

## Public Arbitrator Definition

### SEC Approves Amendments to Arbitration Codes to Revise the Definition of Public Arbitrator

Effective Date: July 1, 2013

#### Executive Summary

The SEC approved amendments to the definition of public arbitrator in the Customer and Industry Codes of Arbitration Procedure.<sup>1</sup> The amended definition excludes persons associated with a mutual fund or hedge fund from serving as public arbitrators and requires individuals to wait for two years after ending certain affiliations before FINRA may permit them to serve as public arbitrators.

The amendments are effective on July 1, 2013, and apply to all cases in which FINRA has not sent to the parties lists of chair-qualified public arbitrators and public arbitrators for arbitrator selection.

The text of the amendments is set forth in Attachment A.

Questions concerning this *Notice* should be directed to:

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- ▶ Margo A. Hassan, Assistant Chief Counsel, Dispute Resolution, at (212) 858-4481 or [margo.hassan@finra.org](mailto:margo.hassan@finra.org).

#### Background & Discussion

FINRA classifies arbitrators under the Customer and Industry Codes of Arbitration Procedure (Codes) as either “non-public” or “public.” Non-public arbitrators are affiliated with the securities industry either through their current or former employment in a securities business, or because they provide professional services to securities businesses. Public arbitrators do not have any significant affiliation with the securities industry; nor are they the spouses or immediate family members of an individual with a significant affiliation to the securities industry.

June 2013

#### Notice Type

- ▶ Rule Amendment

#### Suggested Routing

- ▶ Compliance
- ▶ Legal
- ▶ Registered Representatives

#### Key Topics

- ▶ Arbitration
- ▶ Codes of Arbitration Procedure
- ▶ Definition of Public Arbitrator

#### Referenced Rules & Notices

- ▶ Rule 12100
- ▶ Rule 13100

Investor representatives raised concerns that they do not perceive certain arbitrators on FINRA's public arbitrator roster as public because of their background or experience. To address this perception, FINRA amended Rules 12100(u)(3) and 13100(u)(3), which currently exclude investment advisers from serving as public arbitrators, to exclude also persons associated with, including registered through, a mutual fund or hedge fund. In addition, FINRA amended the public arbitrator definition to add a two-year "cooling off" period before FINRA may permit certain individuals to serve as public arbitrators.

Currently under the Codes, an individual may not serve as a public arbitrator if he or she is:

1. an investment adviser;
2. an attorney, accountant, or other professional whose firm derived 10 percent or more of its annual revenue in the past two years from certain financial industry entities;
3. an attorney, accountant or other professional whose firm derived \$50,000 or more in annual revenue in the past two years from professional services rendered to certain financial industry entities relating to any customer disputes concerning an investment account or transaction;
4. employed by, or is the spouse or an immediate family member of a person who is employed by, 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; or
5. a director or officer of, or is the spouse or an immediate family member of a person who is a director or officer of, 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.

However, if the individual ends the affiliation that was the basis for the exclusion from the public roster, the individual may begin immediately serving as a public arbitrator. FINRA amended Rules 12100(u) and 13100(u) to provide that a person whom FINRA would not designate as a public arbitrator because of an affiliation under subparagraphs (3)-(7) (the exclusions detailed above) shall not be designated as a public arbitrator for two calendar years after ending the affiliation.<sup>2</sup> As stated above, FINRA added persons associated with mutual funds and hedge funds to the exclusion noted in Rules 12100(u)(3) and 13100(u)(3). Therefore, the two-year cooling off period also applies to these individuals. FINRA believes that the amendments will improve its constituents' perception about the neutrality of the arbitrators on the public roster.

## Effective Date

The amendments are effective on July 1, 2013, and apply to all cases in which FINRA has not sent to the parties lists of chair-qualified public arbitrators and public arbitrators for arbitrator selection.

## Endnotes

1. See Securities Exchange Act Rel. No. 69297 (April 4, 2013), 78 Federal Register 21449 (April 10, 2013) (File No. SR-FINRA-2013-003).
2. FINRA will determine the cooling off period by making an individual wait for two full calendar years after the year in which the individual ended an affiliation. For example, if an arbitrator applicant left a firm that derived 10 percent or more of its annual revenue anytime in 2013, the applicant would be eligible to serve as a public arbitrator on January 1, 2016.

## ATTACHMENT A

New language is underlined.

### Code of Arbitration Procedure for Customer Disputes

#### 12100. Definitions

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##### **(u) Public Arbitrator**

The term “public arbitrator” means a person who is otherwise qualified to serve as an arbitrator and:

(1) is not engaged in the conduct or activities described in paragraphs (p)(1)–(4);

(2) was not engaged in the conduct or activities described in paragraphs (p)(1)–(4) for a total of 20 years or more;

(3) is not an investment adviser, or associated with, including registered through, a mutual fund or hedge fund;

(4) is not an attorney, accountant, or other professional whose firm derived 10 percent or more of its annual revenue in the past two years from any persons or entities listed in paragraphs (p)(1)–(4);

(5) is not an attorney, accountant, or other professional whose firm derived \$50,000 or more in annual revenue in the past two years from professional services rendered to any persons or entities listed in paragraph (p)(1) relating to any customer disputes concerning an investment account or transaction, including but not limited to, law firm fees, accounting firm fees, and consulting fees;

(6) is not employed by, and is not the spouse or an immediate family member of a person who is employed by, 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;

(7) is not a director or officer of, and is not the spouse or an immediate family member of a person who is a director or officer of, 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; and

(8) is not the spouse or an immediate family member of a person who is engaged in the conduct or activities described in paragraphs (p)(1)–(4). For purposes of this rule, the term immediate family member means:

- (A) a person’s parent, stepparent, child, or stepchild;
- (B) a member of a person’s household;
- (C) an individual to whom a person provides financial support of more than 50 percent of his or her annual income; or
- (D) a person who is claimed as a dependent for federal income tax purposes.

A person whom FINRA would not designate as a public arbitrator because of an affiliation under subparagraphs (3)-(7) shall not be designated as a public arbitrator for two calendar years after ending the affiliation.

For purposes of this rule, the term “revenue” shall not include mediation fees received by mediators who are also arbitrators, provided that the mediator acts in the capacity of a mediator and does not represent a party in the mediation.

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## Code of Arbitration Procedure for Industry Disputes

### 13100. Definitions

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The term “public arbitrator” means a person who is otherwise qualified to serve as an arbitrator and:

- (1) is not engaged in the conduct or activities described in paragraphs (p)(1)–(4);
- (2) was not engaged in the conduct or activities described in paragraphs (p)(1)–(4) for a total of 20 years or more;
- (3) is not an investment adviser, or associated with, including registered through, a mutual fund or hedge fund;

(4) is not an attorney, accountant, or other professional whose firm derived 10 percent or more of its annual revenue in the past two years from any persons or entities listed in paragraphs (p)(1)–(4);

(5) is not an attorney, accountant, or other professional whose firm derived \$50,000 or more in annual revenue in the past two years from professional services rendered to any persons or entities listed in paragraph (p)(1) relating to any customer disputes concerning an investment account or transaction, including but not limited to, law firm fees, accounting firm fees, and consulting fees;

(6) is not employed by, and is not the spouse or an immediate family member of a person who is employed by, 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;

(7) is not a director or officer of, and is not the spouse or an immediate family member of a person who is a director or officer of, 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; and

(8) is not the spouse or an immediate family member of a person who is engaged in the conduct or activities described in paragraphs (p)(1)–(4). For purposes of this rule, the term immediate family member means:

- (A) a person’s parent, stepparent, child, or stepchild;
- (B) a member of a person’s household;
- (C) an individual to whom a person provides financial support of more than 50 percent of his or her annual income; or
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