## SECURITIES AND EXCHANGE COMMISSION

**[Release No. 34–78836; File No. SR–FINRA–2016–022]**

## Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Order Approving Proposed Rule Change To Amend Rule 12403 (Cases With Three Arbitrators) of the Code of Arbitration Procedure for Customer Disputes Relating to the Panel Selection Process in Arbitration

September 14, 2016.

### I. Introduction

On July 1, 2016, Financial Industry Regulatory Authority, Inc. (''FINRA'') filed with the Securities and Exchange Commission (''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 12403 (Cases with Three Arbitrators) of the Code of Arbitration Procedure for Customer Disputes (''Customer Code'') relating to the panel selection process in arbitration. The proposal was published for comment in the **Federal Register** on July 15, 2016.[3] The comment period closed on August 5, 2016. The Commission received eight (8) comment letters on the proposal.[4] On August 12, 2016, FINRA extended the time, until October 13, 2016, for Commission action on the proposal.[5] FINRA responded to the comment letters on August 18, 2016.[6] 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. 78279 (July 11, 2016), 81 FR 46139 (July 15, 2016) (File No. SR–FINRA–2016–022) (''Notice'').

[4] *See* Letter from Steven B. Caruso, Maddox Hargett & Caruso, P.C., dated July 14, 2016 (''Caruso Letter''); Letter from Julius Z. Frager, J.D., M.B.A., dated July 24, 2016 (''Frager Letter''); Letter from Ryan K. Bakhtiari, Aidikoff, Uhl & Bakhtiari, dated July 26, 2016 (''Bakhtiari Letter''); Letter from Philip M. Aidikoff, Aidikoff, Uhl & Bakhtiari, dated July 27, 2016 (''Aidikoff Letter''); Letter from Hugh D. Berkson, President, Public Investors Arbitration Bar Association (''PIABA''), dated August 4, 2016 (''PIABA Letter''); Letter from David T. Bellaire, Esq., Executive Vice President and General Counsel, Financial Services Institute (''FSI''), dated August 4, 2016 (''FSI Letter''); Letter from Tyler M. Fiorillo, Student Intern, and Elissa Germaine, Supervising Attorney, Pace Investor Rights Clinic (''PIRC''), dated August 5, 2016 (''PIRC Letter''), and Letter from Glenn S. Gitomer, Chair of Litigation Practice Group, McCausland Keen Buckman, dated August 5, 2016 (''Gitomer Letter'').

[5] *See* Letter from Margo A. Hassan, Associate Chief Counsel, Office of Dispute Resolution, FINRA, to Lourdes Gonzalez, Assistant Chief Counsel—Sales Practices, Division of Trading and Markets, Securities and Exchange Commission, dated August 12, 2016.

[6] *See* Letter from Margo A. Hassan, Associate Chief Counsel, Office of Dispute Resolution, FINRA, to Brent J. Fields, Secretary, Securities and Exchange Commission, dated August 18, 2016 (''FINRA Response Letter'').

### II. Description of the Proposed Rule Change

FINRA allows parties to participate in selecting the arbitrators who serve on their cases. Parties select their arbitration panel from computer generated lists of arbitrators that FINRA sends them. Under current FINRA Rule 12403(a), in customer cases with three arbitrators,[7] FINRA sends the parties three lists: a list of ten (10) chair-qualified public arbitrators, a list of ten (10) public arbitrators, and a list of ten (10) non-public arbitrators.[8] The parties select their panel through a process of striking and ranking the arbitrators on the lists.[9] Under current Rule 12403(c)(2), each party is allowed to strike up to four (4) arbitrators on the chair-qualified public list and four (4) arbitrators on the public list. At least six (6) names must remain on each list. However, Rule 12403(c)(1) provides for unlimited strikes on the non-public list so that any party may select a panel of all public arbitrators in a customer case.[10]

Under the Customer Code, when parties collectively strike all of the non-public arbitrators from the list, FINRA fills all three panel seats from the two 10-person lists of public arbitrators.[11] When parties collectively strike all of the arbitrators appearing on the non-public list, FINRA returns to the public list to select the next highest ranked available arbitrator to fill the seat.[12] If no public arbitrators remain available to fill the vacancy, FINRA returns to the chair-qualified public list to select the next highest ranked public chair.[13] In doing so, there is a likelihood that FINRA will appoint an arbitrator who the parties accepted, but ranked lower on the public or chair-qualified public lists.[14] FINRA believes that where parties collectively strike all the non-public arbitrators (*i.e.,* where they desire an all-public panel), the parties should have greater choice of public arbitrators.[15]

Consequently, FINRA is proposing to amend Rule 12403(a)(1) to increase the number of arbitrators on the public arbitrator list FINRA sends the parties from ten (10) to fifteen (15). FINRA believes this amendment would provide the parties with greater choice of public arbitrators during the panel selection process.[16]

FINRA is also proposing to amend Rule 12403(c)(2) to increase the number of strikes to the public arbitrator list from four (4) to six (6), so that the proportion of strikes is the same under the amended rule as it is under the current rule. FINRA believes that increasing the number of strikes the parties can make to the newly increased public list will improve the likelihood that the parties' preferred arbitrators will be appointed to the panel.[17]

[7] *See* FINRA Rule 12401, which provides that if the amount of a claim is more than $100,000, exclusive of interest and expenses, or is unspecified, or if the claim does not request money damages, the panel will consist of three arbitrators, unless the parties agree in writing to one arbitrator.

[8] Public arbitrators do not have an affiliation with the financial industry. The non-public arbitrator roster includes individuals who: (1) Are employed in the financial industry; (2) provide services to industry entities and their employees; or (3) devote a significant part of their business to representing or providing services to parties in disputes concerning investments or employment relationships. See Notice, 81 FR at 46139; *see also* Securities Exchange Act Release No 74383 (Feb. 26, 2014), 80 FR 11695 (Mar. 4, 2014) (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).

[9] *See* FINRA Rule 12403(c).

[10] *See* Notice, 81 FR at 46139.

[11] *See* FINRA Rule 12403(d), (e).

[12] *See* FINRA Rule 12403(e).

[13] *Id.*

[14] *See* Notice, 81 FR at 46139.

[15] *Id.*

[16] *Id.* at 46139–40.

[17] *Id.* at 46140

### III. Summary of Comments and FINRA's Response

The Commission received eight (8) comment letters on the proposed rule change,[18] and a response letter from FINRA.[19] As discussed in more detail below, six (6) commenters expressed support for the proposal as filed,[20] one (1) commenter generally supported the proposal while expressing additional concerns,[21] and one (1) commenter proposed an alternative approach for panel selection in customer cases.[22] The sections below outline the support, concerns raised and alternatives proposed by commenters, as well as FINRA's response.

#### *Support for the Proposal*

Six (6) commenters supported the proposed increase in the number of arbitrators on the public arbitrator list from ten (10) to fifteen (15), as well as the proportional increase from four (4) to six (6) strikes that parties may make to the public arbitrator list. These commenters stated, among other things, that the proposal would provide parties

[18] *See supra* note 4.

[19] *See supra* note 6.

[20] *See* Caruso Letter; Bakhtiari Letter; Aidikoff Letter; FSI Letter; PIRC Letter; Gitomer Letter.

[21] *See* PIABA Letter.

[22] *See* Frager Letter.

with a greater choice in the arbitrator selection process, increasing the likelihood that an arbitrator preferred by both parties would be appointed to the panel.[23] Consequently, these commenters generally believe that the proposed rule change ''is a fair, equitable and reasonable approach[,]'' [24] ''is an important step towards protecting the investing public[,]'' [25] ''will greatly enhance the fairness of the forum to both the investing public and FINRA members[,]'' [26] ''results in more equitable arbitration proceedings,'' [27] and ''benefits all parties, with a particularly positive impact on modest-means investors.'' [28]

*Additional Concerns*

One (1) commenter generally supported the proposal, but also expressed concerns about other aspects of the arbitrator selection process.[29] Specifically, this commenter believes that FINRA should address the shortage of local arbitrators by intensifying its efforts to recruit suitable local individuals to serve as public and chair-qualified arbitrators, particularly in locations with shallow arbitrator pools.[30] In addition, this commenter recommends that FINRA increase the transparency of its list-selection process.[31]

In response, FINRA stated that it believes this commenter's suggestions are outside the scope of the proposal.[32] Therefore, FINRA did not address them in its response.[33]

*Alternative Proposal*

One (1) commenter did not directly oppose the proposal but did recommend that FINRA adopt an alternative approach for panel selection in customer cases. Among other things, this commenter suggested that FINRA maintain the three current ten-person lists of non-public, chair-public and public arbitrators. Each party could strike all of the names on the non-public list, and four names on each public list. Each party would then submit to FINRA one combined list of ranked chair-public and public arbitrators. FINRA would appoint the highest ranked chair-qualified arbitrator as chair. If the parties collectively struck all of the non-public arbitrators, FINRA would then appoint two public arbitrators from those remaining on the parties' combined list (regardless of whether they are chair-qualified).[34] The commenter believes that this proposal would benefit parties to an arbitration because, among other things, they would not need to vet the proposed additional five public arbitrators.[35]

In its response, FINRA stated that forum users generally prefer greater choice during the arbitrator selection process.[36] FINRA also stated that unlike the commenter's suggestion, the proposed rule change would provide parties greater choice by adding five (5) public arbitrators to the panel selection process.[37] In addition, FINRA believes that the commenter's approach to panel selection would be complex and difficult for parties to navigate, especially parties or party representatives that do not use the forum on a regular basis.[38] Accordingly, FINRA did not amend the proposal to reflect the commenter's recommended amendments.

## IV. Discussion and Commission Findings

The Commission has carefully considered the proposal, the comments received, and FINRA's response to the comments. Based on its review of the record, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities association.[39] In particular, the Commission finds that the proposed rule change is consistent with Section 15A(b)(6) of the Act,[40] 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. FINRA believes, and the Commission agrees, that the proposed rule change would protect investors and the public interest by providing greater choice for parties in customer cases with three arbitrators during the panel selection process.

As discussed above, the proposal would amend Rule 12403(a)(1) to increase the number of arbitrators on the public arbitrator list that FINRA sends the parties from ten (10) to fifteen (15).[41] It would also amend Rule 12403(c)(2) to increase the number of strikes to the public arbitrator list from four (4) to six (6), so that the proportion of strikes is the same under the amended rule as it is under the current rule.[42]

The Commission has considered the eight (8) comment letters received on the proposed rule change,[43] along with FINRA's response to the comments.[44] The Commission notes that most of the commenters support the proposed rule change, expressing the belief that the proposal would increase parties' choice among public arbitrators during the arbitrator selection process,[45] and thereby benefit parties in arbitration and enhance the fairness of the forum.[46] However, the Commission also recognizes commenters' concerns and suggestions.[47]

While the Commission acknowledges that FINRA's proposed amendments to Rule 12403 might result in an increased burden in vetting additional arbitrators, the Commission agrees with FINRA that parties would benefit from having greater choice in selecting public arbitrators, and that the benefits of this greater choice would outweigh the cost of additional vetting.[48] The Commission additionally agrees with FINRA's assessment that the proposed alternative arbitrator selection process suggested by one commenter [49] would not provide the benefit of greater choice and would unnecessarily complicate the arbitrator selection process.[50]

In addition, the Commission agrees with FINRA's assessment that the ''shortage of local arbitrators'' and the transparency of FINRA's arbitrator list-selection process [51] are outside the scope of the proposal.[52]

For the reasons stated above, the Commission finds that the proposed rule change is consistent with the Act

[23] *See* Caruso Letter, Aidikoff Letter, FSI Letter, and PIRC Letter; *see also* Bakhtiari Letter, Gitmore Letter and PIABA Letter (stating that ''having the ability to consider more candidates helps both claimants and respondents.''

[24] *See* Caruso Letter; *see also* Aidikoff Letter and FSI Letter.

[25] *See* Bakhtiari Letter.

[26] *See* Gitomer Letter.

[27] *See* FSI Letter.

[28] *See* PIRC Letter.

[29] *See* PIABA Letter.

[30] *Id.*

[31] *Id.*

[32] *See* FINRA Response Letter.

[33] *Id.*

[34] *See* Frager Letter; *see also* FINRA Response Letter (describing the commenter's proposal).

[35] *See* Frager Letter.

[36] *See* FINRA Response Letter (stating that forum users have indicated that ''the benefits of additional choice outweigh the cost of vetting additional arbitrators'').

[37] *See* FINRA Response Letter.

[38] *Id.*

[39] In approving the proposed rule change, the Commission has also considered its impact on efficiency, competition, and capital formation. *See* 15 U.S.C. 78c(f).

[40] 15 U.S.C. 78o–3(b)(6).

[41] *See* Notice, 81 FR at 46139.

[42] *Id.*

[43] *See supra* note 4.

[44] *See supra* note 6.

[45] *See supra* note 23.

[46] *See supra* notes 24–28.

[47] *See* PIABA Letter and Frager Letter.

[48] *See* FINRA Response Letter.

[49] *See* Frager Letter.

[50] *See* FINRA Response Letter.

[51] *See* PIABA Letter.

[52] *See* FINRA Response Letter.

and the rules and regulations thereunder.

**V. Conclusion**

*It is therefore ordered,* pursuant to Section 19(b)(2) of the Act,[53] that the proposed rule change (SR–FINRA–2016–022) be, and hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[54]

**Robert W. Errett,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

**[Release No. 34–78838; File No. SR–BX–2016–050]**

## Self-Regulatory Organizations; NASDAQ BX, Inc.; Notice of Filing of Proposed Rule Change To Describe Changes to System Functionality Necessary To Implement the Tick Size Pilot Program

September 14, 2016.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (''Act''),[1] and Rule 19b–4 thereunder,[2] notice is hereby given that on September 7, 2016, NASDAQ BX, Inc. (''BX'' or ''Exchange'') filed with the Securities and Exchange Commission (''SEC'' or ''Commission'') the proposed rule change as described in Items I, II, and III, below, which Items have been prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

The Exchange proposes to adopt paragraph (d) to Exchange Rule 4770 to describe changes to System [3] functionality necessary to implement the Regulation NMS Plan to Implement a Tick Size Pilot Program (''Plan'').[4] The Exchange is also proposing amendments to Rule 4770(a) and (c) to clarify how the Trade-at exception may be satisfied.

The text of the proposed rule change is available on the Exchange's Web site at *http://nasdaqbx.cchwallstreet.com/,* at the principal office of the Exchange, and at the Commission's Public Reference Room.

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

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

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

1. Purpose

Background

On August 25, 2014, NYSE Group, Inc., on behalf of Bats BZX Exchange, Inc. (f/k/a BATS Exchange, Inc.), Bats BYX Exchange, Inc. (f/k/a BATS Y-Exchange, Inc.), Chicago Stock Exchange, Inc., EDGA Exchange, Inc., EDGX Exchange, Inc., the Exchange, Financial Industry Regulatory Authority, Inc. (''FINRA''), The NASDAQ Stock Market LLC, New York Stock Exchange LLC, NASDAQ PHLX LLC, NYSE Arca, Inc., and the NYSE MKT LLC, (collectively ''Participants''), filed the Plan with the Commission pursuant to Section 11A of the Act [5] and Rule 608 of Regulation NMS thereunder.[6] The Participants filed the Plan to comply with an order issued by the Commission on June 24, 2014 (the ''June 2014 Order'').[7] The Plan [8] was published for comment in the **Federal Register** on November 7, 2014,[9] and approved by the Commission, as modified, on May 6, 2015.[10]

The Plan is designed to allow the Commission, market participants, and the public to study and assess the impact of increment conventions on the liquidity and trading of the common stocks of small capitalization companies. The Commission plans to use the Tick Size Pilot Program to assess whether wider tick sizes enhance the market quality of Pilot Securities for the benefit of issuers and investors. Each Participant is required to comply with, and to enforce compliance by its members, as applicable, with the provisions of the Plan.

On October 9, 2015, the Operating Committee approved the Exchange's proposed rules as model Participant rules that would require compliance by a Participant's members with the provisions of the Plan, as applicable, and would establish written policies and procedures reasonably designed to comply with applicable quoting and trading requirements specified in the Plan.[11] As described more fully below, the proposed rules would require members to comply with the Plan and provide for the widening of quoting and trading increments for Pilot Securities, consistent with the Plan.

The Plan will include stocks of companies with $3 billion or less in market capitalization, an average daily trading volume of one million shares or less, and a volume weighted average price of at least $2.00 for every trading day. The Plan will consist of a control

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[53] 15 U.S.C. 78s(b)(2).

[54] 17 CFR 200.30–3(a)(12).

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

[2] 17 CFR 240.19b–4.

[3] The term ''System'' is defined as the automated system for order execution and trade reporting owned and operated by the Exchange. The System comprises: (1) A montage for Quotes and Orders, referred to herein as the ''Exchange Book,'' that collects and ranks all Quotes and Orders submitted by Participants; (2) an Order execution service that enables Participants to automatically execute transactions in System Securities; and provides Participants with sufficient monitoring and updating capability to participate in an automated execution environment; (3) a trade reporting service that submits ''locked-in'' trades for clearing to a registered clearing agency for clearance and settlement; transmits last-sale reports of transactions automatically to the national trade reporting system, if required, for dissemination to the public and industry; and provides participants with monitoring and risk management capabilities to facilitate participation in a ''locked-in'' trading environment; and (4) data feeds that can be used to display with attribution to Participants' MPIDs all Quotes and displayed Orders on both the bid and offer side of the market for all price levels then within the NASDAQ OMX BX Equities Market, and that disseminate such additional information about Quotes, Orders, and transactions within the System as shall be reflected in the Exchange Rules. *See* Rule 4701(a).

[4] *See* Securities Exchange Act Release No. 74892 (May 6, 2015), 80 FR 27513 (May 13, 2015) (''Approval Order'').

[5] 15 U.S.C. 78k–1.

[6] *See* Letter from Brendon J. Weiss, Vice President, Intercontinental Exchange, Inc., to Secretary, Commission, dated August 25, 2014.

[7] *See* Securities Exchange Act Release No. 72460 (June 24, 2014), 79 FR 36840 (June 30, 2014).

[8] Unless otherwise specified, capitalized terms used in this rule filing are based on the defined terms of the Plan.

[9] *See* Securities and Exchange Act Release No. 73511 (November 3, 2014), 79 FR 66423 (File No. 4–657) (Tick Plan Filing).

[10] *See* Tick Plan Approval Order, *supra* note 4. *See also* Securities Exchange Act Release No. 77277 (March 3, 2016), 81 FR 12162 (March 8, 2016) (File No. 4–657), which amended the Plan to add National Stock Exchange, Inc. as a Participant.

[11] The Operating Committee is required under Section III(C)(2) of the Plan to ''monitor the procedures established pursuant to the Plan and advise Participants with respect to any deficiencies, problems, or recommendations as the Operating Committee may deem appropriate.'' The Operating Committee is also required to ''establish specifications and procedures for the implementation and operation of the Plan that are consistent with the provisions of the Plan.''