Electronic Comments

• Use the Commission's Internet comment form (*http://www.sec.gov/rules/sro.shtml);* or

• Send an email to *rule-comments@sec.gov.* Please include File Number SR–FINRA–2014–040 on the subject line.

Paper Comments

• Send paper comments in triplicate to Brent J. Fields, Secretary, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549.

All submissions should refer to File Number SR–FINRA–2014–040. This file number should be included on the subject line if email is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (*http://www.sec.gov/rules/sro.shtml).* Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for Web site viewing and printing in the Commission's Public Reference Room, 100 F Street NE., Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filing also will be available for inspection and copying at the principal office of FINRA. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR–FINRA–2013–040 and should be submitted on or before November 5, 2014.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[12]

Kevin M. O'Neill,

Deputy Secretary.

[FR Doc. 2014–24454 Filed 10–14–14; 8:45 am]

BILLING CODE 8011–01–P

[12] 17 CFR 200.30–3(a)(12).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–73319; File No. SR–FINRA–2014–005]

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Order Approving a Proposed Rule Change, as Modified by Partial Amendment No. 1, To Broaden Arbitrators' Authority To Make Referrals During an Arbitration Proceeding

October 8, 2014.

I. Introduction

On July 12, 2010, the Financial Industry Regulatory Authority, Inc. (''FINRA'') filed a proposal pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (''Act'') [1] and Rule 19b-4 thereunder,[2] with the Securities and Exchange Commission (''Commission'') to amend Rule 12104 (Effect of Arbitration on FINRA Regulatory Activities) of the Code of Arbitration Procedure for Customer Disputes (''Customer Code'') and Rule 13104 (Effect of Arbitration on FINRA Regulatory Activities) of the Code of Arbitration Procedure for Industry Disputes (''Industry Code'') (collectively, the ''Codes''). This initial proposal would have permitted arbitrators to make referrals to FINRA during an arbitration case, would have required the FINRA Director of Arbitration (''Director'') to disclose the referral to the parties, and would have required the entire panel to withdraw upon a party's request that a referring arbitrator withdraw (''original proposal''). The Commission published the original proposal for comment on September 17, 2010.[3] On July 7, 2011, FINRA responded to comments received by the Commission by filing an amendment to the original proposal,[4] which replaced the original proposal in its entirety.

Under the Amended Original Proposal, an arbitrator would have been permitted to make a mid-case referral if he or she became aware of any matter or conduct that the arbitrator had reason to believe posed a serious threat, whether ongoing or imminent, that was likely to harm investors unless immediate action was taken. A mid-case referral could not have been based solely on allegations in the pleadings. The Amended Original Proposal also would have instructed the arbitrator to wait until the arbitration concluded to make a referral if, in the arbitrator's judgment, investor protection would not have been materially compromised by the delay. Further, if an arbitrator made a mid-case referral, the Director would have disclosed the act of making the referral to the parties, and a party would have been permitted to request recusal of the referring arbitrator. The Amended Original Proposal would have required either the President of FINRA Dispute Resolution (''President'') or the Director to evaluate the referral and determine whether to forward it to other divisions of FINRA for further review. Finally, the Amended Original Proposal would have retained the provisions in Rule 12104(b) of the Customer Code and Rule 13104(b) of the Industry Code that permits an arbitrator to make a post-case referral. The Commission received five comment letters in response to the Amended Original Proposal.

On January 29, 2014, FINRA withdrew the Amended Original Proposal [5] without responding to the comments and filed the current proposal (''Proposed Rule''). The Proposed Rule was identical to the Amended Original Proposal. As part of the Proposed Rule, FINRA responded to comments received on the Amended Original Proposal. The Proposed Rule was published for comment in the **Federal Register** on February 12, 2014.[6] The Commission received 10 comment letters in response. On March 28, 2014, FINRA extended to May 20, 2014, the time period in which the Commission must approve the Proposed Rule, disapprove the Proposed Rule, or institute proceedings to determine whether to approve or disapprove the Proposed Rule. On May 19, 2014, FINRA responded to comments to the Proposed Rule and filed Partial Amendment No. 1.[7]

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

[2] 17 CFR 240.19b–4.

[3] *See* Securities Exchange Act Rel. No. 62930 (Sept. 17, 2010), 75 FR 58007 (Sept. 23, 2010) (SR–FINRA–2010–036).

[4] *See* Securities Exchange Act Rel. No. 64954 (Jul. 25, 2011), 76 FR 45631 (Jul. 29, 2011) (SR–FINRA–2010–036) (Notice of Filing Proposed Rule Change and Amendment No. 1 to Amend the Codes of Arbitration Procedure To Permit Arbitrators To Make Mid-Case Referrals) (hereinafter, the ''Amended Original Proposal,'' to distinguish Amendment No.1 to the original proposal from the current proposal as amended by Partial Amendment No. 1.).

[5] *See* SR–FINRA–2010–036, Withdrawal of Proposed Rule Change, available at *http://www.finra.org/Industry/Regulation/RuleFilings/2010/P121722.*

[6] *See* Securities Exchange Act Rel. No. 71534 (Feb. 12, 2014), 79 FR 9523 (Feb. 19, 2014) (SR–FINRA–2014–005) (''Notice of Filing'').

[7] *See* Letter from Mignon McLemore, Assistant General Counsel, FINRA Dispute Resolution, to Lourdes Gonzalez, Commission, dated May 19, 2014 (''May Response''). The May Response and the text of Partial Amendment No. 1 are available on

Continued

On May 20, 2014, the Commission published for comment both Partial Amendment No. 1, and an order instituting proceedings pursuant to Section 19(b)(2)(B) of the Act[8] to determine whether to approve or disapprove the Proposed Rule, as modified by Partial Amendment No. 1.[9] The Commission received nine comments on the Proposed Rule as modified by Partial Amendment No. 1 (together, the ''Amended Current Proposal'').[10] On August 14, 2014, FINRA responded to these comments.[11]

This order approves the Amended Current Proposal.

II. Description of the Amended Current Proposal

As further described in the Notice of Filing, FINRA is proposing to amend Rule 12104 of the Customer Code and Rule 13104 of the Industry Code to broaden arbitrators' authority to make referrals during an arbitration proceeding. Under the Amended Current Proposal, an arbitrator would be permitted to make a mid-case referral if the arbitrator becomes aware of any matter or conduct that the arbitrator has reason to believe poses a serious threat, whether ongoing or imminent, that is likely to harm investors unless immediate action is taken. A mid-case referral could not be based solely on allegations in the pleadings. The Amended Current Proposal would further provide that when a case is nearing completion, the arbitrator should wait until the case concludes to make a referral if, in the arbitrator's judgment, investor protection would not be materially compromised by the delay. If an arbitrator makes a mid-case referral, the Director would disclose the act of making the referral to the parties, and a party would be permitted to request recusal of the referring arbitrator. The Amended Current Proposal would require either the President or the Director to evaluate the referral and determine whether to forward it to other divisions of FINRA for further review. The Amended Current Proposal would retain the provisions in Rule 12104(b) of the Customer Code and Rule 13104(b) of the Industry Code that permit an arbitrator to make a post-case referral. Partial Amendment No. 1 would require that a party requesting recusal of an arbitrator following a mid-case referral, and based on such a referral, do so within three days of being notified of the mid-case referral. FINRA stated that the amendment is intended to prevent a party from receiving notice of the mid-case referral and reserving the right to strategically request recusal when it would best benefit that party.

III. Comments on the Amended Current Proposal

The Commission received nine comments on the Amended Current Proposal.[12] Five commenters opposed the Amended Current Proposal,[13] three commenters partially supported the Amended Current Proposal,[14] and one commenter supported the Amended Current Proposal.[15]

A. Support for the Goals of the Amended Current Proposal

One commenter states that the Amended Current Proposal, along with certain suggested changes, would enhance the investor protection mission of FINRA and the SEC.[16] Two other commenters support FINRA's efforts to identify and stop ongoing securities market schemes that could harm investors by authorizing arbitrators to make mid-case referrals.[17] They express concerns, however, about the potential impacts of the Amended Current Proposal on individual claimants and suggest further changes that, in their view, would minimize the negative impact of the Amended Current Proposal.[18]

FINRA replies that it has carefully considered the impact that its proposal could have on an individual investor claimant. However, it states further that its regulatory obligations also require it to weigh the potential effect that failing to allow mid-case referrals could have on a large group of investors. In considering these potential effects, FINRA determined that the proposal would help FINRA detect serious threats to investors at an earlier stage than would otherwise occur; this early warning, FINRA states, could help curb financial losses of a potentially large group of investors. Therefore, FINRA states that providing additional protection to public investors generally by strengthening its regulatory structure outweighs the potential increased costs to an investor party.[19]

B. Effect on Retail Investors

The Commission solicited comment on the Amended Current Proposal's effects on retail investors.[20] In response, some commenters express concern about increased costs and delays incurred by the investor in the arbitration if an arbitrator made a mid-case referral.[21] Two commenters also contend that a retail investor should not be expected to incur the costs that could arise if an arbitrator made a mid-case referral.[22] These commenters suggest that the costs that result from a mid-case referral should be borne by the party seeking recusal or by FINRA.[23]

Regarding the suggestion that FINRA pay an investor's costs and expenses that could arise as a result of a mid-case referral, FINRA states it does not believe that it would be appropriate for the forum that administers the arbitration process to bear the costs for any party. FINRA states also that it provides an arbitration forum that is neutral and fair for all parties to a dispute, and that if the forum were to agree to pay for one party's costs and expenses it would raise questions about the forum's neutrality and its role in administering the arbitration process; FINRA therefore declines to make such a change.[24]

While FINRA acknowledges that it cannot eliminate all of the potential costs or delays to an individual claimant

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FINRA's Web site at *http://www.finra.org,* at the principal office of FINRA, and at the Commission's Public Reference Room. The May Response is also available on the Commission's Web site at *http://www.sec.gov.*

[8] 15 U.S.C. 78s(b)(2)(B).

[9] *See* Securities Exchange Act Rel. No. 72196 (May 20, 2014), 76 FR 30206 (May 27, 2014) (''Order Instituting Proceedings'').

[10] Jenice L. Malecki, Esquire, Malecki Law (May 20, 2014, commenting only on the Proposed Rule) (''Malecki''); George H. Friedman, Esquire, George H. Friedman Consulting, LLC (Jun. 9, 2014) (''Friedman''); Nicole G. Iannarone, Assistant Clinical Professor, and Patricia Uceda, Student Intern, Investor Advocacy Clinic, Georgia State University College of Law (Jun. 20, 2014) (''Georgia State''); Guillermo Gleizer, Esq. (Jun. 25, 2014) (''Gleizer''); Jason Doss, President, Public Investors Arbitration Bar Association (Jun. 26, 2014) (''PIABA''); Ellen Liang, Student Intern, Elissa Germaine, Supervising Attorney, and Jill Gross, Director, Pace Investor Rights Clinic (Jun. 26, 2014) (''Pace''); Richard P. Ryder, Esquire, President, Securities Arbitration Commentator, Inc. (Jun. 26, 2014) (''Ryder''); Andrea Seidt, President, North American Securities Administrators Association and Ohio Securities Commissioner, (Jun. 27, 2014) (''NASAA''); and Steven B. Caruso, Esq., Maddox Hargett & Caruso, P.C. (July 2, 2014) (''Caruso'').

[11] Letter from Mignon McLemore, Assistant Chief Counsel, FINRA Dispute Resolution, Inc., to Kevin O'Neill, Deputy Secretary, Commission, dated August 14, 2014 (''FINRA Letter'').

[12] See note 10, *supra.*

[13] PIABA, Georgia State, Gleizer, Ryder, and Caruso.

[14] Pace, NASAA, and Malecki.

[15] Friedman.

[16] Friedman.

[17] Pace and NASAA. *See also* Malecki (supporting the goal of the Proposed Rule).

[18] Pace and NASAA. These suggestions are discussed further below.

[19] FINRA Letter at 4.

[20] *See* Order Instituting Proceedings, note 9, *supra.*

[21] See, e.g., PIABA, Ryder, and Pace.

[22] PIABA and Malecki.

[23] *Id.*

[24] FINRA Letter at 5, incorporating by reference May Response at 12.

associated with a mid-case referral, it also describes a number of ways in which the Codes permit a hearing panel to allocate costs in a manner that takes into account the circumstances leading to the costs' incursion, ways in which the Codes permit FINRA to absorb some costs that may be incurred as a result of a mid-case referral, as well as ways in which the parties themselves can minimize costs and delays.[25]

For example, FINRA notes that the Codes permit a panel to allocate the amount of certain costs and expenses incurred by the parties, and which party or parties will pay those costs and expenses.[26] Citing an example, FINRA states that if an investor party incurs costs and expenses as a result of a mid-case referral, the investor can request that the arbitrator or panel assign liability for the investor's costs and expenses to the respondent.[27] Similarly, FINRA notes that the Codes give arbitrators the ability to allocate postponement fees against the party that contributed to the need for the postponement.[28] FINRA notes further that, under Rule 12601(b)(1) of the Customer Code and Rule 13601(b)(1) of the Industry Code, if a party requests a postponement as a result of an arbitrator's recusal based on a mid-case referral request, the panel could also assess part or all of any postponement fees against a party that did not request the postponement, if the panel determines that the non-requesting party caused or contributed to the need for the postponement.[29]

As to existing Code provisions that allow FINRA to help absorb some costs associated with any need for the replacement of an arbitrator, FINRA notes that it pays the replacement arbitrator to review the hearing record (e.g., listen to the digital recording or review a transcript, when available, of the prior hearing sessions) and learn about the arbitration case up to the point at which it was stopped.[30] Pursuant to forum policy, FINRA notes the parties would not be assessed any fees for this review time.[31]

FINRA also highlights the options parties have to control the costs they could incur if an arbitrator makes a mid-case referral.[32] For example, FINRA states that the parties may agree to rehearing only key witnesses, or stipulate to summaries of prior testimony.[33] In light of these factors, FINRA believes its current policies and procedures address the commenters' concerns and declines to make any changes to the Amended Current Proposal.[34]

Other commenters raise concerns about the adverse effects a recusal request would have on an investor's arbitration case, as well as the resulting motion to vacate that the commenters believe a respondent would file, if the referring arbitrator denies a recusal request.[35] In response, FINRA notes that, while a denial of a recusal request could result in a motion to vacate, courts have found that such actions do not provide parties with valid bias grounds on which to challenge an award.[36] Further, FINRA notes that it expects to issue a Regulatory Notice if the Amended Current Proposal is approved that would, among other things, emphasize that arbitrators are not required to grant a recusal request based on making a mid-case referral, and also provide guidance on the courts' findings on what constitutes grounds for evident partiality.[37] This guidance, FINRA believes, could further mitigate the effect of these motions on a retail investor claimant. Consequently, FINRA believes that its current policies and procedures, as well as case law, address these concerns.[38]

C. Standard of Referral

The Commission solicited comment on the proposed standard of referral, and whether FINRA should propose a different standard. In response, one commenter states that a different standard of referral under proposed Rule 12104(b) would not insulate a claimant from the adverse impacts of the proposal.[39] Another commenter states that the proposed standard may be inadequate for those arbitrators who are not attorneys and not trained in the nuances of the legal system.[40] A third commenter states that the standard is designed to assure that the rule is rarely invoked, but does not believe it would prevent arbitrators from making an unnecessary and wrongly-based referral.[41] In response, FINRA states that the reasonable belief standard is appropriate for arbitrators because it would allow arbitrators to use their judgment, based on their assessment of the facts, evidence, and testimony, when making decisions during an arbitration.[42] Further, FINRA agrees to provide training for arbitrators on the mid-case referral rule and how it should be applied.[43]

One commenter, who supports the standard for referral as well as FINRA's proposed training, states that the standard, along with the training, should help prevent arbitrators from making unnecessary mid-case referrals, and facilitate a smoother transition for them to learn how to apply the rule.[44] FINRA agrees, and, believes the proposed standard is appropriate and should remain unchanged.[45]

One commenter suggests that FINRA eliminate the proposed provision of the rule that directs an arbitrator to delay a referral if a case is nearing completion until the case concludes if, in the arbitrator's judgment, investor protection will not be materially compromised by this delay. [46] This commenter believes the phrase ''nearing completion'' in the proposed rule text is vague and would invite inconsistent interpretation.[47] In response, FINRA states that this option to delay a referral permits arbitrators to protect a party from the effects that a mid-case referral could have on a person's case, if the facts and circumstances support waiting until the case concludes, and that such a result could provide protections to investors in the arbitration process.[48] FINRA also states that this provision provides additional guidance to arbitrators as to when it is appropriate to make a mid-case referral.[49] Thus, FINRA declines to make the commenters' suggested changes.

D. Whether Partial Amendment No. 1 Ameliorates Potential Adverse Effects on Claimants

Partial Amendment No. 1 requires that a party file a recusal request for the referring arbitrator no later than three days after the Director notifies the parties of the referral, or forfeit the right

[25] FINRA Letter at 4, incorporating by reference May Response at 12–13.

[26] FINRA Letter at 5, citing Rule 12902(c) and Rule 13902(c).

[27] FINRA Letter at 5, incorporating by reference May Response at 11–12.

[28] FINRA Letter at 5, incorporating by reference May Response at 12.

[29] Id.

[30] FINRA Letter at 5, incorporating by reference May Response at 13.

[31] FINRA Letter at 5, incorporating by reference May Response at 14.

[32] FINRA Letter at 5, incorporating by reference May Response at 12–13.

[33] FINRA Letter at 5, incorporating by reference May Response at 14.

[34] FINRA Letter at 5.

[35] Caruso, Ryder, and Pace.

[36] FINRA Letter at 4.

[37] *Id.*

[38] FINRA Letter at 4–5.

[39] PIABA.

[40] Caruso.

[41] Ryder.

[42] FINRA Letter at 8, incorporating by reference May Response at 8–9.

[43] FINRA Letter at 6.

[44] Pace.

[45] FINRA Letter at 6.

[46] Friedman.

[47] *Id.*

[48] FINRA Letter at 6, incorporating by reference May Response at 5.

[49] FINRA Letter at 6.

to request recusal based on the mid-case referral. The Commission solicited comment on this amendment, and in particular whether the amendment ameliorates commenters' concerns that notifying parties of a mid-case referral could lead to adverse consequences to the claimant, including requests for recusal and challenges to an award. In response, three commenters state they do not believe Partial Amendment No. 1 will ameliorate the rule's potential adverse effects on claimants.[50]

One commenter contends that Partial Amendment No. 1 would not minimize the negative consequences of the Amended Current Proposal.[51] The commenter states that if the respondent inadvertently or purposefully fails to file a recusal request within three days of being notified about the referral, this failure would serve as basis for a subsequent motion to vacate an award.[52] One commenter indicates that Partial Amendment No. 1 does not ameliorate its concerns because the proposal contains an explicit reference to recusal.[53] This commenter argues that a mid-case referral should not provide any grounds for recusal or for a motion to vacate an award.[54] Another commenter believes that Partial Amendment No. 1 does not ameliorate its concerns about the effect that notifying the parties would have on the claimant's case, namely that a mid-case referral would result in a recusal request and a motion to vacate if the subject of the mid-case referral loses the request or case.[55] Finally, one commenter suggests that FINRA expressly state in the rule that mid-case referral is not grounds for recusal.[56]

In response, FINRA states that a party's inadvertent or deliberate failure to comply with a forum's rules, such as by not filing a recusal request within three days, is not grounds, under the Federal Arbitration Act, for vacating an arbitration award.[57]

As to commenters' suggestion that the Amended Current Proposal either creates a right to request recusal, encourages recusal motions, or that the rule should mandate the outcome of such motions, FINRA notes that a party currently may make such a request under the Codes in any arbitration case; the Amended Current Proposal does not create such a right.[58] FINRA also explains that its rules do not dictate the grounds for granting recusal requests and do not require specific decisions by arbitrators in response to such requests.[59] In response to the commenter's concern about the subject of a mid-case referral filing a motion to vacate if the request is denied or case is lost, FINRA acknowledges that such motions may occur, but notes that courts have found that an arbitrator's denying a recusal request does not provide parties with valid bias grounds on which to challenge an award.[60] FINRA believes that its current policies, procedures, and case law address the commenters' concerns and declines to amend the Amended Current Proposal.[61]

E. Eliminating the Notice Requirement

The Commission solicited comment regarding whether the requirement to notify parties of a mid-case referral should be eliminated. Commenters were divided, with three commenters opposing elimination,[62] and three other commenters supporting it.[63] One commenter believes that notification is consistent with the current obligations of arbitrators to provide full disclosure to help ensure fairness in the arbitration process.[64] FINRA, in response, points to the forum's policies encouraging a wide variety of arbitrator disclosures and its rules that require arbitrators to make disclosures when appointed to a FINRA arbitration, at any stage of the arbitration, or as circumstances dictate.[65] Further, FINRA also notes that, in addition to its rules and practices, case law has established a broad requirement that arbitrators make full disclosures,[66] and, that a failure to do so could provide a party with grounds to challenge an award by claiming evident partiality against the arbitrator.[67] For the reasons, FINRA declines to eliminate the notice requirement.[68]

One commenter suggests that providing the subject of a mid-case referral advance notice of a potential investigation could negatively impact subsequent criminal or regulatory investigations.[69] In particular, the commenter believes that such notice could lead to destruction of evidence and obstruction of the investigation.[70] FINRA states in response that knowledge of behavior that would warrant a mid-case referral, if revealed during a hearing, would likely not be a revelation to the alleged wrongdoer. However, the airing of such information during a hearing would serve as notice to the wrongdoer that the matter or conduct is on the verge of public exposure.[71] FINRA states that, after that, the wrongdoer could begin to engage in the behavior described by the commenter, regardless of whether a mid-case referral is made.[72] FINRA believes that, in these instances, disclosure of a mid-case referral would give regulators advance notice of a serious threat that is likely to harm investors, and, thus, permit them to take immediate action instead of waiting until the end of the case.[73] FINRA states further that if FINRA did not learn of the referral until after the case closes, there is a risk that the wrongdoer would have extra time to destroy evidence.[74]

F. Forwarding the Mid-Case Referral to the President or Director

Two commenters suggest removing the provision that would require forwarding the mid-case referral to the President or Director for review.[75] One commenter believes the referral could be forwarded directly to the regulatory or enforcement department of FINRA.[76] The other commenter suggests expanding the direct referral concept to include the SEC, state securities regulators, or local or federal law enforcement.[77] FINRA states that it modeled this provision after the current practice used when an arbitrator makes a post-case referral.[78] FINRA also states that the purpose of the review is to determine which FINRA division should receive the referral, and whether other divisions or regulators should be notified.[79] FINRA believes that this provision would result in an efficient use of its resources, and, thus, declines to make the suggested change.[80]

[50] PIABA, Pace, and Georgia State.
[51] PIABA.
[52] *Id.*
[53] Pace.
[54] *Id.*
[55] Georgia State.
[56] NASAA.
[57] FINRA Letter at 7 (citing 9 U.S.C. 10(a)).
[58] FINRA Letter at 7.
[59] *Id.*
[60] FINRA Letter at 4.
[61] FINRA Letter at 8.
[62] Pace, Ryder, and Friedman.
[63] Georgia State, NASAA, and Caruso.
[64] Pace.
[65] FINRA Letter at 8, incorporating by reference May Letter at 9–10.
[66] *Id.*
[67] FINRA Letter at 8.
[68] *Id.*
[69] Caruso.
[70] *Id.*
[71] FINRA Letter at 8–9.
[72] *Id.*
[73] *Id.*
[74] *Id.*
[75] Friedman and NASAA.
[76] Friedman.
[77] NASAA.
[78] FINRA Letter at 9.
[79] *Id.*
[80] *Id.*

G. Other Issues Related to the Amended Current Proposal Than Those Specifically Raised by the Commission

1. Explicit References to Recusal

Two commenters contend that the explicit reference to recusal in the Amended Current Proposal suggests implicitly that an arbitrator could be biased after the person has heard enough evidence of wrongdoing.[81] One commenter states that finding liability based on evidence presented does not mean that the arbitrator is sufficiently biased against the wrongdoer to justify good cause for recusal.[82] Another commenter compares the proposal to the Federal laws, such as the Bankruptcy Code, which, according to the commenter, are less stringent and do not expressly provide for recusal.[83] This commenter contends that by explaining the availability of a recusal request in the Amended Current Proposal, even though it is available in other parts of the Codes, FINRA is seeking to make its rules more stringent than the Federal laws.

In response, FINRA first notes that the Amended Current Proposal does not create a right to make a recusal request, which already exists in any arbitration case.[84] Second, FINRA disagrees that the explicit reference to recusal implies potential bias on the part of an arbitrator.[85] Last, FINRA notes that the Federal laws, to which one commenter refers, relate to grounds for recusal. The reference in this rule is not about the grounds for recusal.[86] FINRA states that arbitrators are expected to make decisions based on evidence presented during a hearing, and such decisions alone have been insufficient to support a showing of evident partiality.[87]

FINRA states also that the act of making a mid-case referral is not evidence of bias, whether implied or overt.[88] The forum's rules, according to FINRA, are designed to guide parties and staff in the administration of arbitration cases. FINRA believes its rules are more effective when procedures are expressly incorporated in the arbitration rules, and that this transparency results in the efficient administration of cases and consistent application of the rules.[89]

2. Rely on Current Referral Process

Three commenters suggest that FINRA rely on the current process for referring actions or matters for further investigation.[90] These commenters believe FINRA should use this process to detect wrongdoing rather than rely on the arbitrators to enforce the rules and, thus, create issues of bias and impartiality.[91] FINRA, in response, notes that when an arbitration claim is filed, FINRA's Central Review Group (''CRG'') receives a copy of statements of claims and pleadings and reviews them to determine if referral to FINRA Enforcement is warranted.[92] FINRA states also that the enforcement procedures conducted by CRG prior to an arbitration hearing would not be an effective substitute for arbitrator action taken during a hearing based on evidence presented.[93] FINRA notes further that analysis by FINRA Enforcement employees conducted on the claims and pleadings permit FINRA to monitor and analyze volumes of data through various market data systems to detect evidence of wrongdoing.[94] FINRA states, however, that expanding these Enforcement procedures would not necessarily provide the same benefits as having earlier notification by arbitrators, who may learn of a serious threat during the course of a hearing.[95] For these reasons FINRA declines to expand its enforcement procedures as an alternative to the Amended Current Proposal.[96]

3. No Evidence To Support the Need for the Amended Current Proposal

Three commenters contend that FINRA did not provide evidence to support the need for the Amended Current Proposal or FINRA's assertion that it would prevent ongoing fraud or losses for investors.[97] FINRA responds that its assessment of its regulatory structure, as well as its determination that its rules would be strengthened by closing a gap that currently permits arbitrators to make post-case referrals only, justify the need for the Amended Current Proposal.[98] FINRA believes that its assessment of the issue addresses this concern.[99]

4. Amended Current Proposal May Compromise an Arbitrator's Role

Three commenters express concern that the Amended Current Proposal would deputize arbitrators as examiners, who would be required to evaluate and report rule violations.[100] They believe this role would conflict with an arbitrator's duty, which is to serve as an arbiter of a dispute to achieve the best resolution in a manner that serves the interests of the parties.[101] FINRA responds that its rules require arbitrators to be impartial and free from conflicts that could hinder their ability to decide a case fairly.[102] FINRA cites case law in support of its position that arbitrators would not compromise their neutrality by making a mid-case referral, because, in doing so, arbitrators would be performing one of the duties that is expected of arbitrators.[103] FINRA believes that its current rules, case law, and the Code of Ethics for Arbitrators in Commercial Disputes address these concerns.[104]

5. Monitor Effectiveness and Provide Statistics to the Commission

Two commenters recommend that FINRA monitor the effects of the Amended Current Proposal on individual investors and disclose statistics periodically to the Commission on the number of mid-case referrals that arbitrators make.[105] FINRA notes that it has implemented procedures to track post-case referrals and says that it will update its procedures to track the number of mid-case referrals made under the Amended Current Proposal and would provide this data to the Commission a year after the effective date of the proposed rules, and thereafter at the Commission's request.[106] FINRA would also monitor the effects of the Amended Current Proposal to determine whether further action would be necessary.[107]

IV. Discussion

After carefully considering the Amended Current Proposal, the comments submitted, and FINRA's response to the comments, the Commission finds that the Amended Current Proposal is consistent with the requirements of the Act and the rules and regulations thereunder applicable to

[81] Pace and Malecki.
[82] Pace.
[83] Malecki.
[84] FINRA Letter at 10.
[85] *Id.*
[86] *Id.*
[87] *Id.*
[88] *Id.*
[89] FINRA Letter at 10.
[90] Georgia State, PIABA, and Malecki.
[91] Georgia State, PIABA, and Malecki.
[92] FINRA Letter at 10.
[93] FINRA Letter at 10–11.
[94] FINRA Letter at 11.
[95] FINRA Letter at 11, citing May Response at 7–8.
[96] FINRA Letter at 11.
[97] Georgia State, Malecki, and Caruso.
[98] FINRA Letter at 11.
[99] *Id.*
[100] Ryder, Gleizer, and Malecki.
[101] *Id.*
[102] FINRA Letter at 11–12.
[103] FINRA Letter at 12.
[104] *Id.*
[105] NASAA and Pace.
[106] FINRA Letter at 12.
[107] *Id.*

a national securities association.[108] In particular, the Commission finds that the Amended Current Proposal is consistent with Section 15A(b)(6) of the Act,[109] which requires, among other things, that FINRA rules 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.

The rule will permit arbitrators to refer to FINRA any matter or conduct that an arbitrator has reason to believe poses a serious threat, whether ongoing or imminent, that is likely to harm investors unless immediate action is taken. The Commission believes that allowing arbitrators to voice a serious concern under extremely limited circumstances provides a necessary means of alerting FINRA senior staff should an arbitrator have reason to believe during the pendency of an arbitration that there is a threat of serious ongoing or imminent harm. This notification would provide FINRA with earlier warning of potentially harmful conduct than might otherwise occur, and allow FINRA to better protect investors by intervening more quickly under the appropriate circumstances.

As FINRA acknowledges, the rule may cause delays and increase costs for a claimant in some instances. However, the rule is designed in a way that should make its invocation rare, limiting such negative effects. First, the standard for reporting is high. Because the rule limits mid-case referrals to situations where the arbitrator has reason to believe that a matter or conduct poses a serious threat likely to harm investors unless immediate action is taken, it should be rarely invoked. Second, permitting mid-case referrals only for matters or conduct unearthed during the proceedings—and not on the basis of allegations in the pleadings—means that an arbitrator will need to make a mid-case referral decision only in cases when FINRA might not otherwise know about the potentially harmful conduct. Third, the proposal allows an arbitrator to delay making a mid-case referral when, in the arbitrator's judgment, investor protection would not be materially compromised, further reducing the number of times the rule is invoked. Fourth, as amended, the rule limits recusal requests based on the referral itself to three days after the parties are notified of the recusal, limiting the opportunity for recusal requests and the potential strategic delay of a recusal request.

Even in those rare instances where the rule is invoked and there is potential harm to an investor whose case involves a referral, such as a delay or additional costs, FINRA has identified ways that such harm can be limited. First, allocation of costs by an arbitrator or panel can take into account relative fault of the parties. Second, FINRA will bear certain costs itself, such as paying a replacement arbitrator to review the hearing record and to learn about the arbitration up to the point where the case was interrupted. Third, FINRA has identified ways in which the parties themselves can help minimize costs and delays, such as by agreeing to rehear only key witnesses, or stipulating to summaries of prior testimony.

While this would not eliminate every potential cost or dilatory burden on an investor whose case may be adversely affected by a referral, we believe FINRA has identified ways those harms to parties in arbitration can be mitigated or minimized while better protecting investors and the public interest.

Moreover, notifying parties of the fact of a referral can help to safeguard the fairness of the arbitration forum by keeping the parties equally informed, consistent with current arbitration practices. Also, having the Director or President serve as an intake point for any referrals would result in an efficient review and assignment process, and could help direct appropriate resources toward potentially harmful conduct as quickly as possible. In addition, by requiring requests for recusal to be made within three days of being notified, the rule will limit the uncertainty associated with whether a mid-case referral will result in an eventual recusal request. The Commission notes also that a recusal request can still be made for any reason at any time for reasons other than the referral request itself.

In light of the potential gravity of the misconduct that may be reported, and because we believe the potential negative effects will be relatively limited and partially mitigated by the operation of other FINRA rules, we believe the Amended Current Proposal is consistent with the Act in that it is 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.

We appreciate the concerns of some commenters that mid-case referrals may disrupt or delay some arbitration proceedings. Therefore, as some commenters have suggested, and FINRA has agreed, FINRA will gather statistics and report to the Commission, for the period of one year from the effective date of this rule change and for later periods upon request, on the number of cases in which an arbitrator made a mid-case referral. FINRA will also monitor the effects of the Amended Current Proposal to determine whether further action is necessary.

V. Conclusion

It is therefore ordered pursuant to Section 19(b)(2) of the Act [110] that the proposed rule change (SR–FINRA–2014–0005), as modified by Partial Amendment No. 1, be and hereby is approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[111]

Kevin M. O'Neill,

Deputy Secretary.

[FR Doc. 2014–24420 Filed 10–14–14; 8:45 am]

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[108] In approving this proposed rule change, the Commission has considered the proposed rule change's impact on efficiency, competition, and capital formation. *See* 15 U.S.C. 78c(f).

[109] 15 U.S.C. 78o–3(b)(6).

[110] 15 U.S.C. 78s(b)(2).

[111] 17 CFR 200.30–3(a)(12).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–73318; File No. SR–ISE–2014–49]

Self-Regulatory Organizations; International Securities Exchange, LLC; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change To Amend Rule 723 to Add a New PIM ISO Order Type

October 8, 2014.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (''Act''),[1] and Rule 19b–4 thereunder,[2] notice is hereby given that on October 3, 2014 the International Securities Exchange, LLC (''Exchange'' or ''ISE'') filed with the Securities and Exchange Commission the proposed rule change, as described in Items I and II below, which items have been prepared by the self-regulatory organization. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

The ISE proposes to amend its rules to add a new PIM ISO order type. The text of the proposed rule change is available on the Exchange's Web site (*http://www.ise.com*), at the principal

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

[2] 17 CFR 240.19b–4.