SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-58004; File No. SR-FINRA-2008-009)

June 23, 2008

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Order Approving Proposed Rule Change to the Code of Arbitration Procedure for Customer Disputes and the Code of Arbitration Procedure for Industry Disputes to Amend the Chairperson Eligibility Requirements

I. Introduction

On March 12, 2008, the Financial Industry Regulatory Authority, Inc. ("FINRA") (f/k/a National Association of Securities Dealers, Inc. ("NASD")) 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 relating to amendments to NASD Rule 12400(c) of the Code of Arbitration Procedure for Customer Disputes ("Customer Code") and NASD Rule 13400(c) of the Code of Arbitration Procedure for Industry Disputes ("Industry Code"). The proposed rule change was published for comment in the Federal Register on March 25, 2008.[3] The Commission received five comment letters in response to the proposed rule change.[4] This order approves the proposed rule change.

---

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

2 17 CFR 240.19b-4.

3 See Securities Exchange Act Release No. 34-57529 (March 19, 2008); 73 FR 15817 (Mar. 25, 2008).

4 See letter from Scot D. Bernstein, dated April 4, 2008 ("Bernstein letter"); letter from William A. Jacobson, Esq., Associate Clinical Professor, Director, Securities Law Clinic, Cornell Law School, dated April 15, 2008 ("Cornell letter"); letter from Lawrence S. Schultz, President, Public Investors Arbitration Association, dated April 16, 2008 ("PIABA letter"); letter from Karen Lockwood, dated May 12, 2008 ("Lockwood letter"); and letter from Barry D. Estell, Esquire, dated May 22, 2008 ("Estell letter").

II. Description of the Proposed Rule Change

The proposed rule change amends the chairperson eligibility requirements under Rule 12400(c) of the Customer Code and Rule 13400(c) of the Industry Code.

On January 24, 2007, the SEC approved the Customer and Industry Codes (collectively referred to as "Codes").[5] The Codes reorganized the dispute resolution rules into separate procedural codes, simplified the language of the old NASD Code of Arbitration Procedure, codified current practices, and implemented several substantive changes. One such substantive change involved improving the arbitrator selection process by creating and maintaining a new roster of arbitrators who are qualified to serve as chairpersons.

Under the Codes, arbitrators are eligible for the chairperson roster if they have completed chairperson training provided by FINRA[6] or have substantially equivalent training or experience, and satisfy one of two remaining requirements of the rule.[7] In the rule filing proposing this change, FINRA explained that "substantially equivalent training or experience would include service as a judge or administrative hearing officer, chairperson training offered by another recognized dispute resolution forum, or the like. Decisions regarding whether particular training or experience other than FINRA chairperson training would qualify under this provision would be in the sole discretion of the Director."[8] In referring to the "substantially equivalent training or experience" criterion (hereinafter, "substantially

---

5 See Securities Exchange Act Release No. 55158 (January 24, 2007); 72 FR 4574 (January 31, 2007) (File Nos. SR-NASD-2003-158 and SR-NASD-2004-011). The new Codes became effective on April 16, 2007.

6 Although some of the events referenced in this rule filing occurred prior to the formation of FINRA, the rule filing refers to FINRA throughout for simplicity.

7 Rule 12400(c) of the Customer Code and Rule 13400(c) of the Industry Code.

8 See Securities Exchange Act Release No. 51856 (June 15, 2005); 70 FR 36442, at 36446 (June 23, 2005).

equivalent"), the proposal also stated that FINRA believed that the proposal would allow arbitrators of all professional backgrounds to qualify as chairpersons.[9] FINRA believed that this criterion would help ensure that the forum could meet the demands of the Codes concerning the new chairperson roster, while allowing FINRA to continue to administer effectively the arbitrator selection process.

In the year since the Codes were approved, FINRA has determined that the "substantially equivalent" criterion has not been essential to creating and maintaining the chairperson roster, and therefore proposed to remove this criterion from the rule. FINRA notes that all arbitrators currently coded as chairpersons have completed the FINRA Chairperson Training course (chair training),[10] and the chair training has never been waived for an arbitrator claiming to satisfy the "substantially equivalent" criterion. FINRA believes that all arbitrators wishing to serve as chairpersons would benefit from the information contained in the chair training, which instructs arbitrators on the added responsibilities of arbitrators assuming the essential role of chairperson in the FINRA forum. Moreover, FINRA believes that removing the "substantially equivalent" criterion would make the chairperson eligibility standards more objective and uniform, thereby eliminating any perception that large numbers of arbitrators may be added to the chairperson roster without the benefit of the chair training.

---

9 Id.

10 The online Chairperson training course costs $50 and is available at http://www.finra.org/ArbitrationMediation/ResourcesforArbitratorsandMediators/ArbitratorTraining/ArbitratorTrainingPrograms/index.htm (last visited March 5, 2008).

III. Comment Letters

The Commission received five comment letters on the proposal.[11] Three commenters opposed the proposal;[12] one commenter urged the Commission to postpone taking final action on the proposed rule change pending further study;[13] and one commenter offered no opinion on the proposal.[14]

Two commenters argued that the amendments would further reduce the potential size of FINRA's pool of arbitrators who could be eligible to serve as chair by removing the "substantially equivalent" criterion from the rule.[15]

In a letter to the Commission, FINRA responded to these comments, stating that the proposal will not narrow the pool of arbitrators who could be eligible to serve as chair.[16] FINRA explained that, in the year since the Codes were approved, the substantially equivalent criterion has proved irrelevant to creating and maintaining the chairperson roster.[17] Further, FINRA explained that all arbitrators currently coded as chairpersons have completed the FINRA Chairperson Training course (chair training) and that FINRA has never waived the chair training for an arbitrator under the substantially equivalent criterion.[18]

---

11 See supra, footnote 3.

12 Bernstein, PIABA and Estell letters.

13 Cornell letter.

14 Lockwood letter.

15 PIABA and Estell letters.

16 See letter from Mignon McLemore, Assistant Chief Counsel, FINRA Dispute Resolution, dated June 2, 2008 ("FINRA letter").

17 FINRA letter.

18 Id.

Finally, FINRA suggested that this criterion has had no impact on its ability to maintain or expand the chairperson roster, and is therefore not necessary.[19]

Three commenters contended that by removing the substantially equivalent criterion, FINRA would be, in effect, implementing a mandatory arbitrator training requirement, which would give FINRA undue control over the arbitrators who may serve as chairs.[20]

FINRA responded that the proposal would, instead, result in less staff discretion because staff would not be assessing the arbitrator's prior experience or training to determine whether it was substantially equivalent to FINRA chair training.[21] Under the proposal, arbitrators would be required to take FINRA's online chair training to become chair eligible. FINRA indicated that this requirement (which is easily measured) would make chair eligibility determinations more objective, because staff would not have to decide whether an arbitrator's experience meets the substantially equivalent threshold.[22] FINRA stated that it believes the proposed amendments to the chair eligibility standards are reasonable and, along with the rule's other criteria, will provide investors with access to well-trained and well-qualified arbitrators.[23]

One commenter suggested that chair training should not be a prerequisite to appointment as chair.[24] Rather, the commenter suggested that FINRA could require that

---

19 Id.

20 Bernstein, PIABA and Estell letters.

21 FINRA letter.

22 Id.

23 Id.

24 Cornell letter at footnote 2.

arbitrators, appointed as chair, complete the training prior to the initial pre-hearing conference (IPHC).[25]

FINRA responded by stating that it has considered this suggestion, but concluded that it would be unworkable in its forum.[26] FINRA pointed out that there could be instances in which an arbitrator is appointed as chair, but does not want to serve as the chair, refuses to take the chair training, or delays taking the training and does not complete it by the time of the IPHC.[27] In such instances, FINRA explained, the case would be delayed while either the arbitrator is removed and another is appointed, or the IPHC is re-scheduled to give the arbitrator additional time to take the training.[28] FINRA also stated that this suggestion would create a significant administrative burden on staff, as staff would be required to monitor continuously the arbitrators' training reports to ensure that they have completed the chair training prior to IPHCs.[29] For these reasons, FINRA declined to amend the proposal to implement this suggestion.[30]

One commenter requested that FINRA make available arbitrator selection records, beyond information publicly available from the Arbitration Awards Online database, so that it could be analyzed to determine whether arbitrators who award punitive or large compensatory awards are appointed to cases with less frequency due to strikes from industry

---

25 Cornell letter. See also FINRA letter, footnote 10, stating that "a pre-hearing conference is a hearing session that takes place before the hearing on the merits. Rule 12100(t) of the Customer Code and Rule 13100(t) of the Industry Code."

26 FINRA letter.

27 Id.

28 Id.

29 Id.

30 Id.

parties, and whether the fragmentation of the random selection process through a chair-qualified slot exacerbates the problem.[31]

FINRA responded that its arbitrator selection records are proprietary and confidential.[32] FINRA explained, that the arbitrator selection records are generated during the resolution of a private matter between parties and contain the parties' confidential information, such as their striking and ranking choices.[33] Further, FINRA stated that it does not make this information available to the public because it could inhibit the parties' decisions during the arbitration process, which would compromise the integrity of the arbitration process.[34] For these reasons, FINRA declined to make this information available.[35]

Finally, four commenters objected to the existence of the separate chair roster.[36] FINRA stated that it is not proposing to amend the structure of its arbitrator rosters in this rule filing.[37] Further, FINRA noted that these same concerns were addressed by FINRA in connection with the proposal and adoption of the Codes,[38] and the changes to the arbitrator

---

31 Cornell letter.

32 FINRA letter.

33 Id.

34 Id.

35 Id.

36 Bernstein, Cornell, PIABA, and Estell letters.

37 FINRA letter.

38 Id. citing Response to Comments and Amendment No. 5, May 4, 2006 (File No. SR-NASD-2003-158), at 21-22; see also Response to Comments and Partial Amendment 7, August 15, 2006 (File No. SR-NASD-2003-158), at 8.

rosters were approved by the SEC.[39] FINRA stated that these comments are, therefore, outside the scope of the rule filing.[40]

IV. Discussion and Findings

After careful review, the Commission finds that the proposed rule change is consistent with the requirements of the Act, and the rules and regulations thereunder that are applicable to a national securities association.[41] In particular, the Commission believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,[42] because it would enhance the fairness and neutrality of FINRA's arbitration forum by making the chairperson eligibility rules more objective and uniform.

---

39 FINRA letter.

40 Id.

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

42 15 U.S.C. 78o-3(b)(6).

V. Conclusions

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,[43] that the proposed rule change (SR-FINRA-2008-009) be, and hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[44]

Florence E. Harmon
Acting Secretary

---

43 15 U.S.C. 78s(b)(2).

44 17 CFR 200.30-3(a)(12).