

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-2016-025, and should be submitted on or before August 5, 2016.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.¹¹

Robert W. Errett,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-78286; File No. SR-BX-2016-032]

Self-Regulatory Organizations; NASDAQ BX, Inc.; Notice of Filing and Immediate Effectiveness of Proposed Rule Change Relating to the Automated Removal of Quotes

July 11, 2016.

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 July 1, 2016, NASDAQ BX, Inc. (“BX” or “Exchange”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I and II below, which Items have been prepared by the Exchange. 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 Exchange proposes to amend Chapter VII, Section 6(f), entitled “Automated Removal of Quotes.”

The text of the proposed rule change is available on the Exchange’s Web site at <http://nasdaqomxbx.cchwallstreet.com/>, at the principal office of the Exchange, and at the Commission’s Public Reference Room.

II. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the Exchange included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The Exchange has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

The Exchange proposes to amend BX Rules at Chapter VII, Section 6(f), entitled “Automated Removal of Quotes” to modify the minimum Specified Percentage (as described below). A BX Options Market Maker³ sets the Specified Percentage to enhance its risk management for an underlying security as market conditions warrant, based on its own risk tolerance level and quoting behavior. The Exchange proposes to permit the BX Options Market Maker to set the Specified Percentage more broadly, no less than 1%, with this rule change. The Exchange also proposes to replace the definition of “disseminated size”⁴ with a quantitative description to add transparency with respect to the calculation of Series Percentage.

Background

Today, Chapter VII, Section 6(f) permits BX Options Market Makers to monitor risk arising from multiple executions across multiple options series of a single underlying security. A BX Options Market Maker may provide a specified time period and a specified percentage by which the Exchange’s System will automatically remove a BX Options Market Maker’s quotes in all series of an underlying security

³ The term “BX Options Market Maker” or “Options Market Maker” (herein “BX Options Market Maker”) means an Options Participant registered with the Exchange for the purpose of making markets in options contracts traded on the Exchange and that is vested with the rights and responsibilities specified in Chapter VII of these Rules.” [sic] See BX Rules at Chapter I, Section 1(a)(9).

⁴ See Securities Exchange Act Release No. 76317 (October 30, 2015), 80 FR 68586 at 68587 (November 5, 2015) (SR-BX-2015-060). The Exchange defined disseminated size in this rule change in footnote 12, as the original size quoted by the Participant.

submitted through designated BX protocols, as specified by the Exchange, during a specified time period not to exceed 15 seconds (“Percentage-Based Specified Time Period”).⁵

For each series in an option, the System determines: (i) The percentage that the number of contracts executed in that series represents relative to the BX Options Market Maker’s disseminated size of each side in that series (“Series Percentage”); and (ii) the sum of the Series Percentage in the option issue (“Issue Percentage”). The Exchange proposes herein to replace the term “disseminated size” with the more precise phrase “number of contracts available at the time of execution plus the number of contracts executed in unexpired prior executions.”

The System tracks and calculates the net impact of positions in the same option issue during the Percentage-Based Specified Time Period. Specifically, the System tracks transactions, *i.e.*, the sum of buy-side put percentages, the sum of sell-side put percentages, the sum of buy-side call percentages, and the sum of sell-side call percentages. The System then calculates the absolute value of the difference between the buy-side puts and the sell-side puts plus the absolute value of the difference between the buy-side calls and the sell-side calls. If the Issue Percentage, rounded to the nearest integer, equals or exceeds a percentage established by the BX Options Market Maker, not less than 100% (“Specified Percentage”), the System automatically removes a BX Options Market Maker’s quotes in all series of an underlying security submitted through designated BX protocols, as specified by the Exchange, during the Percentage-Based Specified Time.

The Percentage-Based Specified Time Period commences for an option every time an execution occurs in any series in such option and continues until the System removes quotes as described in Chapter VII, Section 6(f)(iv) or (v) or the Percentage-Based Specified Time Period expires. The Percentage-Based Specified Time Period operates on a rolling basis among all series in an option in that there may be multiple Percentage-Based Specified Time Periods occurring simultaneously and such Percentage-Based Specified Time periods may overlap.

Proposal

The Exchange proposes to lower the minimum Specified Percentage, which

⁵ A specified time period commences for an option when a transaction occurs in any series in such option.

¹¹ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

is set by the BX Options Market Maker, from 100% to 1%. The proposal would amend the rule text to state, if the Issue Percentage, rounded to the nearest integer, equals or exceeds a percentage established by the BX Options Market Maker, not less than 1% (“Specified Percentage”), the System automatically removes a BX Options Market Maker’s quotes in all series of an underlying security submitted through designated BX protocols, as specified by the Exchange, during the Percentage-Based Specified Time. This proposal would allow a BX Options Market Maker to establish a Specified Percentage at any percentage level greater than or equal to 1% for an option in which the BX Options Market Maker is appointed. Today, the Specified Percentage would be set by the BX Options Market Maker at greater than or equal to 100%. This amendment will allow BX Options Market Makers to better manage their risk and assist them to avoid trading a number of contracts that exceeds the BX Options Market Maker’s risk tolerance level across multiple series of a single underlying when such series are executed in rapid succession.

BX Options Market Makers will be able to more precisely customize their risk settings within the System. BX Options Market Makers will be able to consider factors such as present and anticipated market conditions, news in an option, and a sudden change in volatility of an option. BX Options Market Makers are required to utilize either the Percentage Based Threshold or the Volume Based Threshold. BX Options Market Makers that select to utilize the Percentage-Based Threshold will be able to adopt more precise controls with this proposal based on the BX Options Market Maker’s risk tolerance level. BX Options Market Makers must utilize either the Percentage-Based⁶ or Volume-Based risk controls. BX Options Market Makers may contact Market Operations to set their percentage, which is 1% or greater with this proposal, and specified time period.

By way of example, if a BX Options Market Maker has set the percentage setting to 50% and a Specified Time

Period of 15 seconds and the Order Book reflects:

MM1 has a displayed quote of 1.10 (100) × 1.20 (100) for IBM May 20, 2016 70 puts and MM1 is the only displayed size on BX and an order is submitted to buy 75 IBM May 20, 2016 70 Puts for 1.20.

Chapter VII, Section 6(f) would cause the following:

- (1) Provide MM1 with an execution—Sold [sic] 75 @ 1.20; and
- (2) Trigger the Percentage-Based Threshold and remove MM1’s quotes in IBM.

Another example is with multiple executions. Presume the following:

MM1 has set the percentage setting to 80% by 5 seconds and MM1 has a displayed quote of 2.00 (100) × 2.25 (100) for IBM May 20, 2016 70 puts and he is the only displayed size on the BX. Also, presume an order comes in to buy 50 IBM May 20, 2016 70 puts for 2.25.

Chapter VII, Section 6(f) would cause the following:

- (1) Provide MM1 with an execution—Sold 50 @ 2.25;
- (2) Update MMI [sic] quote to 2.00 (100) × 2.25 (50);
- (3) Within 1 second an order comes in to buy 45 IBM May 20, 2016 70 puts for 2.25;
- (4) Provide MM1 with an execution—Sold 45 @ 2.25; and
- (5) Trigger the Percentage-Based Threshold and remove MM1’s quotes in IBM.

The Exchange also proposes to replace the term “disseminated size” with a quantitative description to add transparency with respect to the calculation of Series Percentage. The language proposed amends the original definition of disseminated size. With respect to the disseminated size, the Exchange previously defined disseminated size as “. . . the original size quoted by the Participant.”⁷

The Exchange proposes to amend the definition as follows: “For each series in an option, the System will determine: (i) The percentage that the number of contracts executed in that series represents relative to the number of contracts available at the time of execution plus the number of contracts executed in unexpired prior executions of each side in that series (“Series Percentage”); and (ii) the sum of the Series Percentage in the option issue (“Issue Percentage”).” The Exchange counts Specialized Quote Feed (“SQF”)⁸ quotes in determining the

number of contracts traded and removed by the System. SQF permits a two-sided quote for each BX Options Market Maker.

By way of example, with the proposed definition, if a BX Options Market Maker with a Percentage-Based Specified Time Period of 10 seconds and a Specified Percentage of 100% submits a quote over SQF of 1.00 (100) × 1.10 (100) and a buy order executes 75, the remaining size would be 1.00 (100) × 1.10 (25). Thereafter a new Percentage-Based Specified Time Period begins and current Series Percentage executed is 75 and three seconds pass and the BX Options Market Maker re-quotes 1.00 (100) × 1.10 (100), an incoming buy order of 43 would cause the Issue Percentage to meet the Percentage-Based Threshold. This is due to a counted size of 175 (the executed 75 plus the newly quoted 100) and rounding ($0.75 + 43/175 = 0.9957$ rounds up to 100%). If the former definition applied, the size would have been 100 and an execution of only 25 contracts on the same side would have caused the Issue Percentage to meet the Percentage-Based Threshold, which is not the case. In other words, the current SQF quote on that side for that series (for that BX Options Market Maker) in addition to all the executions that have occurred on that side for that series (for that BX Options Market Maker) within the Percentage-Based Specified Time Period would comprise the size.

This new definition accurately represents the manner in which the Issue Percentage is calculated. Also, the more precise language within the rule text will provide BX Options Market Makers with a more accurate description of the operation of this risk mechanism. The Exchange has always calculated the BX Options Market Maker’s size in this fashion. The definition, as described in the prior rule change, was not accurate and the Exchange seeks to amend the definition with this proposal and memorialize the definition within the rule.

2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act⁹ in general, and furthers the objectives of Section 6(b)(5) of the Act¹⁰ in particular, in that it is designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general to protect investors and the public interest, by

⁶ BX Options Market Makers selecting the Percentage-Based risk control in Rule 1095(i) [sic] are required to provide a specified time period, up to 15 seconds, and a specified percentage with a number of 1% or greater, as proposed herein, to the BX Market Operations staff to select this risk control. If a BX Options Market Maker does not desire to utilize the Percentage-Based risk control the BX Options Market Maker must utilize the Volume-Based risk control which is similarly set-up by contacting Market Operations and providing certain settings.

⁷ See note 4 above.

⁸ SQF permits the receipt of quotes. SQF Auction Responses and market sweeps are also not included.

⁹ 15 U.S.C. 78f(b).

¹⁰ 15 U.S.C. 78f(b)(5).

offering BX Options Market Makers the ability to better manage their own risk with this risk feature.

BX Options Market Makers are obligated to submit continuous two-sided quotations in a certain number of series in their appointed option classes for a certain percentage of each trading session.¹¹ This obligation renders them vulnerable to risk from unusual market condition, volatility in specific options, and other market events that may cause them to receive multiple, extremely rapid automatic executions before they can adjust their quotations and overall risk exposure in the market. Without adequate risk management tools in place on the Exchange, the incentive for BX Options Market Makers to quote aggressively, respecting both price and size could be diminished. Such a result may undermine the quality of the markets, which are enhanced by the depth and liquidity such Market Makers provide in the marketplace.

By allowing the Specified Percentage provided by the BX Options Market Maker to be reduced from 100% to 1%, the Exchange provides its BX Options Market Makers the desired flexibility to take into account such factors as present and anticipated market conditions, news in an option or sudden change in volatility of an option without any limitation regarding the Specified Percentage. This should encourage BX Options Market Makers to provide additional depth and liquidity to the Exchange's markets, thereby removing impediments to and perfecting the mechanisms of a free and open market and a national market system and, in general, protecting investors and the public interest.

The proposal is consistent with the Act because the reduction of the Specified Percentage to not less than 1% provides more alternatives to BX Options Market Makers in setting their percentage without impacting their firm quote obligations. The System operates consistently with the firm quote obligations of a broker-dealer pursuant to Rule 602 of Regulation NMS. Specifically, with respect to BX Options Market Makers, their obligation to provide continuous two-sided quotes on

a daily basis is not diminished by the removal of such quotes by the Percentage-Based Threshold. BX Options Market Makers are required to provide continuous two-sided quotes on a daily basis.¹² BX Options Market Makers that utilize the Percentage-Based Threshold will not be relieved of the obligation to provide continuous two-sided quotes on a daily basis, nor will the change prohibit the Exchange from taking disciplinary action against a BX Options Market Maker for failing to meet the continuous quoting obligation each trading day. All quotes entered into the System are considered firm. Quotes will only be removed from the System once the Percentage-Based Threshold has been met if the quote was not otherwise executed by an incoming order.

This risk feature will continue to remove impediments to and perfect the mechanism of a free and open market and a national market system and protect investors and the public interest by allowing BX Options Market Makers to remove their quotes in the event that market conditions warrant, based on their own risk tolerance level. BX Options Market Makers provide liquidity to the market place and have obligations unlike other market participants.¹³ This risk feature is important because it will enable BX Options Market Makers to manage their exposure at the Exchange. Further, permitting BX Options Market Makers to enter a broader setting would continue to allow BX Options Market Makers to have flexibility in setting their risk exposure to prevent unintended triggers of the Percentage-Based Threshold. This proposal continues to allow BX Options Market Makers to also select a Percentage-Based Specified Time Period. Each BX Options Market Maker has different levels of sensitivity and its own system safeguards as well. The proposed setting would permit each BX Options Market Maker to select a setting that is appropriate to capture the needs of that BX Options Market Maker.

Further, it is important to note that any interest that is executable against a BX Options Market Maker's quotes and orders that are received¹⁴ by the Exchange prior to the trigger of the Percentage-Based Threshold, which is processed by the System, automatically executes at a price up to the BX Options Market Maker's size. The system-

generated Purge Notification Message is accepted by the System in the order of receipt in the queue and is processed in that order so that interest that is already accepted into the System is processed prior to the message. Incoming orders received prior to the Purge Notification Message would not be cancelled, rather they be [sic] executed at a price up to the BX Options Market Maker's size.

The Exchange notes that Miami International Securities Exchange, LLC ("MIAX") implemented a rule that changed its Allowable Engagement Percentage from a minimum of 100% to any percentage established by the Market Maker.¹⁵ The BX rule is similar to MIAX's in that a member is required to have a setting, although MIAX has a default setting in place in the instance that no percentage is provided. BX Options Market Makers that select the Percentage-Based risk tool must provide the Exchange with a Percentage-Based Specified Time Period and a Specified Percentage greater than or equal to 1%.

Amending the definition of disseminated size will provide market participants with greater information on the manner in which the Exchange computes the Issue Percentage. The Exchange believes that the manner in which the Exchange calculates the number of contracts, which are counted for the Issue Percentage, is consistent with the Act. The counting method permits the Exchange to update the reference number to include the executed contracts. While this method differs from the method previously described, the Exchange believes that there is no industry standard for counting and its method permits market participants to achieve the desired risk protection. With the proposed definition, each execution uses the Percentage-Based Specified Time Period that existed at the time of the execution. BX Options Market Makers can change the Percentage-Based Specified Time Period at any time. If a BX Options Market Maker is using a Percentage-Based Specified Time Period of 15 seconds when an execution happens, then changes the Percentage-Based Specified Time Period to half a second, that first execution will not expire until 15 seconds have passed. The selected Percentage-Based Specified Time Period will persist for 15 seconds and the number of executed contracts will be included in the denominator of subsequent executions for a full 15 seconds.

¹¹ Pursuant to BX Rules at Chapter VII, Section 5, entitled "Obligations of Market Makers", in registering as a market maker, an Options Participant commits himself to various obligations. Transactions of a BX Options Market Maker must constitute a course of dealings reasonably calculated to contribute to the maintenance of a fair and orderly market, and Market Makers should not make bids or offers or enter into transactions that are inconsistent with such course of dealings. Further, all Market Makers are designated as specialists on BX for all purposes under the Act or rules thereunder. See Chapter VII, Section 5.

¹² *Id.*

¹³ *Id.*

¹⁴ The time of receipt for an order or quote is the time such message is processed by the Exchange book.

¹⁵ See Securities Exchange Act Release No. 77817 (May 12, 2016), 81 FR 31286 (May 18, 2016) (SR-MIAX-2016-10).

B. Self-Regulatory Organization's Statement on Burden on Competition

The Exchange does not believe that the proposed rule change will impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act. The Percentage-Based Threshold is intended to protect BX Options Market Makers from exposure to excessive risk. The Exchange believes this proposal will foster competition by providing BX Options Market Makers with the ability to enhance and customize their percentage in order to compete for executions and order flow. Specifically, the proposal does not impose a burden on intra-market or inter-market competition; rather, it provides BX Options Market Makers with the opportunity to avail themselves of similar risk tools, which are currently available on other exchanges.¹⁶ BX Options Market Makers quote across many series in an option creating the possibility of "rapid fire" executions that can create large, unintended principal positions that expose BX Options Market Makers. The Percentage-Based Threshold permits BX Options Market Makers to monitor risk arising from multiple executions across multiple options series of a single underlying security.

The Exchange is proposing this rule change to continue to permit BX Options Market Makers to reduce their risk in the event the BX Options Market Maker is suffering from a system issue or due to the occurrence of unusual or unexpected market activity. Reducing such risk will enable BX Options Market Makers to enter quotations without any fear of inadvertent exposure to excessive risk, which in turn will benefit investors through increased liquidity for the execution of their orders. Reducing risk by utilizing the proposed risk protections enables BX Options Market Makers, specifically, to enter quotations with larger size, which in turn will benefit investors through increased liquidity for the execution of their orders. Such increased liquidity benefits investors because they receive better prices and because it lowers volatility in the options market.

The Exchange believes that amending the definition of disseminated size does not create an undue burden on competition because the Exchange will uniformly calculate the Percentage-Based Threshold in a uniform manner for all BX Options Market Makers. The Exchange is memorializing the definition within the Rule.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants, or Others

No written comments were either solicited or received.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Because the foregoing proposed rule change does not: (i) Significantly affect the protection of investors or the public interest; (ii) impose any significant burden on competition; and (iii) become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate, it has become effective pursuant to Section 19(b)(3)(A) of the Act¹⁷ and Rule 19b-4(f)(6) thereunder.¹⁸ The Exchange has requested that the Commission waive the thirty-day operative delay so that the proposal may become operative immediately. The Commission believes that waiving the thirty-day operative delay is consistent with the protection of investors and the public interest. The Exchange proposes to change a setting in an existing risk protection feature to enhance market makers' ability to protect against excessive risk arising from multiple executions across multiple options series of a single underlying security. The Commission notes that another options exchange currently has a similar setting for a like risk protection feature for market makers. Moreover, the Commission notes that the proposal to replace the term "disseminated size" with an accurate and more precise description would add transparency with respect to the operation of the risk protection feature. Therefore, the Commission hereby waives the thirty-day operative delay and designates the proposal operative upon filing.¹⁹

At any time within 60 days of the filing of the proposed rule change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of

the purposes of the Act. If the Commission takes such action, the Commission shall institute proceedings to determine whether the proposed rule change should be approved or disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

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-BX-2016-032 on the subject line.

Paper Comments

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549-1090.

All submissions should refer to File Number SR-BX-2016-032. 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 the filing also will be available for inspection and copying at the principal office of the Exchange. 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-BX-2016-032 and should be submitted on or before August 5, 2016.

¹⁷ 15 U.S.C. 78s(b)(3)(A).

¹⁸ 17 CFR 240.19b-4(f)(6). In addition, Rule 19b-4(f)(6) requires a self-regulatory organization to give the Commission written notice of its intent to file the proposed rule change, along with a brief description and the text of the proposed rule change, at least five business days prior to the date of filing of the proposed rule change, or such shorter time as designated by the Commission. The Exchange has satisfied this requirement.

¹⁹ For purposes of waiving the 30-day operative delay, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

¹⁶ See Section 8 of the 19b4.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.²⁰

Robert W. Errett,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-78279; File No. SR-FINRA-2016-022]

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of a Proposed Rule Change To Amend Rule 12403 (Cases With Three Arbitrators) of the Code of Arbitration Procedure for Customer Disputes Relating to the Panel Selection Process in Arbitration

July 11, 2016.

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 July 1, 2016, Financial Industry Regulatory Authority, Inc. (“FINRA”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by FINRA. 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

FINRA is proposing to amend Rule 12403 of the Code of Arbitration Procedure for Customer Disputes (“Code”) concerning customer cases with three arbitrators, to increase the number of public arbitrators on the list that FINRA sends parties during the arbitration panel selection process from 10 arbitrators to 15 arbitrators. FINRA would also increase the number of strikes that parties may make to the public list from four to six strikes to keep the proportion of strikes the same under the amended rule as it is under the current rule.

The text of the proposed rule change is available on FINRA’s Web site at <http://www.finra.org>, at the principal office of FINRA and at the Commission’s Public Reference Room.

II. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, FINRA included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. FINRA has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

Background

FINRA allows parties to participate in selecting the arbitrators who serve on their cases. Parties select their arbitration panel from computer generated lists of arbitrators that FINRA sends them. Under FINRA Rule 12403(a), in customer cases with three arbitrators,³ FINRA sends the parties three lists: A list of 10 chair-qualified public arbitrators, a list of 10 public arbitrators, and a list of 10 non-public arbitrators.⁴ The parties select their panel through a process of striking and ranking the arbitrators on the lists.⁵ Under Rule 12403(c)(2), each party is allowed to strike up to four arbitrators on the chair-qualified public list and four arbitrators on the public list. At least six names must remain on each list. However, Rule 12403(c)(1) provides for unlimited strikes on the non-public list so that any party may select a panel of all public arbitrators in a customer case.

When parties collectively strike all of the non-public arbitrators from the list, FINRA fills all three panel seats from the two 10-person lists of public arbitrators. Specifically, the Code provides that when parties collectively

³ See FINRA Rule 12401 which provides that if the amount of a claim is more than \$100,000, exclusive of interest and expenses, or is unspecified, or if the claim does not request money damages, the panel will consist of three arbitrators, unless the parties agree in writing to one arbitrator.

⁴ Public arbitrators do not have an affiliation with the financial industry. The non-public arbitrator roster includes individuals who: (1) Are employed in the financial industry; (2) provide services to industry entities and their employees; or (3) devote a significant part of their business to representing or providing services to parties in disputes concerning investments or employment relationships.

⁵ See FINRA Rule 12403(c) (Striking and Ranking Arbitrators).

strike all of the arbitrators appearing on the non-public list, FINRA returns to the public list to select the next highest ranked available arbitrator to fill the seat. If no public arbitrators remain available to fill the vacancy, FINRA returns to the chair-qualified public list to select the next highest ranked public chair. In doing so, there is a likelihood that FINRA will appoint an arbitrator who the parties accepted, but ranked lower on the public or chair-qualified public lists.

FINRA Dispute Resolution Task Force

In 2014, FINRA formed the FINRA Dispute Resolution Task Force (“Task Force”) to suggest strategies to enhance the transparency, impartiality, and efficiency of FINRA’s securities dispute resolution forum for all participants. The Task Force discussed panel selection in customer cases. During its discussions, the Task Force reviewed statistics on how often parties were striking all of the non-public arbitrators on the list. The data indicated that between September 30, 2013 (the effective date of the rule change providing for all public panels) and January 16, 2015, claimants struck all non-public arbitrators in 69 percent of cases. Given the data on strikes, the Task Force concluded that in many cases, the parties are selecting the three public arbitrators from the 20 candidates appearing on the public lists. The Task Force recommended that in instances where parties collectively strike all the non-public arbitrators, FINRA should provide a new list of 10 public arbitrators to fill the third public arbitrator seat.

Proposed Rule Change

FINRA agrees with the Task Force that FINRA should provide parties with greater choice of public arbitrators in cases with all public panels. However, if FINRA waits until the parties collectively strike all the non-public arbitrators from the list before it provides the parties with additional names of public arbitrators, the panel selection process is likely to take at least one additional month to complete. Also, FINRA is concerned about the additional time and expense the parties would incur in vetting an additional list of 10 public arbitrators.

To address the Task Force’s recommendation without delaying the panel selection process, or unduly burdening the parties, FINRA is proposing to amend Rule 12403(a)(1) to increase the number of arbitrators on the public arbitrator list FINRA sends the parties from 10 to 15. In doing so, FINRA would provide greater choice of

²⁰ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.