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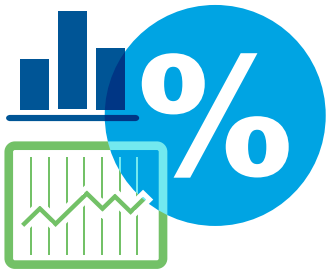

Financial Services Employment Arbitration Q&A

SEC Approves FINRA Rule Change Limiting Public Arbitrator Roster

By Robert Whitman and Cameron Smith

The SEC has approved FINRA's latest arbitrator classification rule change to amend the "non-public" and "public" arbitrator definitions in the Industry and Customer Codes of Arbitration.

FINRA's rule change will permanently prohibit all persons who are now or have ever been affiliated with any financial industry entity from serving as public arbitrators. FINRA will also prohibit individuals who have represented financial services companies, such as lawyers or accountants, from serving as public arbitrators until expiration of expanded cooling-off periods.

FINRA has explained the changes as necessary to address perceived concerns about the fairness and neutrality of its public arbitrator roster. Public comments raised questions about whether FINRA will continue to have sufficient qualified public arbitrators. The SEC found that FINRA's plans to recruit and retain new public arbitrators will adequately address these concerns. FINRA committed to perform a cost-benefit analysis of the revised rules' effect on the public arbitrator roster, but has not said when it will perform that analysis.

The revisions are extensive, but some of the more significant changes include:

- Arbitrators who have ever been affiliated with a financial industry entity for any length of time will permanently be classified as non-public arbitrators, with no exceptions or cooling-off periods. Under the old rules, these individuals could become public arbitrators after a five-year cooling off period.
- Persons associated with or registered through a mutual fund, hedge fund, or investment advisor may never serve as public arbitrators. The new rules will also create an omnibus reference in the non-public arbitrator definition to cover industry-affiliated persons not otherwise specified in the rule and potential categories of industry professionals that may be created in the future.
- Individuals such as attorneys, accountants, and other professionals who have provided services to industry entities for 15 or more calendar years (decreased from 20 years), which need not be consecutive, will be permanently disqualified from serving as public arbitrators.

- Individuals, such as attorneys and accountants, who have devoted 20 percent or more of their professional time within the past five years to serving financial services entities, will be classified as non-public arbitrators. The cooling-off period for these individuals will also increase from two to five years. However, if they have accumulated 15 or more years of qualifying work for industry entities, they will be permanently disqualified from serving as public arbitrators.

These expanded disqualifications and cooling off periods will inevitably limit the number of individuals qualified to serve as public arbitrators. Public arbitrators will also be less likely to have experience with or an understanding of complex financial instruments or compliance issues specific to the industry. This may increase the use of experts in FINRA arbitrations, with a corresponding increase in costs. (For more on the use of experts in FINRA arbitrations, see our posts *here* and *here*.)

The extent to which these rule changes impact the quality and fairness of arbitral deliberations and decisions remains an open question and one FINRA has said it will review further.

The changes will go into effect by the end of May; the specific date depends on when FINRA issues the required regulatory notice, which must be no later than 60 days from the SEC's February 26, 2015 approval order.

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