BDWEEK
Regulatory news and compliance best practices.
Issue Date: September 23, 2013

Pending change in arbitrator-selection process is likely to favor customers

The odds of your firm winning arbitrated disputes with customers probably will get tougher.

The SEC has approved a **FINRA-proposed rule change** that likely will lead to more arbitration panels that include no one with industry ties. Panels with such a composition ("all-public") tend to side with the customer more frequently than do standard arbitration panels composed of one industry (non-public) arbitrator and two non-industry (public) ones.

The change would involve arbitrations heard by three-person panels. Such panels generally deal with claims that exceed $100,000, although they're also used when the amount of the claim is unspecified or the claim doesn't request money damages.

Under the proposal, which the SEC approved last week, customers no longer would "elect" whether or not to have an all-public arbitration panel with the default being a panel with one industry and two public arbitrators if the customer fails make a choice.

Under the new plan, the standard panel would be three public arbitrators, although that wouldn't automatically rule out the presence of an industry arbitrator.

Each party would be given three lists - a list of chair-qualified public arbitrators, a list of public arbitrators, and a list of industry arbitrators. Any party could strike up to four of the names on the chairman list and the public arbitrator list, but also could strike all of the names on the industry list, a move that would result in an all-public panel.

FINRA says there are a number of reasons for making the change.

"First, having one panel composition method would simplify the arbitrator selection process for all parties and FINRA staff while leaving in place the method affirmatively chosen by customers in approximately three-quarters of customer cases," FINRA said in the proposal it submitted to the Commission in June.

"Second, it would ensure that every party has an opportunity to see the list of non-public arbitrators and rank or strike any or all of the arbitrators on the list. Third, the proposal would ensure that customers would not miss the opportunity to select an all-public panel because of the inherent complexity of the rule."

In the wake of accusations from investor advocates that FINRA's arbitration process was biased toward industry, the self-regulatory organization implemented the all-public option in February 2011.

FINRA noted that between February 1, 2011 and March 31, 2013, those customers who used the standard "majority public panel" option (one non-public and two public arbitrators) did so by default 77%

of the time as opposed to making an affirmative choice for it.

Even though those customers ended up using this option, they didn't indicate in their claims that they wanted this, and didn't respond to FINRA's follow-up letter telling them the all-public option was available.

In the same time period, according to FINRA, customers who selected the all-public option chose to strike all the non-public arbitrators in 66 percent of the cases.

During that time, *industry* parties sought panels that included non-public (industry) arbitrators in 97% of cases.

FINRA said it has been tracking the results of these two different kinds of panels and that during that time period, investors "prevailed" 49% of the time in cases decided by all-public panels and 34% of the time in cases decided by majority-public panels.

The proposal doesn't state whether "prevailed" means the investor received all of the restitution he or she sought, or some of it.

FINRA to reexamine definition of arbitrator

The **Financial Services Institute** (FSI) said it generally supports FINRA's proposal but that the regulator also should change the definition of "public" arbitrator to prohibit those slots from being occupied by lawyers who spend a significant amount of their time working on behalf of investors and claimants. The FSI noted that individuals with a recent history of representing firms are prohibited from being public arbitrators in the interest of fairness and, argues the FSI, the same concept should apply to lawyers who represent investors.

FINRA said in a letter responding to comments that it isn't proposing to change arbitrator definitions as part of this rule because that's outside the scope of this rulemaking. But it added that "FINRA staff is currently reviewing its non-public and public arbitrator definitions, including the concern raised in the FSI letter."

Some see flaw in ditching option for standard panel

A number of investor advocates submitted comments supporting FINRA's proposal, and a letter from **Pace University** School of Law's Investor Rights Clinic was in that fold. But the letter from Pace also said the proposal is flawed.

J**ill Gross**, the director of the clinic, wrote that under the proposal, investors who want a non-public (industry) arbitrator on their panels might not be able to get one if, for example, the industry party strikes all the non-public arbitrators' names. Therefore, she suggested, FINRA should allow investors to elect to use a "majority-public" panel (one non-public and two public arbitrators), while having the default be the all-public panel.

Similar points were made in a letter submitted by **George Friedman**, immediate past FINRA Director of Arbitration. He wrote that "sometimes there are customers or attorneys who want a non-public arbitrator on their bad broker case because such arbitrators know bad broker conduct when they see it. This is a right they will lose under the proposed rule."