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January 21, 2025

Submitted By SEC Webform[1]

J. Matthew DeLesDernier
Deputy Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

RE: File No. SR-FINRA-2024-022: Notice of Filing of a Proposed Rule Change to Amend the Codes of Arbitration Procedure to Make Clarifying, Technical, and Procedural Changes to the Arbitrator List Selection Process

Dear Mr. DeLesDernier:

On behalf of the North American Securities Administrators Association, Inc. ("NASAA"),[2] I am writing in response to U.S. Securities and Exchange Commission ("SEC" or "Commission") Release No. 34-101993, *Notice of Filing of a Proposed Rule Change to Amend the Codes of Arbitration Procedure to Make Clarifying, Technical, and Procedural Changes to the Arbitrator List Selection Process* (the "Proposal"), recently filed with the SEC by the Financial Industry Regulatory Authority, Inc. ("FINRA") as SR-FINRA-2024-022.[3]

NASAA supports the Proposal and encourages its adoption. To begin, the Proposal would end an inequity in FINRA's current process for generating lists of prospective arbitrators to equilibrate the chances of selection across public arbitrators who are chairperson-eligible and those who are not. The Proposal thus should give all public arbitrators equal opportunities for selection and potential appointment to a hearing.[4] Next, the Proposal would shorten FINRA's deadline for

[1] https://www.sec.gov/comments/sr-finra-2024-022/notice-filing-proposed-rule-change-amend-codes-arbitration-procedure-make-clarifying-technical#no-back.

[2] Organized in 1919, NASAA is the oldest international organization devoted to investor protection. NASAA's membership consists of the securities administrators in the 50 states, the District of Columbia, Canada, México, Puerto Rico, the U.S. Virgin Islands, and Guam. NASAA is the voice of securities agencies responsible for grass-roots investor protection and efficient capital formation.

[3] The Proposal is available at https://www.sec.gov/files/rules/sro/finra/2024/34-101993.pdf. The text of FINRA's proposed rule revisions is available at https://www.finra.org/rules-guidance/rule-filings/sr-finra-2024-022.

[4] *See* Proposal at 5-7.

distributing arbitrator lists, increase the scope of mandatory arbitrator disclosures, and streamline the process by which parties may strike potential arbitrators.[5] Finally, the Proposal would create new rules-based nondisclosure duties for parties in arbitration. Specifically, parties would be obligated not to disclose (i) that another party has made an anonymous request for additional information from a prospective arbitrator or (ii) that another party has sought to remove an arbitrator from the proceeding for cause.[6]

While NASAA supports the Proposal, we recommend that FINRA revise these last two aspects of it. Specifically, FINRA should revise the proposed rules creating nondisclosure duties for anonymous information requests (*i.e.*, new Rules 12402(c)(2)(C), 12403(b)(2)(C) and 13403(c)(2)(C)) by stating that violations are sanctionable as discovery violations within the meaning of FINRA's Discovery Sanctions rules, Rules 12511(a) or 13511(a).[7] In addition, FINRA should revise the proposed rules creating nondisclosure duties over for-cause removal requests (*i.e.*, new Rules 12407(e)(1) and 13410(e)(1)) by adding a similar remedy in these rules. Although the Proposal does include a remedy for violations of these latter rules, FINRA's proposed remedy—removal of the arbitrator—is severe, and aggrieved parties might reasonably want a remedy that is less disruptive to an overall arbitration proceeding.[8]

By expressly stating in the Proposal that violations of these nondisclosure duties constitute discovery violations, FINRA would (i) make clear that these are serious breaches of the arbitration codes and (ii) give arbitrators an appropriate lens through which to view and redress such breaches (*i.e.*, to treat them as akin to willful or negligent discovery violations). Arbitrators have general authority to sanction parties for failing to comply with FINRA's arbitration rules,[9] but not all arbitration rules are created equal. Many rules are purely procedural and have no bearing on parties' rights or claims. For rules that do address such issues (*e.g.*, obtaining fair discovery under the Discovery Sanctions rules or expecting an opponent to file motions in good faith),[10] FINRA expressly states in its rules that violations are sanctionable. Incorporating such an explicit statement into the Proposal would place the new duties created by the Proposal on their appropriate plane. In addition, equilibrating these violations to discovery violations would provide a

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5 *See id.* at 8-9 and 13-16.

6 *Id.* at 11-12 and 19-21.

7 The remedies that would then become available to an arbitrator under these two provisions include monetary sanctions and adverse inferences but would expressly not include the ability to initiate a disciplinary referral or dismiss a claim. *See* Rule 12511(a) (*citing* Rule 12212(a)) and Rule 13511(a) (*citing* Rule 13212(a)).

8 Our explicit remedy would thus be in addition to the right of removal already contained in the Proposal. Violations of Rules 12407(e)(1) and 13410(e)(1) would thus be sanctionable as discovery violations, through removal of the arbitrator, or via both remedies.

9 *See* Rules 12212, 13212 (stating arbitrators "may sanction a party for failure to comply with *any provision*" in the arbitration codes (emphasis added)).

10 *E.g.*, Rules 12206(b)(11) and 12504(a)(11).

readymade framework through which arbitrators could evaluate and redress such violations on a case-by-case basis.[11]

I. FINRA Should Revise the Proposal by Adding Remedies for Breach of the Proposed Nondisclosure Obligations.

A. Add a Remedy for Violations of the New Duty Not to Disclose that Another Party has Made an Anonymous Request for Additional Information from an Arbitrator.

NASAA recommends FINRA revise the Proposal to provide a remedy for violations of the new nondisclosure obligations in Rules 12402(c)(2)(C), 12403(b)(2)(C) and 13403(c)(2)(C). These three new subparagraphs would permit parties in customer or industry arbitrations to request additional information about prospective arbitrators anonymously (assuming no other party objects to the request). Parties would thus be able to conduct greater due diligence on prospective arbitrators before deciding how to rank them (or whether to strike them) without potentially prejudicing that party's standing in the eyes of the arbitrator. These new nondisclosure duties are important and should be protected.

FINRA should revise the three aforementioned rules by adding a statement in these subparagraphs that violations constitute discovery violations within the meaning of FINRA's Discovery Sanctions rules (specifically, Rules 12511(a) and 13511(a)). This change would discourage parties or their representatives (including their attorneys) from breaching these new nondisclosure duties by expressly invoking FINRA's sanctions regime. And, as discussed above, invoking the Discovery Sanctions rules rather than the general Sanctions rules would provide arbitrators with appropriate context for crafting equitable remedies for such violations on a case-by-case basis. Accordingly, we recommend the following additional text be added to these three new subparagraphs:

Proposed Rule 12402(c)(2)(C)

(C) If no opposing party objects to the request for additional information, the Director and the parties shall not disclose the identity of the requesting party to the arbitrator. Any violation of this subparagraph (c) by a party or

[11] It is for this reason that we recommend FINRA incorporate the Discovery Sanctions rules (Rules 12511(a) and 13511(a)) rather than the general Sanctions rules (Rules 12212(a) and 13212(a)). The Sanctions rules list remedies that can be imposed but do not provide context or guidance on how severely (or lightly) arbitrators should treat a particular rule violation. Incorporating the Discovery Sanctions rules would provide this context: arbitrators would understand to treat violations of the Proposal as akin to discovery violations. This is an appropriate and readymade framework through which to do so. If FINRA declines to take this recommendation, we encourage FINRA to at least reference the general Sanctions rules in the Proposal and provide guidance on how seriously FINRA expects arbitrators to treat the new nondisclosure duties FINRA is creating.

> party's representative at any point in an arbitration proceeding shall constitute a failure to comply with discovery provisions of the Code within the meaning of Rule 12511(a).
>
> **Proposed Rule 12403(b)(2)(C)**
>
> (C) If no opposing party objects to the request for additional information, the Director and the parties shall not disclose the identity of the requesting party to the arbitrator or panel. Any violation of this subparagraph (c) by a party or party's representative at any point in an arbitration proceeding shall constitute a failure to comply with discovery provisions of the Code within the meaning of Rule 12511(a).
>
> **Proposed Rule 13403(c)(2)(C)**
>
> (C) If no opposing party objects to the request for additional information, the Director and the parties shall not disclose the identity of the requesting party to the arbitrator or panel. Any violation of this subparagraph (c) by a party or party's representative at any point in an arbitration proceeding shall constitute a failure to comply with discovery provisions of the Code within the meaning of Rule 13511(a).

This additional text would set a standard that any disclosure of the identity of an anonymous information requester is improper and potentially sanctionable as if the party had violated a discovery obligation imposed on the party in the proceeding.[12] This is a reasonable framework and enforcement mechanism through which parties can protect their confidential rights.[13]

B. Add a Similar Remedy for Violations of the New Duty Not to Disclose that Another Party Sought to Remove an Arbitrator for Cause.

Under current FINRA Rules 12407 and 13410, a party to a customer or industry arbitration can seek to remove an arbitrator for cause at any time during an arbitration proceeding. Requests

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[12] This proposed language is purposefully broad. First, "[a]ny violation" is intended to cover both situations in which a party discloses an opponent's anonymous request for information as well as any party's disclosure of *its own* prior anonymous request. Second, this proposed language would, in effect, treat violations as strict liability. Arbitrators would not be asked to assess whether an improper disclosure was done maliciously or inadvertently, nor would the manner of the disclosure (*e.g.*, written versus oral) matter. The only way a party could excuse its violation would be to show that it had "substantial justification" for its conduct as stated in Rules 12511(a) and 13511(a). Third, our proposed language is intended to apply at any point in an arbitration proceeding. An improper disclosure thus would be actionable before an arbitrator has been appointed, throughout the discovery process, and at any time during an arbitration hearing.

[13] Arbitrators of course would not necessarily be required to impose sanctions. In addition, the specific citation to rule subparagraphs 12511(a) and 13511(a) limits the scope of available remedies an arbitrator could impose under the general Sanctions rules. *See supra* note 7.

to remove for cause are decided by FINRA's Director of Dispute Resolution Services ("Director"). FINRA's practice is to advise parties that they are obligated not to divulge such removal requests, but this is not currently a duty under FINRA's rules.

The Proposal would close this gap by (i) creating an explicit duty in the arbitration rules that parties must not disclose for-cause removal requests[14] and (ii) giving parties a right to remove an arbitrator if an opposing party subsequently breached this nondisclosure duty.[15] We support these changes. In addition, though, we recommend FINRA revise the Proposal to incorporate a remedy for breach akin to the remedy we recommended in Part A above.

Incorporating a remedy into Rules 12407 and 13410 akin to the remedy we recommend above would give aggrieved parties greater flexibility when responding to an opponent's violation of these provisions. The existing remedy stated in the Proposal—removal of the arbitrator—is narrow and severe. We can easily envision aggrieved parties not wanting such an all-or-nothing solution. For example, if an improper disclosure were made near the end of a panel proceeding, an aggrieved party reasonably may not want to seek removal of the affected arbitrator (thereby either concluding the arbitration with just two panelists or delaying a conclusion until a replacement panelist can be appointed and prepped). Empowering arbitrators to penalize violations of Rules 12407 and 13410 through the Discovery Sanctions rules would be a much more flexible and equitable alternative. In addition, FINRA's general Sanctions rules do not provide context or guidance for arbitrators to impose such sanctions.[16] The Discovery Sanctions rules provide a better framework. Accordingly, we offer the following additional text to each proposed rule:

Proposed Rule 12407(e)(1)

(1) A party may not inform the arbitrator or panel of another party's request to remove an arbitrator under paragraphs (a) or (b) of this rule. Any violation of this subparagraph (1) by a party or party's representative at any point in an arbitration proceeding shall constitute a failure to comply with discovery provisions of the Code within the meaning of Rule 12511(a).

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[14] See new subparagraphs (e)(1) in Rules 12407 and 13410.

[15] See new subparagraphs (e)(2) in Rules 12407 and 13410. The proposed removal right in subparagraphs (e)(2) is not absolute, but it is nearly so: the rules state the Director "shall grant" such requests "[a]bsent extraordinary circumstances." *See Proposal* at 20.

[16] Also, by expressly including this remedy in Rules 12407 and 13410 without any discussion of the broader arbitration sanctions rules, the Proposal might give arbitrators a misapprehension that removal is the *only* remedy available to parties under these provisions. We assume this is not the intent of the Proposal and that FINRA does intend for the remedies under the Sanctions rules to be available.

Proposed Rule 13410(e)(1)

(1) A party may not inform the arbitrator or panel of another party's request to remove an arbitrator under paragraphs (a) or (b) of this rule. Any violation of this subparagraph (1) by a party or party's representative at any point in an arbitration proceeding shall constitute a failure to comply with discovery provisions of the Code within the meaning of Rule 13511 (a).

II. Conclusion

For the reasons discussed above, NASAA supports the Proposal and encourages its adoption. NASAA recommends, though, that FINRA revise the Proposal before seeking the Commission's approval. Specifically, we recommend FINRA expressly state in new rule subparagraphs 12402(c)(2)(C), 12403(b)(2)(C), 13403(c)(2)(C), 12407(e)(1) and 13410(e)(1) that violations of the nondisclosure duties set forth therein are sanctionable as discovery violations under FINRA Rules 12511(a) or 13511(a).

Thank you for considering these views. NASAA looks forward to continuing to work with the Commission and FINRA in the shared mission to protect investors. Should you have questions, please contact either the undersigned or NASAA's General Counsel, Vince Martinez, at (202) 737-0900.

Sincerely,

Leslie M. Van Buskirk

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