SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-67040; File No. SR-FINRA-2012-011)

May 22, 2012

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Order Approving a Proposed Rule Change Amending FINRA Rule 14107 of the Code of Mediation Procedure to Provide the Director of Mediation with Discretion to Determine Whether Parties to a FINRA Mediation May Select a Mediator Who is Not on FINRA's Mediator Roster

I. Introduction

On February 9, 2012, the Financial Industry Regulatory Authority, Inc. ("FINRA") filed with the Securities and Exchange Commission ("SEC" or "Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Exchange Act" or "Act")[1] and Rule 19b-4 thereunder,[2] a proposed rule change to amend FINRA Rule 14107 of the Code of Mediation Procedure ("Mediation Code") to provide the Director of Mediation ("Mediation Director") with discretion to determine whether parties to a FINRA mediation may select a mediator who is not on FINRA's mediator roster, subject to certain conditions. The proposed rule change was published for comment in the Federal Register on February 28, 2011.[3] The Commission received five comment letters on the proposed rule change,[4] and a response to comments from FINRA.[5] This order approves the proposed rule change.

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

2 17 CFR 240.19b-4.

3 See Exchange Act Release No. 66441 (Feb. 22, 2012), 77 FR 12098 (Feb. 28, 2012) ("Notice"). The comment period closed on March 20, 2012.

4 See Letter from Ryan K. Bakhtiari, President, Public Investors Arbitration Bar Association, dated February 28, 2012 ("PIABA Letter"); letter from William A. Jacobson, Associate Clinical Professor of Law, Cornell Law School, and Director, Cornell Securities Law Clinic, and Patricia Peralta, Cornell Law School '13, dated March 15, 2012 ("Cornell Letter"); letter from Lisa Catalano, Director, Christine Lazaro,

II. Description of the Proposal

As stated in the Notice, FINRA's Mediation Code currently permits parties to mediation to select a mediator either from a list of FINRA mediators supplied by the Mediation Director, or from a list or other source of their own choosing. Although parties usually select a FINRA mediator, parties may select a mediator who is not on FINRA's roster.

FINRA has administered its mediation program for over 15 years. FINRA stated in the Notice that during this time it has developed a deep roster of seasoned securities mediators. Specifically, FINRA represented that its staff carefully screens every mediator applicant, and that the National Arbitration and Mediation Committee ("NAMC")[6] (through its Mediation Subcommittee) reviews and approves each application. FINRA stated that its staff then conducts a background check of approved applicants before placing them on the mediator roster. FINRA also stated that its staff engages in ongoing evaluation of the mediators on its roster by eliciting

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Supervising Attorney, and Ben Kralstein, Andrew Mundo, and Daniel Porco, Legal Interns, St. John's University School of Law Securities Arbitration Clinic, dated March 20, 2012 ("St. John's Letter"); letter from Jill I. Gross, Director; Edward Pekarek, Assistant Director, and Genavieve Shingle, Student Intern, Investor Rights Clinic at Pace Law School, dated March 20, 2012 ("PIRC Letter"); and letter from Thomas K. Potter, III, Burr & Forman LLP, dated March 23, 2012 ("Potter Letter"). Comment letters are available at http://www.sec.gov.

5 See Letter from Margo A. Hassan, Assistant Chief Counsel, FINRA Dispute Resolution, to Elizabeth M. Murphy, Secretary, Commission, dated April 30, 2012 ("Response Letter"). The text of the proposed rule change and FINRA's Response Letter are available on FINRA's website at http://www.finra.org, at the principal office of FINRA, and at the Commission's Public Reference Room. The text of the Response Letter is also available on the Commission's website at http://www.sec.gov.

6 The NAMC makes recommendations to FINRA staff regarding recruitment, qualification, training, and evaluation of arbitrators and mediators. The NAMC also makes recommendations on rules, regulations, and procedures that govern the conduct of arbitration, mediation, and other dispute resolution matters before FINRA.

evaluations of its mediators from parties and counsel who have participated in mediation and conducting periodic quality control reviews of their mediators.

Non-FINRA mediators are not subject to FINRA's screening process, background check, and periodic evaluation. Accordingly, FINRA stated that the selection of a non-FINRA mediator raises concerns for the forum. FINRA stated, however, that if a mediator expresses an interest in applying to be a FINRA mediator, and FINRA's program would benefit by adding the mediator, FINRA staff believes it would be prudent to permit a non-FINRA mediator chosen by the parties to serve on a case. But FINRA stated that if a mediator does not apply for FINRA's roster or FINRA believes the mediator is not appropriate for its forum, the Mediation Director should have the discretion to deny the parties' mediator selection.

For these reasons, in part, FINRA proposed to amend Rule 14107(a) to state that a mediator may be selected, with the Mediation Director's approval upon receipt of the parties' joint request, from a list or other source the parties choose. Under the proposed rule, if the Mediation Director rejects the mediator selected, the parties would still be able to select a FINRA approved mediator or a different non-FINRA mediator subject to the same conditions as the rejected mediator, or to mediate their dispute elsewhere.

FINRA Rule 14107(c) provides that a mediator selected or assigned to mediate a matter must comply with FINRA rules relating to disclosures required of arbitrators unless, with respect to a mediator selected from a source other than a list provided by FINRA, the parties elect to waive such disclosure. The proposed rule change would amend Rule 14107(c) to state that the

paragraph would apply to a non-FINRA mediator who is approved to serve on a FINRA mediation.[7]

The proposed rule change also would make two technical amendments to Rule 14107. It would amend Rule 14107(a) to change the bullet points to numbers to facilitate citation to particular provisions of Rule 14107(a). It would also amend Rule 14107(c) to replace the citation to Rule 12408 of the Customer Code of Arbitration Procedure to Rule 12405 to reflect that former Rule 12408 was re-numbered as part of a prior FINRA rule change.[8]

In the Notice, FINRA represented that giving the Mediation Director discretion to determine whether parties may select a mediator who is not on FINRA's mediator roster would protect the quality and integrity of the process for users of FINRA's mediation program.

III. Discussion of Comment Letters

The Commission received five comment letters on the proposed rule change in response to the Notice.[9] Two commenters supported the proposal,[10] one supported the proposal with a suggested modification,[11] and two opposed the proposal.[12]

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7 FINRA mediators pay an annual $200 fee to remain active on the roster. Additionally, FINRA deducts $150 from the mediator's compensation for each meditation in which the mediator participates (FINRA stated that mediators typically receive $250 to $500 per hour). The Notice stated that under the proposed rule FINRA would require the non-FINRA mediator to complete the application process for inclusion on the mediator roster. The Notice also stated that, if the Commission approves the proposed rule change, FINRA would require any non-FINRA mediator who serves on a case to pay the $200 annual fee charged to FINRA mediators who are active on the roster prior to serving on the case, as well as the $150 mediation case fee.

8 See Exchange Act Release No. 63799 (Jan. 31, 2011), 76 FR 6500 (Feb. 4, 2011).

9 Supra note 4.

10 See PIABA Letter and St. John's Letter.

11 See Cornell Letter.

The PIABA Letter stated that the proposed rule change would assist forum participants in resolving their disputes. The St. John's Letter stated that giving the Mediation Director discretion in approving mediators not on FINRA's roster would help to ensure quality and efficiency in mediation.

The Cornell Letter stated that it supported the proposed rule change because FINRA should be able to control the quality of its mediation program. The letter also noted that, in the Notice, FINRA stated that if the Mediation Director rejects the parties' selected mediator, the parties would still be able to select a FINRA approved mediator or a different non-FINRA mediator subject to the same conditions as the rejected mediator, or to mediate their dispute elsewhere. The letter recommended that FINRA include this language in the proposed rule text or, alternatively, that the Commission acknowledge the language in an order approving the proposed rule change. In its Response Letter, FINRA stated that it included the language in the Notice to call attention to the alternatives that would be available to forum users if the Mediation Director rejects the parties' chosen mediator. FINRA stated that it was unnecessary to include the suggested language in the rule text, and declined to amend the proposal. FINRA also represented that, if the Commission approves the proposed rule change, FINRA would include the suggested language in a Regulatory Notice announcing approval of the proposed rule change to ensure that parties are cognizant of their options under FINRA's program. In addition, FINRA stated that if the Mediation Director rejects the parties' chosen mediator, FINRA would notify the parties of the alternatives available to them.

The PIRC Letter opposed the proposed rule change on the basis that it might inhibit investor choice and control over the mediation process. The letter stated that, under the current

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[12] See PIRC Letter and Potter Letter.

rule, an investor has the ability to select a mediator best suited to represent him or her in his or her specific claim. The letter further stated that this level of choice provides an investor a level of control over the process and increases the perception of its fairness. In particular, the letter stated that under the current rule, an investor could choose lower-cost options that suit the investor's financial status, such as a non-FINRA pro bono mediator, or a mediator who is willing to accept a reduced fee. The letter expressed concern that the proposed rule would increase the overall cost of mediation to investors because it would inhibit their ability to choose affordable non-FINRA mediators. In its Response Letter, FINRA stated that it has a duty to ensure the quality of its program and believes that maintaining control of its mediator roster is necessary to meet this duty. Moreover, the letter reiterated that parties would still have options for mediating their dispute if the Mediation Director rejected their selected mediator: the parties would be able to select a mediator on FINRA's roster, select a different non-FINRA mediator subject to the same conditions as the rejected mediator, or choose to mediate their dispute in another forum.

In its Response Letter, FINRA also stated that it believes its mediation program is cost-effective for investors of all means. FINRA stated it believes that its filing fees (of up to $300) are modest and that the Mediation Director has discretion to waive them. FINRA also stated that it offers many opportunities for parties using its mediators to reduce the cost of mediation, including: (1) when FINRA adds mediators to its roster, it asks them to reduce their rates for smaller claims; (2) FINRA's Mediation Administrators provide, upon request, parties with a list of mediators who have agreed to conduct mediations for $50 per hour in appropriate cases; (3) some mediators on FINRA's roster have agreed to conduct mediations on a pro bono basis for parties of limited means; and (4) every October, FINRA hosts Mediation Settlement Month

during which both FINRA and the mediators on its roster lower their fees in order to encourage participation.[13]

The Potter Letter stated, among other things, that FINRA has not established a need for the proposed rule change. The letter also stated that the proposed rule change would prevent parties from selecting a mediator of their choice and would restrict their freedom to contract. Moreover, the letter stated that the commenter believes the proposed rule would be difficult to enforce because FINRA would be unable to monitor a prohibition against private parties entering into private contracts.

In its Response Letter, FINRA stated that it does not believe the proposed rule change was unnecessary and reiterated that FINRA has a duty to ensure the quality of its mediation program, and that maintaining control of its mediator roster is a necessary to meet this duty. With respect to the letter's other objections, FINRA stated that it believes the commenter misinterpreted the proposal. Specifically, FINRA stated that mediation is voluntary, and that the proposed rule change would not prohibit parties from choosing their own mediators, or from choosing their own forum for mediation. In addition, FINRA reiterated that if the Mediation Director rejects a mediator selected by the parties, they would still be free to mediate their dispute elsewhere. Moreover, FINRA stated that it does not intend to police mediation between parties that occurs outside of FINRA's mediation forum.

For the aforementioned reasons, FINRA declined to amend the proposed rule change as suggested by commenters.

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[13] FINRA lowers its filing fees by 50 percent and its mediators (who typically charge between $250 and $500 per hour for services rendered) reduce their rates to $200 per hour for a four-hour mediation session for claims up to $25,000, and $400 per hour for claims up to $100,000.

IV. Commission's Findings

The Commission has carefully reviewed the proposed rule change, the comments received, and FINRA's Response Letter. Based on its review, 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. In particular, the Commission finds that the proposed rule change is consistent with Section 15A(b)(6) of the Act,[14] which requires, among other things, that FINRA rules must 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.

More specifically, the Commission finds that the proposed rule change to provide the Mediation Director with discretion to determine whether parties to a FINRA mediation may select a mediator who is not on FINRA's mediator roster would benefit investors and other participants in the forum by helping to protect the quality and integrity of FINRA's mediation program for parties using FINRA's forum. While the Commission appreciates the commenters' concerns, particularly regarding whether parties using the forum would understand the options available to them if the Mediation Director rejects a mediator selected by the parties, we believe that FINRA has responded adequately to the commenters' concerns and note that FINRA has stated that it will include in a Regulatory Notice announcing approval of the proposed rule change language designed to ensure that parties are cognizant of their options under FINRA's program, and that if the Mediation Director rejects the parties' chosen mediator, FINRA will notify the parties of the alternatives available to them.

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[14] 15 U.S.C. 78o–3(b)(6).

The Commission has reviewed the record for the proposed rule change and believes that the record does not contain any information to indicate that the proposed rule would have a significant effect on efficiency, competition, or capital formation. In light of the record, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation and has concluded that the proposed rule is unlikely to have any significant effect.[15]

For the reasons stated above, the Commission finds that the proposed rule change is consistent with the Act and the rules and regulations thereunder.

V. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,[16] that the

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15 See 15 U.S.C. 78c(f).

16 15 U.S.C. 78s(b)(2).

proposed rule change (SR-FINRA-2012-011) be, and it hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[17]

Kevin M. O'Neill
Deputy Secretary

[17] 17 CFR 200.30-3(a)(12).