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Invested in America

November 6, 2014

Via E-Mail to rule-comments@sec.gov

Brent J. Fields
Secretary, Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: File No. SR-FINRA-2014-028
SIFMA supplemental comment on FINRA's proposed rule change re: the definitions of public and non-public arbitrator (the **"Proposal"**)[1]

Dear Mr. Fields:

The Securities Industry and Financial Markets Association (**"SIFMA"**)[2] appreciates the opportunity to further comment on the Proposal. In its recent Order Instituting Proceedings,[3] the Securities and Exchange Commission (**"SEC"**) invited comment on whether FINRA's Proposal is consistent with Sections 15A(b)(6) and 15A(b)(9) of the Securities Exchange Act of 1934 (the **"Act"**).

Section 15A(b)(6) requires that FINRA rules be designed to prevent fraud, promote just and equitable principles, and protect investors and the public interest. Section 15A(b)(9) requires that FINRA rules not impose unnecessary or inappropriate burdens on competition.

For all the reasons stated below, SIFMA strongly believes that the Proposal is in fact consistent with the Act, and the rules and regulations thereunder, because it appropriately and necessarily addresses the interests of *both* claimants and respondents in ensuring the neutrality of FINRA arbitrators, and thereby improving the fairness and perceptions of fairness of FINRA's dispute resolution forum.

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[1] SEC Release No. 34-72491; File No. SR-FINRA-2014-028, *Proposed Rule Change Relating to Revisions to the Definitions of Non-Public Arbitrator and Public Arbitrator* (June 27, 2014), available at http://www.sec.gov/rules/sro/finra/2014/34-72491.pdf.

[2] SIFMA brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association. For more information, visit www.sifma.org.

[3] SEC Release No. 34-73277; File No. SR-FINRA-2014-028, *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* (Oct. 1, 2014), available at http://www.sec.gov/rules/sro/finra/2014/34-73277.pdf.

The Proposal is intended to enhance arbitrator neutrality, which underpins the integrity of the arbitration system.

As we explained in our initial comment letter,[4] the stated purpose of the Proposal is to help ensure arbitrator neutrality in the public arbitrator pool. This issue is especially critical today, given that claimants now have the right to select an all-public arbitration panel under FINRA rules.[5] We believe that arbitrator neutrality helps contribute to fair case outcomes and to the parties' perceptions of fairness about the forum. Thus, the pursuit of arbitrator neutrality underpins the integrity of the entire securities arbitration system.

Arbitrator neutrality can be effectively achieved by eliminating potential bias from, and perceptions of bias about, the public arbitrator pool. Bias, of course, can run in either direction. The Proposal recognizes this reality and appropriately and fairly addresses both sides of the equation. The Proposal excises both industry-side and investor side prospective bias from the public pool, as follows:

- Industry-side prospective bias. "[P]ersons who worked in the financial industry for any duration during their careers would always be classified as non-public arbitrators."

- Investor-side prospective bias. "[P]ersons who represent *investors* or the financial industry as a significant part of their business would also be classified as non-public, but could become public arbitrators after a cooling-off period." (emphasis added).

Arbitrator neutrality is achievable only by addressing *both* industry and investor bias.

The Proposal's industry-side provision addresses the claim of plaintiffs' lawyers that some arbitrators presently classified as public have past ties to the industry and thus, could show bias in favor of the industry. While there is no evidence of actual industry-side bias, there is an argument for the potential for bias and a perception of bias. Investor claimants have the right to substantive due process in FINRA's arbitration forum, which includes the right to fair and unbiased adjudicators. Even if there is no actual bias, investor protection consideration generally support FINRA's Proposal to remove even the potential for, and perception of, industry-side bias.

Likewise, the Proposal's investor-side provision addresses the claim of securities firms, registered representatives and others that some arbitrators presently classified as public make their living representing claimants in, or in connection with, FINRA arbitrations and thus, could show bias against the industry. Such arbitrators have a current and/or future pecuniary interest in siding with claimants and contributing to claimant win rates and recoveries. Yet, securities firms and registered representatives have the *same* due process rights as claimants to fair and unbiased arbitrators. Thus,

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[4] SIFMA comment letter to SEC re: File No. SR-FINRA-2014-028 (July 24, 2014), available at: http://www.sec.gov/comments/sr-finra-2014-028/finra2014028-13.pdf.

[5] See FINRA summary of the all-public panel rules, available at: http://www.finra.org/ArbitrationAndMediation/Arbitration/Rules/NoticestoArbitratorsParties/P123997.

FINRA's Proposal to remove the potential for, and perception of, investor-side bias is likewise in the public interest and promotes the integrity of the forum.

The reasons and rationale for eliminating arbitrator bias on both sides of the aisle are identical. There is no basis for, and it would be inappropriate to, differentiate between the due process protections relating to arbitrator bias that are afforded to claimants versus respondents in FINRA's arbitration forum. The federal securities laws likewise impose an obligation on securities regulators to ensure that FINRA rules do not permit "unfair discrimination between customers, issuers, brokers, or dealers."[6]

This is especially true with respect to individuals. For example, FINRA currently oversees approximately 634,000 individual registered representatives.[7] These hundreds of thousands of individuals face potentially significant reputational and career damage, economic loss, and perhaps the loss of their very livelihood, in the aftermath of an arbitration proceeding. Consequently, these individuals often have as much, if not more, at stake as the claimant who brought the dispute.

Thus, when these individuals sign their brokerage license application,[8] which compels them to arbitrate any disputes with their customers under FINRA arbitration rules,[9] they reasonably expect that adequate due process protections will be afforded to them under the rules so that they may properly defend themselves. Under the current system, where these individuals can be forced to face an all-public panel, such protections should provide for, as does the Proposal, the removal from the public pool of arbitrators who make their living from investor claimants, given that such arbitrators carry a significant and unnecessary risk of investor-side bias, and also contribute to perceptions of unfairness of the forum by respondents and others.

None of the arguments against removing investor-side bias are valid, persuasive or outweighed by the forum's compelling interest in arbitrator neutrality.

You cannot pick and choose which arbitrator biases should be cut from, and which should remain in, the public arbitrator pool without completely undermining the fairness and integrity of the dispute resolution forum. Yet, that is precisely what some commenters, like PIABA, suggest. They want to essentially 'rig the jury' by removing alleged industry-side bias, while retaining potential investor-side bias in the public pool, thereby tilting the odds in their favor.

Moreover, the rationales provided by these commenters for doing so are flimsy, and offer nothing that would countervail the blow to the fairness and integrity of the FINRA forum that would be

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[6] 15 U.S.C. § 78o-3(b)(6).

[7] *See About FINRA*, available at http://www.finra.org/AboutFINRA/index.htm.

[8] Form U4, Uniform Application for Securities Industry Registration, available at http://www.finra.org/web/groups/industry/@ip/@comp/@regis/documents/appsupportdocs/p015112.pdf.

[9] *Id.* at p. 15.

dealt by a "half-neutral" public arbitrator pool. Following is a review and rebuttal of the rationales offered by PIABA and others:

- *Rationale* – The distinction between public and non-public arbitrators has always been based on whether the arbitrator has industry experience. We should keep this distinction.

    - *Rebuttal* – The distinction developed because FINRA rules used to require the presence of an industry arbitrator on the panel, who was drawn from the non-public pool. With the advent of the all-public panel rule, and the necessity to ensure arbitrator neutrality within the public pool, based on considerations of due process, fundamental fairness and the integrity of the forum, the historical distinction must now yield to FINRA's enhancements to arbitrator standards and the selection process.

- *Rationale* – Since U.S. courts, the AAA and the general public view professionals who represent investors to be public arbitrators, it would create confusion to change the status quo.

    - *Rebuttal* – As stated above, rule changes to enhance arbitrator standards and the selection process will necessarily result in changes to old ways. Transparency and publicly available information about these changes will avoid confusion and ease the transition to new, higher standards. Moreover, third parties don't necessarily need to be versed in FINRA arbitration pool composition, as long as the parties to the forum understand the relevant rules and procedures.

- *Rationale* – FINRA has no evidence that persons who represent investors are in fact biased against the industry.

    - *Rebuttal* – Likewise, FINRA has no evidence that persons with *industry* experience are in fact biased against investors. But that's not the point. The potential for bias, and perceptions of bias, are equally important factors to address to ensure that participants in and observers of the forum perceive it to be fair. Moreover, the potential for investor-side bias is fairly significant. As one commenter noted, "lawyers who represent investors … work for … members of the public at large who assert claims against the industry." Incredibly, that was an argument *in favor* of retaining claimants' lawyers in the public arbitrator pool. Not surprisingly, the securities industry has little faith that it will get a fair hearing from this group of people who make their livings from investor claimants.

- *Rationale* – The Proposal will result in a drastic reduction in the pool of public arbitrators that would be insufficient to meet future demand. FINRA should conduct a detailed cost-benefit analysis to quantify this.

    - *Rebuttal* – FINRA has represented that the Proposal will not affect a significant number of arbitrators.[10] Moreover, FINRA maintains an aggressive arbitrator recruiting

[10] FINRA response to comments (Sep. 30, 2014), at pp.5-7, available at: http://www.finra.org/Industry/Regulation/RuleFilings/2014/P532203.

campaign which would likely backfill in a timely manner any shortfall in the roster.[11] Finally, even if the Proposal does have some small affect in some small number of jurisdictions on arbitration panels, it's a small price to pay for arbitrator neutrality.

The Proposal, as drafted, is consistent with the federal securities laws.

As drafted, the Proposal is consistent with the Act, and the rules and regulations thereunder. The Proposal is consistent with Sections 15A(b)(6) and 15A(b)(9) of the Act *only* because it appropriately and necessarily addresses *both* industry-side and investor-side prospective arbitrator bias. Both provisions are necessary:

- in the interests of fairness, perceptions of fairness, and arbitrator neutrality for all parties;
- to ensure the regulatory integrity of the Proposal; and
- to ensure the fairness, neutrality, and integrity of the FINRA arbitration forum.

If the investor-side bias provision were stricken from the Proposal, as PIABA and others suggest, then the Proposal would no longer satisfy the compelling public interest in maintaining the integrity of the FINRA arbitration forum by ensuring the fairness and neutrality of the public arbitrator pool and thus, would no longer be consistent with the requirements of the Act.

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If you have any questions, or would like to further discuss our comments, please contact the undersigned at 202.962.7382 or kcarroll@sifma.org.

Sincerely,

Kevin M. Carroll

Kevin M. Carroll
Managing Director and
Associate General Counsel

cc: ***via e-mail to*:**
Robert Colby, Chief Legal Officer, FINRA
Linda D. Fienberg, President, FINRA Dispute Resolution
Kenneth L. Andrichik, Senior Vice President, FINRA Dispute Resolution
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[11] See, e.g., FINRA Statement on PIABA's Arbitrator Report (Oct. 7, 2014), available at: http://www.finra.org/Newsroom/NewsReleases/2014/P601075.