

FINRA Proposes Changes to Arbitrator List Selection Process

March 22, 2023

The Financial Industry Regulatory Authority (FINRA) recently proposed several rule changes aimed at “provid[ing] greater transparency and consistency” with respect to the arbitrator list selection process administered by FINRA Dispute Resolution Services (DRS). The proposed changes — if approved — will affect the arbitrator selection process under both the Code of Arbitration Procedure for Customer Disputes and the Code of Arbitration Procedure for Industry Disputes in the following ways:

- The new rules would codify FINRA’s current practice of using both an algorithm and a manual review to identify potential conflicts of interest and exclude conflicted arbitrators. FINRA identifies potential conflicts of interest in two ways: first, an algorithm screens for geography and randomly generates a list of potential arbitrators, excluding arbitrators based on conflicts of interest known with FINRA member firms, including, for example, arbitrators who are currently employed by or who currently have securities account(s) with a party; then, the algorithm generates three lists of available arbitrators and DRS conducts a manual review for remaining conflicts of interest, including, for example, arbitrators who are immediate family members or relatives of the parties or attorneys involved. Existing rules detail only the algorithm process, and the manual review is instead explained on FINRA’s website. The proposed rule changes would modify existing rules to codify both the algorithm and the manual review process.
- The new rules would also require the FINRA Director to issue a written explanation when granting or denying a party’s request to remove an arbitrator.
- Current FINRA Rules 12407(a) and 13410(a) provide that “[b]efore the first hearing session begins, the Director may remove an arbitrator for conflict of interest or bias, either upon request of a party or on the Director’s own initiative,” but these rules are silent on when a challenge may first be submitted. The new rules would clarify that a party (or the Director) may challenge an arbitrator for cause as early as receipt of arbitrator ranking lists and before the beginning of the first hearing session.

The proposed changes also include several technical changes to requirements under both Codes related to holding prehearing conferences and hearing sessions, initiating and responding to claims, motion practice, claim and case dismissal, and providing a hearing record.

The proposed changes stem from a June 2022 report issued by an outside law firm after an independent review of the DRS arbitrator list selection process (the “Report”). FINRA engaged outside counsel in February 2022 to review its DRS process after a Georgia state court vacated a FINRA arbitration award when it found that the arbitrator pool had been “manipulated” because one of the attorneys allegedly had an ongoing agreement with FINRA to remove arbitrators who had previously ruled against his clients. The Georgia Court of Appeals later disagreed and overturned the lower court ruling, but the Report nevertheless detailed several recommended rule changes to provide greater clarity to FINRA participants to reduce any appearance of impropriety.

FINRA submitted the proposed rule changes to the Securities and Exchange Commission (SEC) on December 23, 2022, requesting approval for the rule changes, but the SEC has yet to issue any approval(s). FINRA recently issued a notice stating that the SEC has until April 12, 2023 to act on the proposed rules.

As a practical matter, these rule changes would not significantly impact the ways in which FINRA reviews and identifies conflicts of interest. However, the changes aim to reduce ambiguity surrounding the process, which should ease the burden on parties to request information from DRS and provide some clarity as to how conflicts are identified and handled. The more specific rules regarding the ability to challenge an arbitrator and the requirement of a written explanation for decisions regarding those challenges will also better enable parties to react to belated discovery of conflicts of interest and to have decisions of FINRA related to such conflicts reviewed if necessary.

CONTACTS

For more information, contact your Katten attorney or any of the following members of Katten's [Financial Markets Litigation and Enforcement](#) practice.



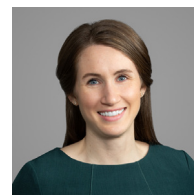
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