



**FINANCIAL
SERVICES
INSTITUTE**

VOICE OF INDEPENDENT
FINANCIAL SERVICES
FIRMS AND INDEPENDENT
FINANCIAL ADVISORS

VIA ELECTRONIC MAIL

December 18, 2017

Ms. Marcia E. Asquith
Office of the Corporate Secretary
Financial Industry Regulatory Authority, Inc.
1735 K Street, NW
Washington, DC 20006-1506

Re: Regulatory Notice 17-33; Amendments to the Code of Arbitration Procedure for Customer Disputes to Expand the Options Available to Customers if a Firm or Associated Person Is or Becomes Inactive (Notice)

Dear Ms. Asquith:

On October 18, 2017, the Financial Industry Regulatory Authority, Inc. (FINRA) published its request for comment on proposed amendments (Proposed Amendments) to its Code of Arbitration Procedure for Customer Disputes (Code). The Proposed Amendments would expand customers' options against firms that become inactive during arbitration. They would also expand customers' options with respect to associated persons who are inactive when an arbitration is filed or who become inactive during a pending arbitration.

The Financial Services Institute¹ (FSI) appreciates the opportunity to comment on the Proposed Amendments. FSI largely supports the Proposed Amendments as set forth in the Notice and the corresponding rule text. As an initial matter, the Proposed Amendments address a scenario that is not currently addressed in FINRA rules and, as such, brings important clarity to the arbitration process. Critically, the Proposed Amendments also require FINRA to notify customers when a member or an associated person becomes inactive during a pending arbitration.² This will ensure that customers are promptly informed of the change in the firm's or the associated person's status. However, as discussed more fully below, FSI is concerned that certain aspects of the Proposed Amendments have the unintended consequence of creating an unbalanced arbitration process and we make suggestions to address that concern.

Background on FSI Members

The independent financial services community has been an important and active part of the lives of American investors for more than 40 years. In the US, there are approximately 167,000 independent financial advisors, which account for approximately 64.5% percent of all

¹ The Financial Services Institute (FSI) is an advocacy association comprised of members from the independent financial services industry, and is the only organization advocating solely on behalf of independent financial advisors and independent financial services firms. Since 2004, through advocacy, education and public awareness, FSI has been working to create a healthier regulatory environment for these members so they can provide affordable, objective financial advice to hard-working Main Street Americans.

² See Proposed FINRA Rule 12202 (b).

producing registered representatives.³ These financial advisors are self-employed independent contractors, rather than employees of the Independent Broker-Dealers (IBD).

FSI's IBD member firms provide business support to independent financial advisors in addition to supervising their business practices and arranging for the execution and clearing of customer transactions. Independent financial advisors are small-business owners with strong ties to their communities and know their clients personally. These financial advisors provide comprehensive and affordable financial services that help millions of individuals, families, small businesses, associations, organizations, and retirement plans. Their services include financial education, planning, implementation, and investment monitoring. Due to their unique business model, FSI member firms and their affiliated financial advisors are especially well positioned to provide Main Street Americans with the financial advice, products, and services necessary to achieve their investment goals.

FSI members make substantial contributions to our nation's economy. According to Oxford Economics, FSI members nationwide generate \$48.3 billion of economic activity. This activity, in turn, supports 482,100 jobs including direct employees, those employed in the FSI supply chain, and those supported in the broader economy. In addition, FSI members contribute nearly \$6.8 billion annually to federal, state, and local government taxes. FSI members account for approximately 8.4% of the total financial services industry contribution to U.S. economic activity.⁴

Discussion

A. Background

The Notice explains that “[w]hen [firms or associated persons] are no longer in business, recovery of arbitration awards against them is often unavailing.”⁵ Thus, the regulatory objectives of the Proposed Amendment are, purportedly, to: i) improve investors' ability to collect arbitration awards against inactive FINRA members; and ii) reduce instances of unpaid arbitration awards by inactive FINRA members. While those regulatory objectives are possible consequences of the Proposed Amendments, FSI notes that the Proposed Amendments do not directly address the issue of unpaid arbitration awards. Instead, they make changes to the arbitration process, which is not guaranteed to result in an award.

The distinction between arbitration “awards” and the arbitration “process” itself, is an important one. The arbitration process should be a fair and balanced process to determine whether a customer award is even warranted. Once an award is entered, it becomes a right of the customer and FINRA should protect this right within its jurisdictional limits to do so. However, we are concerned that making alterations to the arbitration process for the purpose of biasing it in favor of enhancing one party's subsequent recovery efforts would, in itself, undermine the integrity of the process by disrupting its fairness and balance.

³ The use of the term “financial advisor” or “advisor” in this letter is a reference to an individual who is a registered representative of a broker-dealer, an investment adviser representative of a registered investment adviser firm, or a dual registrant. The use of the term “investment adviser” or “adviser” in this letter is a reference to a firm or individual registered with the SEC or state securities division as an investment adviser.

⁴ Oxford Economics for the Financial Services Institute, *The Economic Impact of FSI's Members* (2016).

⁵ See Regulatory Notice 17-33 at p. 1.

B. FSI's Suggested Modifications to the Proposed Amendments

i. Proposed Rule Amendments

The Proposed Amendments expand customers' options with respect to firms and associated persons who become inactive. Those expanded options, include:

- Permitting a customer to withdraw the claim if a member or an associated person becomes inactive during the course of an arbitration;⁶
- Deeming claims against inactive associated persons as ineligible for arbitration, unless the customer and the associated person are parties to a post-dispute arbitration agreement;⁷
- Permitting customers to amend their pleadings, including by adding new parties, upon learning that a firm has become inactive;⁸
- Allowing customers to postpone a hearing date where: i) the customer is notified that the firm has become inactive, and ii) the scheduled hearing date is within sixty (60) days of the notice;⁹ and
- Granting customers the option to withdraw their claim and having their filing fees refunded upon learning that a firm or an associated person has become inactive.¹⁰

ii. Amending Pleadings to Add Parties Should Be Subject to the Arbitration Panel's Approval

A customer's right to add parties to an arbitration should be subject to the arbitration panel's approval. This allows the panel to assess whether the claims against the party to be added have merit and to reject meritless claims before that party incurs unnecessary defense costs.

Under the current iteration of the Code, after an arbitration panel has been selected, new parties may only be added to a claim with the panel's consent. Any request to add new parties must not only be submitted to that party, but that party also has an opportunity to proffer a response to the request.¹¹ This existence of this process is vital because it requires customers to propound a reasonable basis for adding new parties, allows the party to be added to proffer a reason it should not be added and, thereby, discourages the gratuitous addition of unnecessary parties. The Proposed Amendments omit these safeguards when the addition of parties is made in response to notice that a firm, or an associated person, has become inactive.¹² In those circumstances, claimants have, what appears to be, an unfettered right to add new parties, so long as the customer does so within sixty (60) of receiving the notice.¹³

Situations in which FSI members acquire customer accounts from inactive firms are one example in which these continued safeguards are needed. Specifically, once a firm becomes inactive, it is not uncommon for the firm's customer accounts to be transferred to another FINRA member firm for servicing. This transfer facilitates investor protection because it prevents

⁶ See Proposed FINRA Rule 12202(b).

⁷ See, generally, Proposed FINRA Rule 12202.

⁸ See Proposed FINRA Rule 12309(b)(2); see also Proposed FINRA Rule 12309(c)(2).

⁹ See Proposed FINRA Rule 12601(a)(1)(B).

¹⁰ See Proposed FINRA Rule 12900 (c)(3).

¹¹ See FINRA Rule 12309(c).

¹² See Proposed FINRA Rule 12309 (c)(2).

¹³ *Id.*

customers from experiencing prolonged service interruptions. However, for the reasons set forth above, the Proposed Amendments will make it easier for, and likely encourage, customers to pursue claims against the firm that accepts the customer accounts; even where such claims are legally untenable. In an effort to avoid this, firms may elect not to receive customer accounts from inactive firms and, as such, these accounts may become orphaned, which is not in the best interest of the customer. Thus, safeguards prohibiting claimants from adding new parties without the arbitration panel's consent should be preserved.

iii. Related Claims Against Associated Persons and Firms Should Be Litigated in the Same Forum

Under the Proposed Amendments, claims against associated persons will not be eligible for arbitration, unless the parties have entered into a post-dispute arbitration agreement.¹⁴ Customers would, therefore, be able to proceed in court where they could obtain discovery against the associated person, including depositions, interrogatory responses and other customary discovery. Further, the associated person and the customer may engage in extensive motion practice through which additional facts may be disseminated. That information may, thereafter, be used against the firm in arbitration. The firm, however, would not have the opportunity to solicit analogous information from the customer, leading to an unfair and unbalanced process. Thus, FSI suggests the Proposed Amendments clarify that customers would be required to pursue related claims in the same forum. For the purpose of this requirement, claims should be considered related where the claim against the firm, and the claim against the associated person, arise from the same facts and alleged misconduct such that separating the claims may prejudice any party or frustrate the fact-finding process.

Conclusion

We are committed to constructive engagement in the regulatory process and welcome the opportunity to work with the Department on this and other important regulatory efforts.

Thank you for considering FSI's comments. Should you have any questions, please contact me at (202) 393-0022.

Respectfully submitted,



Robin M. Traxler
Vice President, Regulatory Affairs & Associate General Counsel

¹⁴ See Proposed FINRA Rule 12202.