, these commenters were concerned that the classification of Investor Advocates as non-public arbitrators would diminish the number of qualified public arbitrators.[130] For example, one commenter stated that the proposal would result in the most highly trained public arbitrators for customer-member cases being reclassified as non-public arbitrators.[131] Another commenter stated more generally that the proposal would "gut the public arbitrator pool of many experienced and knowledgeable arbitrators" and result in a "brain drain" of the public arbitrator pool.[132]

In its response, FINRA stated that the proposed rule change would not reduce the total number of arbitrators available for selection but rather would shift them to another part of the roster. Accordingly, FINRA stated that it does not believe that the proposed rule change would

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127 See FINRA December Letter; see also FINRA September Letter (stating that if the proposal was approved, it would conduct a more detailed analysis to determine whether additional arbitrator recruitment efforts were necessary in any particular geographic area and would deploy the necessary resources to avoid any undue delay in the arbitration process).

128 See FINRA September Letter and FINRA November Letter.

129 See, e.g., Bender Letter, PIRC First November Letter, GSU Letter, and SAC October Letter.

130 See, e.g., Bender Letter, PIRC First November Letter, GSU Letter, and SAC October Letter.

131 See Bender Letter.

132 See PIRC First November Letter.

drain from the forum the experience and expertise of those arbitrators being reclassified as non-public. FINRA stated that instead, the parties would receive a complete description of the background and experience of each arbitrator on the non-public list and could use that information to rank or strike them accordingly. FINRA stated that the proposal would effectively maintain the reclassified individuals in the pool of arbitrators as non-public arbitrators to be able to continue to utilize their experience and expertise while eliminating the industry's perception of bias of these arbitrators.[133] In addition, FINRA acknowledged the need for aggressive arbitrator recruitment to help ensure that the forum has a sufficient number of qualified public arbitrators[134] and outlined the measures it intends to undertake to fulfill this objective.[135] Accordingly, FINRA declined to amend the proposed rule change.[136]

5. Impact on Qualified Chairpersons

Several commenters expressed concern that the proposed rule change would negatively impact the quantity and quality of chairpersons available to serve in FINRA's arbitration forum.[137] Some commenters suggested changes to the qualification requirements for chairpersons in customer cases, such as allowing arbitrators with investor relationships to serve as chairpersons or requiring that the chairperson be a judge or hold a law degree.[138]

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133 See FINRA November Letter.

134 See FINRA November Letter and FINRA December Letter.

135 See FINRA December Letter.

136 See FINRA November Letter.

137 See Stephens Letter and Bacine Letter (expressing concern that classifying professionals who provide services to customers as non-public arbitrators would negatively impact the quality of chairman-eligible arbitrators); see also Bender Letter.

138 See Bacine Letter and Berthel Letter.

In its response, FINRA stated that allowing arbitrators with investor relationships to serve as chairpersons would nullify the effort to address perceived bias.[139] FINRA also noted that more than 75 percent of the public chair-qualified arbitrators are attorneys and therefore stated that it does not believe that changes to the chair qualifications are necessary.[140] Accordingly, FINRA declined to amend the proposed rule change.[141]

6. Cost-Benefit Analysis

a. Timing

Several commenters stated that the proposed rule change should not be approved until FINRA obtained additional data and published a detailed cost-benefit analysis justifying the proposal.[142] In particular, these commenters expressed concern with FINRA's commitment[143] to perform a detailed cost-benefit analysis after the proposal was implemented in order to assess its impact and determine where to allocate additional resources for arbitrator recruitment.[144] Two of these commenters stated that if FINRA ultimately finds the impact of the proposed rule change unsupportable, forum participants would have to comply with a "bad" rule while proceedings are pending to approve a subsequent rule change.[145] One of these commenters also stated that if the

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139 See FINRA September Letter.

140 Id.

141 Id.

142 See SAC July Letter, Friedman July Letter, Estell Letter, Friedman October Letter, PIRC First November Letter, and SAC October Letter (questioning whether the depletion of public arbitrators resulting from the proposed rule change would lead to delays in hearing claims).

143 See FINRA September Letter.

144 See, e.g., SAC October Letter and PIRC First November Letter.

145 See SAC October Letter and PIRC First November Letter.

effort to conduct a cost-benefit analysis is to be expended in any event, conducting it prior to implementing the proposal could streamline implementation of the proposed rule change.[146]

In its response, FINRA stated that a cost-benefit analysis, while useful for planning purposes, does not outweigh the imperative of addressing the users' perception of neutrality in maintaining the integrity of the forum, and that fairness requires FINRA to address the concerns of all forum users.[147] Further, FINRA noted that the "proposed rule change is the culmination of extensive dialogue with FINRA constituents and FINRA filed the proposed rule change at the urging of its constituents."[148] In addition, FINRA stated that performing a cost-benefit analysis would be time-intensive and require a survey of every public arbitrator on its roster.[149] In the interim, FINRA performed a preliminary analysis of databases currently available to it to obtain estimates of the potential impact of the proposal (discussed above).[150] FINRA also committed to perform a cost-benefit analysis if the proposal is approved.[151]

b. Potential Forum Delays

Three commenters stated that by failing to conduct an in-depth analysis of the impact of the proposed rule change, FINRA failed to weigh the consequences of its actions.[152] For

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146 See SAC October Letter; see also Estell Letter (suggesting that FINRA make information about each arbitrator publicly available, particularly to academic researchers, and that the data could provide FINRA with statistical proof of bias or lack of bias upon which to base its proposal instead of relying on perceptions of bias).

147 See FINRA November Letter; see also FINRA September Letter.

148 See FINRA November Letter; see also FINRA September Letter.

149 See FINRA September Letter.

150 See FINRA November Letter and FINRA December Letter; see also FINRA September Letter.

151 See FINRA September Letter.

152 See Friedman October Letter, SAC October Letter, and PIRC November Letter.

example, one commenter suggested that FINRA may not currently have enough public arbitrators and that this shortage of public arbitrators may be contributing to an increase in overall case turnaround time.[153] Similarly, two commenters identified the lack of a cost-benefit analysis as a reason that FINRA has underestimated the potential impact of the proposal on the public arbitrator pool.[154]

Alternatively, one commenter stated that FINRA's representations that the proposal would not affect a significant number of arbitrators are sufficient.[155] This commenter also stated that even if the impact to the public arbitrator pool is greater than anticipated, it is a small price to pay for arbitrator neutrality.[156]

In its response, FINRA stated that it monitors the amount of time it takes to process a claim in its forum and has not heard from forum users that arbitrator availability is causing delays in processing cases. Instead, FINRA stated that various other factors are more likely to result in delays, including party-initiated postponements; an increase in the number of hearing sessions per case; concentration of law firms representing the majority of parties; and efforts to verify arbitrators' disclosures to protect parties from undisclosed arbitrator conflicts.[157] Moreover, as discussed above, FINRA stated that it recognizes the need for aggressive arbitrator

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153 See SAC October Letter; see also Friedman July Letter and SAC July Letter (expressing concern that a decrease in the number of public arbitrators could result in greater delays in arbitrating claims, particularly (1) during declines in the financial markets (when the number of arbitration claims filed increases) or (2) in certain hearing locations with smaller rosters of arbitrators).

154 See Friedman October Letter, SAC October Letter, SAC July Letter, and Friedman July Letter.

155 See SIFMA November Letter.

156 Id.

157 See FINRA November Letter.

recruitment to address any potential impact and outlined the steps it expects to take in its aggressive recruitment and retention of public arbitrators.[158]

7. Consideration of the Proposal by FINRA's Dispute Resolution Task Force

Two commenters suggested that FINRA withdraw the proposal and submit it to its recently formed Arbitration Task Force[159] for consideration.[160] One of these commenters suggested that the Task Force should be permitted to consider the proposal after a full impact analysis is conducted so that the Task Force would have the benefit of this analysis for its consideration.[161]

In its response, FINRA stated that it has engaged in a comprehensive process soliciting input from interested groups.[162] It also stated that the proposal reflects a balanced approach on classifying arbitrators that would enhance forum users' perception of fairness of the forum.[163] In addition, FINRA stated that while the Task Force is setting its own agenda and is free to discuss the arbitrator definitions, it does not expect to make any recommendations until the fall of 2015, which would make it unlikely for FINRA to file any proposed rule change based on Task Force

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158 See FINRA November Letter and FINRA December Letter.

159 See FINRA News Release, FINRA Announces Arbitration Task Force (Jul. 17, 2014), available at http://www.finra.org/Newsroom/NewsReleases/2014/P554192 (announcing the formation of an Arbitration Task Force to consider possible enhancements to improve transparency, impartiality and efficiency of FINRA's securities arbitration forum for all participants).

160 See Friedman October Letter and SAC October Letter; see also Friedman July Letter.

161 See SAC October Letter.

162 See FINRA November Letter; see also FINRA September Letter.

163 See FINRA November Letter; see also FINRA September Letter.

recommendations until at least 2016.[164] FINRA indicated that it does not believe that it would be in the best interests of forum users to delay action on this fully considered proposal.[165]

8. Alternative Solutions

Several commenters suggested alternatives to the proposal.[166] For example, two commenters suggested that FINRA require arbitrators to disclose additional information about themselves, including their mix of work and the percentage of revenue derived from representation for or against the financial industry, so that parties can make independent determinations about each arbitrator.[167] One of these commenters also suggested that FINRA eliminate the labels of public and non-public altogether and allow parties to choose from a single pool of arbitrators.[168] Another commenter stated that Industry Affiliates should not permanently remain classified as non-public arbitrators but rather should be reclassified as being precluded from acting as an arbitrator in any capacity (i.e., a "no-man's land") for a number of years after ceasing their respective affiliation with the financial industry.[169] Three other commenters

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164 See FINRA November Letter.

165 See FINRA September Letter and FINRA November Letter.

166 See Bender Letter, NASAA November Letter, PIRC First November Letter, Friedman July Letter, and Nicinski Letter.

167 See Bender Letter and PIRC First November Letter; see also Estell Letter.

168 See PIRC First November Letter; see also Nicinski Letter.

169 See Friedman October Letter; see also Friedman July Letter (suggesting that instead of public and non-public, arbitrators should be classified as affiliated with financial industry or not).

objected to broker-dealers' use of pre-dispute mandatory arbitration agreements.[170] Other commenters suggested ways to improve the quality of arbitration panels.[171]

As discussed above, FINRA stated that it has engaged in a robust review process, including consultation with its NAMC, interested groups, and other forum constituents, during which it encouraged interested persons to raise their concerns about the definitions and to make suggestions on how to improve them.[172] FINRA stated that its NAMC did not recommend that FINRA eliminate the arbitrator classifications.[173] In addition, FINRA stated that eliminating the arbitrator classifications would undermine many of its recent changes to arbitrator selection rules, notably its all-public panel rule, which have been positively received by parties. In addition, FINRA stated that the recommended alternatives were either outside the scope of, or would cause undue delay to, the proposed rule change.[174] Accordingly, FINRA declined to amend the proposed rule change.[175]

IV. Discussion

The Commission has carefully considered the proposed rule change, the comments received, and FINRA's responses to the comments. Based on its review of the record, the Commission finds that the proposal is consistent with the requirements of the Act and the rules

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170 See AAJ Letter, Estell Letter, and NASAA October Letter.

171 See, e.g., Nicinski Letter (recommending that arbitrators be required to display some knowledge of the investment products likely to be discussed during an arbitration) and Berthel Letter (recommending (1) that every panel include arbitrators with a strong background in securities laws and (2) that the Chair be a judge or hold a law degree).

172 See FINRA September Letter and FINRA November Letter.

173 See FINRA September Letter and FINRA November Letter; see also supra note 109.

174 See FINRA September Letter.

175 See FINRA September Letter and FINRA November Letter.

and regulations thereunder applicable to a national securities association.[176] In particular, the Commission finds that the proposal is consistent with section 15A(b)(6) of the Act, which requires, among other things, that FINRA's rules 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.[177]

As stated above, FINRA classifies arbitrators as "non-public" or "public" based on their professional and personal affiliations.

The proposal would, among other things: (1) permanently classify as "non-public arbitrators" individuals with certain affiliations with the financial industry; and (2) classify as non-public arbitrators certain professionals (e.g., accountants and attorneys) who represent or provide services to parties in disputes concerning investment accounts or transactions, or employment relationships within the financial industry.[178] Consequently, the proposed rule change would, in some instances, require the reclassification of current public arbitrators to non-public arbitrators.

As stated in the Notice of Filing, the proposed rule change was designed to address concerns regarding the perceived neutrality of the public arbitrator roster raised by both investor representatives and financial industry representatives.[179] Specifically, the classification of individuals affiliated with the financial industry as non-public arbitrators responds to concerns of

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176 In approving this proposed rule change, the Commission has considered the proposed rule change's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

177 15 U.S.C. 78o-3(b)(6).

178 See infra pp. 41-42 for a discussion of other provisions of the proposed rule change.

179 See Notice of Filing, 79 FR 38080, 38081 (Jul. 3, 2014).

potential bias of arbitrators, whether actual or perceived, in favor of the industry.[180] Similarly, the classification of Investor Advocates as non-public arbitrators responds to concerns of potential bias of arbitrators, whether actual or perceived, in favor of investors.[181]

The Commission believes that the proposed rule change would help to address any perceived bias of public arbitrators by classifying certain individuals with either financial industry experience or significant experience representing investors as non-public arbitrators. Accordingly, the Commission also believes that the proposal would enhance the perception of neutrality of the entire FINRA arbitration forum. The Commission recognizes commenters' concerns that classifying Investor Advocates as non-public investors may be inconsistent with their historic view of non-public and public arbitrators (i.e., classifying public arbitrators and non-public arbitrators based on their affiliations (or lack thereof) with the financial industry).[182] The Commission also recognizes, however, that the public interest would be served by addressing concerns of fairness and neutrality for all forum users.[183]

The Commission also recognizes the concerns of some commenters that the proposed rule change would require FINRA to reclassify some current public arbitrators as non-public arbitrators and that these reclassifications may temporarily reduce the number and quality of the

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180 See SIFMA November Letter and CSLC Letter; see also SIFMA July Letter, Aidikoff Letter, Bakhtiari July Letter, NASAA July Letter, and PIABA Letter.

181 See SIFMA November Letter and AIG Letter; see also SIFMA July Letter, FSI Letter, Berthel Letter, and Type A Form Letters; but see Friedman October Letter, UMIRC Letter, GSU Letter, CSLC Letter, NASAA November Letter, Second PIRC November Letter, NASAA July Letter, PIABA Letter, Stephens Letter, PIRC July Letter, Bacine Letter, Mass Letter, Hardiman Letter, and Friedman July Letter.

182 See, e.g., CSLC Letter, NASAA November Letter, NASAA July Letter, PIABA Letter, Stephens Letter, PIRC July Letter, Bacine Letter, Friedman July Letter, Hardiman Letter, and Mass Letter.

183 See FINRA September Letter, FINRA November Letter, and FINRA December Letter.

public arbitrator pool, particularly in light of the implementation of FINRA's all-public-panel rules.[184] The Commission, however, also recognizes FINRA's current and proposed future efforts to help ensure the sufficiency of the public arbitrator pool.[185]

Although FINRA stated that it currently anticipates having a sufficient number of public arbitrators to serve the immediate needs of forum users, it also acknowledged that the proposal may necessitate aggressive arbitrator recruitment.[186] Accordingly, FINRA stated that it is committed to help ensure that the forum has a sufficient number of public arbitrators to serve the needs of its forum members in each of its hearing locations.[187] For example, FINRA stated that it intends to conduct a detailed survey of its public arbitrators as part of an impact analysis to assist in allocating its resources to recruit public arbitrators in the areas most needed.[188] In addition, FINRA stated that it intends to devote its resources to recruiting arbitrators.[189]

Furthermore, FINRA stated that it has taken steps to enhance arbitrator retention. For example, FINRA stated that it has implemented a new rule to increase the amount of honoraria paid to its arbitrators.[190] In addition, FINRA stated that it intends to increase the amount of

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184 See, e.g., Bender Letter, PIRC First November Letter, GSU Letter, SAC October Letter, SAC July Letter, and NASAA July Letter.

185 See FINRA November Letter and FINRA December Letter.

186 See FINRA November Letter and FINRA December Letter.

187 See FINRA November Letter and FINRA December Letter.

188 See FINRA September Letter and FINRA December Letter.

189 See FINRA November Letter and FINRA December Letter.

190 See supra note 125.

honoraria paid to arbitrators when a party or parties postpone or cancel hearing sessions on short notice.[191]

While FINRA acknowledges that the proposed rule change will necessitate aggressive arbitrator recruitment to help ensure that its arbitration forum will continue to have sufficient public arbitrators to prevent delays in all hearing locations,[192] the Commission preliminarily believes that FINRA's plan to mitigate such delays is appropriate, particularly in light of the primary objective of the proposal – improving the perceived neutrality of its arbitrators and integrity of its arbitration forum.

In sum, the Commission believes that the proposed rule change would help address forum users' perceptions of neutrality in, and maintain the integrity of, the arbitration forum. In addition, the Commission believes the potential negative effects (in particular, a temporary decline in the number of available public arbitrators) will be mitigated by FINRA's proposed recruitment and retention of public arbitrators.

The proposed rule change would also: (1) extend the cooling off period for Industry Affiliates and Investor Advocates to five years, and (2) use professional time to quantify professional work when determining whether a person qualifies as an Industry Affiliate or Investor Advocate. Although some commenters suggested alternatives, such as proportional cooling off periods or using revenue, instead of professional time, to quantify professional work,

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191 See, e.g., FINRA December Letter; see also Exchange Act Release No. 74289 (Feb. 18, 2015), 80 FR 9773 (Feb. 24, 2015) (Notice of Filing of a Proposed Rule Change to Amend the Codes of Arbitration Procedure to Increase the Late Cancellation Fee) (FINRA proposed rule change to amend Rules 12214 and 12601 of the Customer Code and Rules 13214 and 13601 of the Industry Code to require, among other things, 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).

192 See FINRA November Letter.

FINRA stated its belief that a bright-line test is more workable and eases administrative burdens while addressing concerns about potential or perceived bias in the forum.

In addition to the amendments discussed above, the proposed rule change would make several additional changes to the Codes. For instance, the proposal would (1) add new categories of financial industry personnel who would be classified as non-public arbitrators, in particular persons associated with, including registered through, a mutual fund or hedge fund and persons associated with, including registered through, an investment adviser; (2) reduce from 20 to 15, the number of years a person must work over the course of his or her career in specified capacities in order to be permanently classified as a non-public arbitrator; and (3) redefine the definition of "immediate family member" as well as add a two year cooling off period for individuals whose immediate family members engage in specified activities that disqualify them from serving on the public arbitrator roster.

The Commission also recognizes some of the other concerns raised by commenters regarding the process FINRA used for proposing this rule. Some commenters expressed concern that FINRA did not perform a cost-benefit analysis prior to proposing the rule change.[193] Other commenters recommended that FINRA submit the proposal to its Arbitration Task Force prior to proposing it.[194] In response, FINRA identified the process it took in developing and considering the proposal, including consultation with its NAMC, interested groups, and other forum users; stated that additional consideration by the Arbitration Task Force is not precluded; and stated its intent to perform future cost-benefit analysis to prevent burdening its arbitrators prior to the

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193 See Friedman October Letter, PIRC First November Letter, and SAC October Letter; see also SAC July Letter and Friedman July Letter.

194 See Friedman October Letter and SAC October Letter; see also Friedman July Letter.

effectiveness of the proposed new rule.[195] In sum, the Commission believes that FINRA gave due consideration to the proposal and met the requirements of the Exchange Act. However, the Commission will be interested in the results of FINRA's future cost-benefit analysis and the staff will monitor the consequences of approval of the proposed rule change.

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

V. Conclusion

IT IS THEREFORE ORDERED pursuant to section 19(b)(2) of the Act[196] that the proposed rule change (SR-FINRA-2014-028) be and hereby is approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[197]

Jill M. Peterson,
Assistant Secretary.

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195 See FINRA September Letter, FINRA November Letter, and FINRA December Letter.

196 15 U.S.C. 78s(b)(2).

197 17 CFR 200.30-3(a)(12).