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November 3, 2015

Via email to rule-comments@sec.gov
Brent J. Fields, Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: File Number SR-FINRA-2015-034 - Proposed Rule Change to Merge FINRA Dispute Resolution, Inc. Into and With FINRA Regulation, Inc.

Dear Mr. Fields:

I write on behalf of the Public Investors Arbitration Bar Association ("PIABA"), an international bar association comprised of attorneys who represent investors in securities arbitrations. Since its formation in 1990, PIABA has promoted the interests of the public investor in all securities and commodities arbitration forums, while also advocating for public education regarding investment fraud and industry misconduct. Our members and their clients have a strong interest in rules promulgated by regulatory and self-regulatory securities authorities to govern the conduct of securities firms and their representatives.

We are particularly troubled by FINRA's current proposal to merge FINRA Dispute Resolution, Inc. into and with FINRA Regulation, Inc. The proposed rule is an important one, and one that evidences a complete reversal from the positions FINRA and the SEC have taken for the last fifteen years. The comment period is too short to allow interested parties to fully evaluate the proposal and offer their views. While PIABA has not had the opportunity to review and assess the proposal in detail, we submit this comment addressing certain obvious issues associated with the merger.[1]

In 1996, NASD had received recommendations related to its arbitration program from the Rudman Committee and the Ruder Task Force.[2] The Rudman Committee recommended the Arbitration Department be placed within NASD Regulation, and the Ruder Task Force recommended that the dispute resolution program be housed either within NASD Regulation or the parent company.[3] NASD followed the recommendation of the Rudman Committee and placed its Arbitration Department in NASD Regulation, and shortly thereafter changed the name of the department to the Office of Dispute Resolution.[4]

[1] Please note that there are undoubtedly additional issues which will come to light once the public has had sufficient opportunity to review the proposal.
[2] *See* Notice of Filing of Proposed Rule Change by the National Association of Securities Dealers, Inc. Relating to the Creation of a Dispute Resolution Subsidiary, File No. SR-NASD-99-21, SEC Release No. 34-41510, June 10, 1999.
[3] *Id.*
[4] *Id.*

In 1999, NASD filed a rule proposal with the SEC to create a separate dispute resolution subsidiary.[5] In its rule filing, NASD stated:

> Because there are significant differences between the disciplinary role of NASD Regulation and the sponsorship of a neutral forum for the resolution of disputes between members, associated persons, and customers, however, the NASD believes that creation of a separate dispute resolution entity will further strengthen the independence and credibility of the arbitration and mediation functions. A new dispute resolution subsidiary will benefit from the perception that it is separate and distinct from other NASD entities.[6]

As part of the rule proposal, NASD proposed that NASD Dispute Resolution would have a separate board of directors; determine its own policies, including developing and adopting rules for arbitration and mediation; determine allocation of dispute resolution resources; manage external relations; and oversee the NAMC including appointing the committee members.[7]

When the SEC approved the rule proposal in September 1999, it stated that it "believes that separating the dispute resolution role from the disciplinary role of NASD Regulation will result in a more neutral and independent forum for the resolution of disputes between members, associated persons, and customers."[8] In June 2000, NASD issued a press release stating, "We believe the creation of a separate subsidiary will further enhance the perception of neutrality and increase the confidence and comfort-level of forum users."[9]

Now, fifteen years later, FINRA believes "there is no longer a need to maintain separate subsidiaries to execute its regulatory and dispute resolution functions."[10] FINRA seeks to undo the work it did fifteen years ago when it separated the two entities and combine Regulation and Dispute Resolution, thereby subordinating its dispute resolution department to Regulation.

Curiously, in the current proposal, FINRA states that it "believes that the reorganization and its continued commitment to dispute resolution would ensure that FINRA continues to protect investors and the public interest in an efficient manner."[11] This is directly contradictory to statements made by NASD in 2000, when it stated, "[i]n response to the growing importance of dispute resolution services to the marketplace, a subsidiary of NASD, Inc.,

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[5] *Id.*
[6] *Id.*
[7] *Id.*
[8] *See* Order Approving a Proposed Rule Change by the National Association of Securities Dealers, Inc. to Create a Dispute Resolution Subsidiary, File No. SR-NASD-99-21, SEC Release No. 34-41971, September 30, 1999.
[9] See "NASD Launches New Dispute Resolution Subsidiary," July 17, 2000, available at https://www.finra.org/newsroom/2000/nasd-launches-new-dispute-resolution-subsidiary.
[10] See Notice of Filing of a Proposed Rule Change to Merge FINRA Dispute Resolution, Inc. Into and With FINRA Regulation, Inc., File No. SR-FINRA-2015-034, SEC Release No. 34-76082, October 6, 2015.
[11] *See* SEC Release No. 34-76082, pp.21-22. This statement is set forth as though it is an obvious result of the fact that one part of the rule change would increase the maximum number of FINRA Regulation board seats from 15 to 17 (while maintaining the "numerical dominance of public directors"). PIABA does not believe that FINRA's generic rhetoric regarding "the reorganization" and its "continued commitment to dispute resolution" (whatever that means), without more, is sufficient to demonstrate that the proposed merger will protect investors as much (or more) than they are protected now. Moreover, we question what FINRA means when it says it intends to "ensure that FINRA continues to protect investors and the public interest in an efficient manner.'

NASD Dispute Resolution, Inc., was formed."[12] When the SEC approved the formation of NASD Dispute Resolution, Inc. in 1999, it found that in doing so, "the proposed rule change is consistent with Section 15A(b) of the Act in general and furthers the objectives of Section 15A(b)(6) in particular, in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and to protect investors and the public interest."[13]

The SEC cannot approve the current rule proposal without contradicting its own previous findings. Nonetheless, FINRA offers several explanations for the proposed merger;[14] however, the purported justifications are troubling given the purpose behind separating the two entities initially.

First, FINRA states that the proposed merger would "align the legal structure with the public's perception of FINRA as well as its operational realities." FINRA has offered no support for this conclusory statement. FINRA contends that, from the public's perspective, FINRA, Inc., FINRA Regulation and FINRA Dispute Resolution have the appearance of a single organization.[15] FINRA's conclusion, and the core basis for its proposal of a merger, appears to be the natural result of a self-fulfilling prophecy. FINRA has not articulated its efforts spent over the last fifteen years to educate the public regarding the distinct nature of its various entities and the manner in which the separation of roles has contributed to investor protection. Instead, it issues statements like "FINRA operates the largest securities dispute resolution forum in the United States, and has extensive experience in providing a fair, efficient and effective venue to handle a securities-related dispute."[16] FINRA then feigns surprise that the public does not understand that Dispute Resolution is separate and distinct from the regulatory arm.

The fact remains that, at present, FINRA Dispute Resolution is independent of FINRA Regulation, which distinction serves an important purpose. The forum is intended to be neutral and should not be under the control of FINRA Regulation. If there is public confusion regarding the distinct nature of the entities, PIABA suggests the confusion results from FINRA, Inc.'s, FINRA Regulation's, and FINRA Dispute Resolution's failure to adequately explain to the public their distinct roles. Indeed, we do not know what FINRA means when it states that the proposed merger would "align the legal structure … to its [FINRA's] operational realities," but it seems to suggest that FINRA has not been treating, or at least does not now treat, FINRA Dispute Resolution as separate from FINRA Regulation despite the fact that it is (and has been) separate.[17] FINRA should not be permitted to bring its conduct, to the extent it has been (or is now) outside of the regulatory scheme previously approved by the SEC, into compliance by simply changing the rules to conform to its conduct. Such a result would be nonsensical and yet the proposed merger seems to be attempting to do just that.

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[12] *See* 2000 NASD Annual Financial Report, available at http://www.finra.org/sites/default/files/Corporate/p009758.pdf.
[13] *See* SEC Release No. 34-41971.
[14] We are troubled by the fact that many of FINRA's purported justifications supporting a merger consisting of little more than buzz words and industry jargon mixed together in an effort to make the proposed merger seem necessary when, in truth, it is not.
[15] See Notice of Filing of a Proposed Rule Change to Merge FINRA Dispute Resolution, Inc. Into and With FINRA Regulation, Inc., File No. SR-FINRA-2015-034, SEC Release No. 34-76082, October 6, 2015.
[16] See https://www.finra.org/arbitration-and-mediation.
[17] FINRA actually admits that "the three corporate [FINRA] entities largely function as a single organization." *See* SEC Release No. 34-76082, p.5. FINRA refers to this as "operational cohesiveness that furthers FINRA's mission of protecting investors," but what does that mean and how does it protect investors? The example given is that FINRA Dispute Resolution staff work with the FINRA Department of Enforcement to "identify misconduct by individuals or firms involved in arbitration cases that court justify further action." Surely the separate entities have been working together in this way for years – why is it now necessary that they be merged and will the cooperation stop if the proposed merger is not approved?

As recognized in 1999 when Dispute Resolution was created, FINRA's regulatory function is wholly separate from its sponsorship of a neutral dispute resolution forum. Regardless of the public perception of the two entities, it is important that Dispute Resolution be independent from Regulation and be able to adopt its own policies, determine the appropriate allocation of its resources, and manage its external relations. It is also important that the NAMC remain separate and apart from Regulation. If Dispute Resolution is a department within FINRA Regulation, it will be under the direction of Regulation and will not maintain autonomy. FINRA Regulation would then have say over arbitration rules as well as the administrative side of the arbitration process, including arbitrator training.

There may be other unintended repercussions as well. For example, if the proposed merger is approved and FINRA Enforcement declines to take action against a member firm for behavior that is the subject of a pending arbitration complaint, as it often does, the "no action letter" would no longer be issued by an entity separate and distinct from the dispute resolution role of the organization. We therefore expect that the industry will assert as a defense to a customer claim that FINRA Enforcement's refusal to act can be treated as a finding of the arbitration department that no wrongdoing took place since Enforcement and Dispute Resolution are the same entity.

Moreover, rather than simply state that the public is confused regarding the roles of the separate FINRA entities, FINRA should be taking steps to improve the public's understanding that its Dispute Resolution entity is separate, independent, and distinct from its Regulation entity, and thereby improve the confidence level of forum users. This was an issue in 2000, and clearly remains one today. In 2005, amid concerns about the fairness of the arbitration process, the Securities Industry Conference on Arbitration ("SICA") conducted a study of perceived fairness in the arbitration process.[18] SICA sent a survey to over 30,000 participants with questions assessing perception of the arbitration process. Particular emphasis was placed on: a) fairness of the SRO arbitration process; b) competence of arbitrators to resolve investors' disputes with their broker-dealers; c) fairness of SRO arbitration as compared to their perceptions of fairness in securities litigation in similar disputes; and d) fairness of the outcome of arbitrations.[19] Not surprisingly, the SICA study found that the overall perception of the securities arbitration process was negative.[20] Over sixty percent of customers perceived the process as unfair,[21] with nearly half perceiving arbitral panels as being biased.[22] And, most significantly, three out of every four customers found securities arbitration to be "very unfair" or "somewhat unfair" when compared with the judicial system.[23] Public perception will not improve by placing Dispute Resolution back within Regulation. Rather than simply refusing to educate the public about the distinct nature of the FINRA entities, and now giving up because the Public doesn't understand the current structure, FINRA should be taking steps to improve the public perception of Dispute Resolution, not ensure that the entity conforms with the public perception of the entity.

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[18] *See* Barbara Black & Jill Gross, *Perceptions of Fairness of Securities Arbitration: An Empirical Study*, Report to the Securities Industry Conference on Arbitration (2008), *available at* http://www.publicjustice.net/Repository/Files/Perceptions%20of%20Fairness.pdf.

[19] *See id.* at 1.

[20] *See id.* at 3.

[21] *See id.* at 45 (finding that approximately 63% of investors answered "Disagree/Strongly Disagree" when responding to the statement, "As a whole, I feel the arbitration process was fair").

[22] *See id.* at 50 (finding that 47% of responses disagreed with the statement that "arbitration is conducted by the arbitrators in a way that is fair to all parties" and 44% disagreed with the statement that arbitrators conduct the arbitration without bias).

[23] *See id.* at 47 (finding that 75.55% of customers found arbitration to be "very unfair" or "somewhat unfair" when compared to civil litigation).

Second, FINRA states that the merger will "reduce unnecessary administrative burdens required to maintain separate legal entities."[24] FINRA specifically points to savings it will realize by eliminating the need to file separate tax filings, state registrations and annual reports, and eliminating a separate payroll entity. FINRA does not provide a cost/benefit analysis or otherwise quantify these savings, nor does it state what it will do with these savings. This past year, FINRA paid compensation and benefits of $652.5 million of which $12.5 million was paid to its top ten executives, had net income of $129 million, and distributed a $20 million discretionary rebate to firms.[25] FINRA makes no mention in the rule proposal of passing any of these savings on to investors or using the savings to make improvements to the dispute resolution forum.

FINRA also states in the rule proposal that the merger will not have any impact on corporate governance, because "[m]embers of the FINRA Board's Regulatory Policy Committee currently serve as the directors of both the FINRA Regulation and FINRA Dispute Resolution boards."[26] Again, the mere fact that FINRA has chosen not to operate the two entities as separate and distinct as originally intended is not a reason to eliminate the actual distinction. The two boards are in fact separate and need not contain the same members. The FINRA Board contains sufficient members so that the two entities can have different boards.

The cross-pollination of the boards of directors serves is yet another example of FINRA attempting to operate Dispute Resolution as an alter ego of Regulation, in contravention of the intent of the original rule filing in 1999. When Dispute Resolution was first formed, it was intended to have several board members who were not FINRA Board members, allowing for a board that would be wholly independent of Regulation.[27] However, in 2010, FINRA amended the Dispute Resolution By-Laws so that all of the directors on its board would be drawn from the FINRA Board.[28]

For the foregoing reasons, PIABA respectfully requests that the SEC: (1) reject FINRA's rule proposal at this time; (2) require FINRA to resubmit the rule proposal with additional information provided concerning the justifications for the merger and detail regarding the purported cost savings; and, (3) extend the comment period to allow the public additional time to consider the impact of this or a subsequent proposed merger of FINRA Dispute Resolution into FINRA Regulation. Thank you for the opportunity to comment on such an important issue.

Respectfully submitted,

Hugh D. Berkson
PIABA President

[24] *See* SEC Release No. 34-76082.
[25] *See* 2014 FINRA Year in Review and Annual Financial Report, pp. 9, 22 and 31, available at http://www.finra.org/sites/default/files/2014_YIR_AFR.pdf.
[26] *See* SEC Release No. 34-76082, pp. 5-8.
[27] *See* SEC Release No. 34-41510.
[28] *See* FINRA Regulatory Notice 10-32, "Dispute Resolution By-Laws; SEC Approves Amendments to FINRA Dispute Resolution By-Laws," July 2010, available at http://finra.complinet.com/net_file_store/new_rulebooks/r/e/RegulatoryNotice10_32.pdf.