



8011-01
SECURITIES AND EXCHANGE COMMISSION
[Release No. 34-88254; File No. SR-FINRA-2019-027]

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Order Approving a Proposed Rule Change to Amend FINRA Rule 12000 Series to Expand Options Available to Customers if a Firm or Associated Person is or Becomes Inactive
February 20, 2020.

I. Introduction

On November 5, 2019, Financial Industry Regulatory Authority, Inc. (“FINRA”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Exchange Act”)¹ and Rule 19b-4 thereunder,² a proposed rule change to amend FINRA Rules 12100, 12202, 12214, 12309, 12400, 12601, 12702, 12801, and 12900 of the Code of Arbitration Procedure for Customer Disputes (“Customer Code” or “Code”) to expand a customer’s options to withdraw an arbitration claim if a member or an associated person becomes inactive before a claim is filed or during a pending arbitration. In addition, the proposed amendments would allow customers to amend pleadings, postpone hearings, request default proceedings, and receive a refund of filing fees in these situations.

The proposed rule change was published for comment in the Federal Register on November 22, 2019.³ The public comment period closed on December 13, 2019. The Commission received five comment letters in response to the Notice.⁴ On February 11, 2020,

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Exchange Act Release No. 87577 (Nov. 18, 2019), 84 FR 64581 (Nov. 22, 2019) (File No. SR-FINRA-2019-027) (“Notice”).

⁴ See Letter from Steven B. Caruso, Maddox Hargett Caruso, P.C., dated November 19, 2019 (“Caruso Letter”); letter from Benjamin P. Edwards, Associate Professor of Law, University of Nevada, Las Vegas, December 11, 2019 (“Edwards Letter”); letter from Kevin M. Carroll, Managing Director and Associate General Counsel, SIFMA, December

FINRA responded to the comment letters received in response to the Notice.⁵ On December 18, 2019, FINRA extended the time period in which the Commission must approve the proposed rule change, disapprove the proposed rule change, or institute proceedings to determine whether to approve or disapprove the proposed rule change to February 20, 2020.⁶ This order approves the proposed rule change.

II. Description of the Proposed Rule Change⁷

Background

Firms and individuals whose FINRA registration has been terminated, suspended, cancelled, or revoked, or who have been expelled from FINRA are generally referred to as “inactive,” and are no longer FINRA members or associated with a FINRA member, although they may continue to operate in another area of the financial services industry where FINRA registration is not required. Firms and individuals can become inactive prior to an arbitration claim being filed, during an arbitration proceeding, or subsequent to an arbitration award, and

12, 2019 (“SIFMA Letter”); letter from Samuel B. Edwards, President, Public Investors Arbitration Bar Association (“PIABA”), December 13, 2019 (“PIABA Letter”); and letter from Robin M. Traxler, Senior Vice President, Policy & Deputy General Counsel, Financial Services Institute (“FSI”), December 13, 2019 (“FSI Letter”). Comment letters are available on the Commission’s website at <https://www.sec.gov>.

⁵ See Letter from Mignon McLemore, Assistant General Counsel, Office of General Counsel, FINRA, to Vanessa Countryman, Secretary, U.S. Securities and Exchange Commission, dated February 11, 2020 (“FINRA Letter”). The FINRA Letter is available on FINRA’s website at <http://www.finra.org>, at the principal office of FINRA, at the Commission’s website at <https://www.sec.gov/comments/sr-finra-2019-027/srfinra2019027-6796335-208356.pdf>, and at the Commission’s Public Reference Room.

⁶ See Letter from Mignon McLemore, Assistant General Counsel, FINRA, to Lourdes Gonzalez, Assistant Chief Counsel, Division of Trading and Markets, U.S. Securities and Exchange Commission, dated December 18, 2019.

⁷ The subsequent description of the proposed rule change is substantially excerpted from FINRA’s description in the Notice. See Notice, 83 FR at 64581-64583.

this status can be caused by FINRA action, such as when a firm or individual is suspended for failing to pay an award, or by the firm's or individual's own voluntary action.⁸

Current FINRA arbitration rules provide options to a customer when dealing with those members or associated persons that are inactive either at the time the claim is filed or at the time of the award. For example, when a customer claimant first files an arbitration claim, FINRA alerts, by letter, the customer claimant if the respondent, whether a member or an associated person, is inactive. FINRA also informs the claimant that awards against such members or associated persons have a much higher incidence of non-payment and that FINRA has limited disciplinary leverage over inactive members or associated persons that fail to pay arbitration awards. Thus, the customer knows before pursuing the claim in arbitration that collection of an award may be more difficult. In addition, upon learning that the member or associated person is inactive, a customer may determine to amend his or her claim to add other respondents from whom the customer may be able to collect should the claim go to award.

Proposed Rule Change

FINRA is proposing to amend the Customer Code to expand further the options available to customers in situations where a firm becomes inactive during a pending arbitration, or where an associated person becomes inactive either before a claim is filed or during a pending arbitration. In particular, FINRA is proposing to amend the Code to allow customers to amend pleadings, postpone hearings, request default proceedings and receive a refund of filing fees if the customer withdraws the claim under these situations.

A. Arbitrating Claims Against Inactive Members and Associated Persons

⁸ See FINRA Rule 9554 (Failure to Comply with an Arbitration Award or Related Settlement or an Order of Restitution or Settlement Providing for Restitution).

Currently, under FINRA Rule 12202 (Claims Against Inactive Members), a customer's claim against a firm whose membership is terminated, suspended, cancelled or revoked, or that has been expelled from FINRA, or that is otherwise defunct, is ineligible for arbitration unless the customer agrees in writing to arbitrate after the claim arises.⁹ The Code does not address situations, however, where a member firm becomes inactive during a pending arbitration. In addition, the Code does not provide specific procedures for a customer to withdraw a claim against an associated person who becomes inactive before the customer files a claim or during a pending arbitration.

Accordingly, FINRA is proposing to amend FINRA Rule 12202 to expand a customer's option to withdraw a claim to situations where a member becomes inactive during a pending arbitration, or where an associated person becomes inactive either before a claim is filed or during a pending arbitration. Under the proposal, FINRA Rule 12202 would specify that a customer's claim against an associated person who is inactive at the time the claim is filed is ineligible for arbitration unless the customer agrees in writing to arbitrate after the claim arises. In addition, as amended Rule 12202 would specify that if a member or an associated person becomes inactive during a pending arbitration, FINRA would notify the customer of the status change, and provide the customer with 60 days to withdraw the claim(s) with or without prejudice.¹⁰

⁹ If the customer notifies FINRA in writing that he or she does not want to proceed against the inactive member in FINRA's forum, FINRA deems the customer's agreement to submit to arbitration rescinded and sends the customer a full refund of any filing fee remitted.

¹⁰ FINRA Rule 12702 (Withdrawal of Claims) provides that before a party answers a statement of claim, the claimant can withdraw the claim with or without prejudice. However, after a party submits an answer, the claimant can only withdraw the claim with prejudice unless the panel or the parties agree otherwise. FINRA is proposing to make a conforming change to FINRA Rule 12702 to provide that a customer can withdraw a

FINRA believes that similar to the current rules and procedures relating to claims filed against inactive members, the proposed amendments would allow the customer to evaluate the likelihood of collecting on an award and make an informed decision whether to proceed in arbitration, to file the claim in court or to take no action, regardless of whether the customer signed a predispute arbitration agreement.

In addition, FINRA is proposing to amend FINRA Rule 12100 (Definitions) to add definitions of “inactive member” and “inactive associated person.” Consistent with current Rule 12202, FINRA proposed to define an “inactive member” as a member whose membership is terminated, suspended, cancelled or revoked, that has been expelled or barred¹¹ from FINRA, or that is otherwise defunct.¹²

Under the proposed rule change, an “inactive associated person” would be defined as a person associated with a member whose registration is revoked, cancelled, or suspended, who has been expelled or barred from FINRA, or whose registration has been terminated for a minimum of 365 days.¹³ Thus, if an associated person’s registration is not revoked, cancelled, or suspended, the person has not been expelled or barred from FINRA, and the individual’s

claim without prejudice if the party that submitted an answer is an inactive member or inactive associated person. Withdrawal without prejudice would allow the customer to re-file the arbitration at a later date.

¹¹ FINRA is proposing to add “or barred” to the definition of an “inactive member” to capture that a member may be inactive due to a bar.

¹² The proposed rule change would amend the definition of “member” under the Customer Code, the Code of Arbitration Procedure for Industry Disputes (“Industry Code”), and in Article I of the By-Laws of FINRA Regulation, Inc. to conform the definition to the proposed definition of an “inactive member” as discussed below. FINRA believes the proposed changes would make the definition of “member” consistent in the FINRA rules that apply to FINRA’s arbitration forum.

¹³ See Proposed Rule 12100(r).

registration has been terminated for less than one year, the individual would not be classified as terminated and, therefore, would not be deemed inactive.

FINRA believes the 365-day minimum termination requirement for associated persons would help ensure that enough time has elapsed to assume reasonably that the associated person has permanently left the securities industry. FINRA further believes that the proposed requirement would allow enough time for those associated persons who may have temporarily left the industry to return before the arbitration closes.¹⁴

B. Amending Pleadings

Currently, FINRA Rule 12309 (Amending Pleadings) limits a party's ability to amend a statement of claim, among other pleadings, after FINRA has appointed a panel to the case. Specifically, once FINRA appoints a panel to a case, a party can amend a pleading only if the arbitrators grant a party's motion to do so. Current FINRA Rule 12309 also provides that a party cannot add a new party to the case after arbitrator ranking lists are due to the Director of Arbitration until FINRA appoints the panel and the arbitrators grant a party's motion to add the new party.

FINRA believes that a customer should be able to change his or her litigation strategy during a pending case once the customer learns that a firm or an associated person has become inactive. Accordingly, FINRA is proposing to amend FINRA Rule 12309 to provide that if FINRA notifies a customer that a firm or an associated person has become inactive during a

¹⁴ As stated in the Notice, termination, in some cases, may be a voluntary action that can be of short duration. For instance, in FINRA's analysis of 2,054 customer cases closed by hearing, on the papers, or by stipulated award from 2014 to 2018, FINRA identified 78 cases where an associated person was not in the industry while the arbitration was pending but returned to the industry in fewer than 365 days. See Notice at note 25.

pending arbitration, the customer may amend a pleading, including adding a new party, within 60 days of receiving such notice.¹⁵

C. Postponing Hearings

Currently, FINRA Rule 12601 (Postponement of Hearings) addresses when a scheduled hearing date can be postponed. Specifically, the parties can agree to postpone a hearing. In addition, a hearing can be postponed by FINRA in extraordinary circumstances, by the arbitrators at their discretion, or by the arbitrators upon a party's motion.

FINRA is proposing to amend FINRA Rule 12601 to provide that if FINRA notifies a customer that a firm or an associated person has become inactive and the scheduled hearing date is within 60 days of the date the customer receives the notice from FINRA, the customer may postpone the hearing date. FINRA believes that since the proposed amendment would provide a customer with 60 days to determine how to proceed after FINRA notifies the customer of the status change to inactive, it would be appropriate to allow the customer to postpone a scheduled hearing that falls within that time period.

In addition, FINRA currently assesses postponement fees against the parties for each postponement agreed to by the parties, or granted upon the request of one or more parties. FINRA also charges an additional fee of \$600 per arbitrator if a postponement takes place within 10 days of a scheduled hearing date. The additional \$600 per arbitrator fee is paid to the arbitrators to compensate them for the late adjournment.¹⁶

¹⁵ Proposed FINRA Rule 12309(d) would permit any party to file a response to an amended pleading, provided the response is filed and served within 20 days of receipt of the amended pleading, unless the panel determines otherwise. Thus, the newly-added party could file a response to the amended pleading for the panel or arbitrator to consider.

¹⁶ See FINRA Rule 12214 (Payment of Arbitrators).

FINRA is proposing to amend FINRA Rule 12601 to provide that if FINRA notifies a customer that a firm or an associated person has become inactive and the scheduled hearing date is within 60 days of the date the customer receives the notice from FINRA, FINRA would not charge the customer a postponement fee or an additional fee of \$600 per arbitrator if a customer chooses to postpone a scheduled hearing. FINRA also is proposing to amend FINRA Rule 12214 to provide that it would continue to pay the \$600 honoraria to the arbitrators to compensate them for their time if a customer chooses to postpone a scheduled hearing within 10 days before it is scheduled because the customer learns that the firm or associated person has become inactive.

D. Default Proceedings

Currently, FINRA Rule 12801 (Default Proceedings) permits a claimant to request default proceedings against any respondent whose registration is terminated, revoked or suspended, and who failed to file an answer¹⁷ to a claim within the time provided in the Code. A single arbitrator will decide the case based on the claimant's pleadings and other documentation.¹⁸ The claimants must present a sufficient basis to support the making of an award.¹⁹ The arbitrator may not issue an award based solely on the nonappearance of a party.²⁰

As noted, the proposed amendments would define an inactive associated person as a person associated with a member whose registration is revoked, cancelled, or suspended, who

¹⁷ A respondent must serve each party with a signed and dated Submission Agreement and answer specifying the relevant facts and available defenses to the statement of claim within 45 days of receipt of the statement of claim. See FINRA Rule 12303(a).

¹⁸ See FINRA Rule 12801(b)(2)(B). No hearings are held in default proceedings unless the customer requests one. See FINRA Rule 12801(c).

¹⁹ See FINRA Rule 12801(e)(1).

²⁰ Id. If the defaulting respondent files an answer before an award has been issued, the proceedings against this respondent will be terminated and the claim will proceed under the regular provisions of the Code. See FINRA Rule 12801(f).

has been expelled or barred from FINRA, or whose registration has been terminated for a minimum of 365 days. In the context of a default proceeding, FINRA believes that it would be appropriate to continue to allow a customer to request default proceedings against any terminated associated person who fails to answer a claim, regardless of how long the associated person has been terminated, consistent with the existing rule. Accordingly, FINRA is proposing to amend FINRA Rule 12801(a) to specify that a claimant may request a default proceeding against a terminated associated person who fails to file an answer within the time provided in the Code regardless of the number of days since termination.

E. Refunding Filing Fees

Currently, FINRA Rule 12900 (Fees Due When a Claim is Filed) specifies that if a claim is settled or withdrawn more than 10 days before the date that the hearing is scheduled to begin, a party paying a filing fee will receive a partial refund of the filing fee. The rule also provides that FINRA will not refund any portion of the filing fee if a claim is settled or withdrawn within 10 days of the date that the hearing is scheduled to begin.

FINRA is proposing to amend FINRA Rule 12900 to provide that FINRA would refund a customer's full filing fee if FINRA notifies a customer that a firm or an associated person has become inactive during a pending arbitration, and the customer withdraws the case against all parties within 60 days of the notification. FINRA would refund the filing fee even if the customer withdraws the case within 10 days of the date that the hearing is scheduled to begin.

F. Non-substantive changes

FINRA is proposing to amend the Code to update cross-references and make other non-substantive, technical changes to the rules impacted by the proposal.

III. Comment Summary

The Commission received five comment letters on the proposed rule change.²¹ One commenter fully supported the proposed rule change.²² Three of the commenters generally supported the proposed rule change, but suggested further changes to address unpaid arbitration awards and other matters.²³ The fifth commenter did not support the proposal, stating that the proposal did not do enough to address the issue of unpaid arbitration awards.²⁴

Supporting the Proposal

Four commenters supported the proposed rule change as expanding the options available to customers in arbitration proceedings.²⁵ One commenter believes that the amendments in the proposed rule change “address a scenario that is not currently addressed in FINRA rules and, as such, brings important clarity to the arbitration process.”²⁶ Another commenter generally supported the proposed amendments “to allow customers to withdraw a claim, amend pleadings, postpone hearings, invoke expedited default proceedings, and receive a refund of filing fees” as “an appropriate expansion of claimant protections.”²⁷ Another commenter believes the amendments would “expand options for customers in pursuing and attempting to collect money awarded to them against industry respondents in arbitration proceedings,” although it described these amendment as addressing “minor problems.”²⁸ Finally, one commenter believes that “the proposed rule filing would enhance the ability of customers to evaluate the likelihood of

²¹ See supra note 4.

²² See Caruso Letter.

²³ See FSI Letter, SIFMA Letter, and PIABA Letter.

²⁴ See Edwards Letter.

²⁵ See Caruso Letter, FSI Letter, SIFMA Letter, and PIABA Letter.

²⁶ FSI Letter.

²⁷ SIFMA Letter.

²⁸ PIABA Letter.

collecting on an award and to make an informed decision whether to proceed in arbitration, to file the claim in court or to take no action.”²⁹

In addition, two commenters supported the proposed rule change because they believe it will help address unpaid arbitration awards.³⁰ One commenter noted that “the proposed amendments recognize that most unpaid customer arbitration awards are rendered against firms or individuals whose FINRA registrations have either been terminated, suspended, cancelled or revoked, or who have been expelled from FINRA.”³¹ The commenter believes that addressing this recognition “clearly serves to protect investors and the public interest by expanding the options available to customers with claims against brokerage firms and individual brokers who are unlikely to pay arbitration awards that may be issued against them.”³² Another commenter stated that its support of the proposed rule change was “predicated on FINRA’s stated purpose of the Proposal – namely, to facilitate ‘dealing with those member firms or associated persons who are responsible for most unpaid awards – firms and associated persons who are no longer in business either at the time the claim is filed or at the time of the award.’”³³ That commenter also stated that it “agree[s] that the Proposal would probably help address the issue of unpaid arbitration awards.”³⁴

Proposal is Insufficient

²⁹ Caruso Letter.

³⁰ See Caruso Letter and SIFMA Letter.

³¹ Caruso Letter.

³² Id.

³³ SIFMA Letter.

³⁴ Id.

Three commenters stated that the proposal does not address the problem of unpaid arbitration awards in a meaningful way and urged FINRA to take further action.³⁵ One of these commenters stated that the proposal “fails to address the major problem faced by victims of thinly capitalized broker-dealer firms: that judgements against them are often rendered valueless”³⁶ and recommended FINRA establish a national recovery pool.³⁷ Another commenter claimed that the proposal “nibble[s] around the edge of the issue” and fails to “require firms to acquire insurance to bear the costs of their operations or to maintain significant capital reserves.”³⁸ A third commenter believed that the proposal does not “improve investors’ ability to collect arbitration awards against inactive FINRA members or reduce instances of unpaid arbitration awards by inactive FINRA members.”³⁹

In response, FINRA stated that the proposed rule change is “intended to expand the options available to a customer when dealing with those members or associated persons that are inactive at the time a claim is filed or become inactive during a pending arbitration.”⁴⁰ Accordingly, FINRA believes that a commenter’s recommendation to create a national recovery pool is outside the scope of this proposal.⁴¹ However, FINRA also stated that the proposal

³⁵ See FSI Letter, PIABA Letter, and Edwards Letter.

³⁶ PIABA Letter.

³⁷ See PIABA Letter.

³⁸ Edwards Letter (urging the Commission to require FINRA to propose “meaningful reforms” regarding unpaid arbitration). Although the Commission acknowledges that this commenter and others are concerned that the proposed rule change does not sufficiently address the issue of unpaid arbitration awards, we note that FINRA is continuing to consider this issue as well as possible responses to further enhance customer recovery. See FINRA Letter.

³⁹ FSI Letter.

⁴⁰ FINRA Letter.

⁴¹ See FINRA Letter.

represents just “one of the ways it is proceeding to implement additional steps to strengthen its rules relating to the important but complex topic of customer recovery.”⁴² FINRA noted that, in a separate proposed rule change, it is proposing amendments to its Membership Application Program (“MAP”) rules “to create further incentives for the timely payment of awards.”⁴³ Specifically, the MAP proposal would, among other things, “prevent a member firm with substantial arbitration claims from avoiding payment of the claims should they go to award or result in a settlement by shifting its assets, which are typically customer accounts, or its managers or owners, to another firm and closing down.”⁴⁴

In addition, FINRA stated it welcomes continued dialogue about “addressing the challenges of customer recovery across the financial services industry while directly informing the further enhancement of recovery in FINRA’s forum[.]”⁴⁵ For example, FINRA cited to its 2018 White Paper and “additional data regarding the circumstances under which awards may be unpaid, along with a discussion of potential regulatory and legislative responses.”⁴⁶

For these reasons, FINRA declined to amend the proposal in response to these commenters.

⁴² Id.

⁴³ FINRA Letter. See Exchange Act Release No. 87810 (Dec. 20, 2019), 84 FR 72088 (Dec. 30, 2019) (Notice of Filing of File No. SR-FINRA-2019-030).

⁴⁴ FINRA Letter at note 18.

⁴⁵ FINRA Letter.

⁴⁶ FINRA Letter. See FINRA’s White Paper entitled *FINRA Perspectives on Customer Recovery* (February 8, 2018), https://www.finra.org/sites/default/files/finra_perspectives_on_customer_recovery.pdf and <https://www.finra.org/arbitration-mediation/statistics-unpaid-customer-awards-finra-arbitration>. In addition, FINRA has published a list of firms and associated persons responsible for unpaid arbitration awards. See <https://www.finra.org/arbitration-mediation/member-firms-and-associated-persons-unpaid-customer-arbitration-awards>. This information also appears on a firm’s or individual’s BrokerCheck record.

Expand Proposal to Industry Code

One commenter recommended FINRA expand the proposed rule change to apply not only to customer cases but also to intra-industry cases (i.e., disputes between or among members and associated persons).⁴⁷ The commenter stated that unpaid arbitration awards result from both customer and intra-industry cases and, therefore, “the same arguments that FINRA makes in favor of expanding the options available to a customer claimant when dealing with inactive firms and associated persons apply equally to industry claimants.”⁴⁸

In response, FINRA acknowledged the commenter’s concern but stated that at this time it has decided to focus its attention on customer cases and believes that “providing customers with more control over the arbitration process when faced with a respondent that likely will not be able to pay an award furthers FINRA’s goal of investor protection.”⁴⁹ Accordingly, FINRA declined to amend the proposal in response to the commenter.

Proposal Creates Imbalance between Claimants and Respondents

One commenter stated that the proposed rule change creates an imbalance between claimants and respondents. Specifically, the commenter expressed concern that because the proposal permits a claimant to amend its pleading to add a claim or party without the need for pre-approval by an arbitrator or panel, any newly added party would not be able to participate in the arbitrator panel selection process.⁵⁰ Similarly, the commenter stated that “requiring an arbitrator or panel to grant a motion to add a party serves the important purpose of providing the

⁴⁷ See SIFMA Letter; see also FINRA Rule 13000 Series (Industry Code).

⁴⁸ SIFMA Letter.

⁴⁹ FINRA Letter. FINRA also noted, that it welcomes further discussions regarding the circumstances under which awards may be unpaid, along with potential solutions. See FINRA Letter; see also supra note 46 and accompanying text.

⁵⁰ See FSI Letter.

party to be added with an opportunity to object to being added.”⁵¹ For these reasons, the commenter opposed the elimination of the existing motion requirement for adding a party or amending a pleading.⁵²

In response, FINRA stated that the proposal would not change the panel selection process under the current rules.⁵³ Specifically, “[i]f a panel grants a motion to amend a pleading to add a new party, the party to be added [currently] does not get to participate in the panel selection process.”⁵⁴ However, FINRA would provide arbitrator disclosure reports of the sitting panelists⁵⁵ to any party added after a member or associated person becomes inactive;⁵⁶ and, if the party discovers a conflict, the party may file a motion to recuse the arbitrator.⁵⁷

In addition, FINRA believes that “it is appropriate to remove the requirement that a customer file a motion to amend a pleading after panel appointment if a respondent member firm or associated person has become inactive to help avoid additional costs and delay to the customer.”⁵⁸ FINRA stated that the proposal would not change a party’s ability to respond to an

⁵¹ FSI Letter.

⁵² See FSI Letter.

⁵³ See FINRA Letter.

⁵⁴ FINRA Letter. See generally Part IV of the Customer Code (Appointment, Disqualification, and Authority of Arbitrators); see also Arbitrator Selection, <http://www.finra.org/arbitration-and-mediation/arbitrator-selection>. See FINRA Letter at note 8.

⁵⁵ An arbitrator disclosure report is a summary of the arbitrator’s background and is provided to the parties to help them make informed decisions during the arbitrator selection process. Whenever a party is added to a claim, the panelists must update their disclosures or review them to ensure that further updates are not warranted. See FINRA Letter at notes 9 and 10; see also FINRA Rule 12405 (Disclosures Required of Arbitrator).

⁵⁶ See FINRA Letter.

⁵⁷ See FINRA Letter; see also FINRA Rule 12406 (Arbitrator Recusal).

⁵⁸ FINRA Letter.

amended pleading by filing an answer and raising any available defenses under the current rules.⁵⁹ Accordingly, a party added under the proposal would still be able to respond to a pleading.

For these reasons, FINRA declined to amend the proposal in response to the commenter.

IV. Discussion and Commission Findings

After careful review of the proposed rule change and the comment letters, the Commission finds that the proposal is consistent with the requirements of the Exchange Act and the rules and regulations thereunder that are applicable to a national securities association.⁶⁰ Specifically, the Commission finds that the proposed rule change is consistent with Section 15A(b)(6) of the Exchange Act,⁶¹ 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.

Public Interest

The Commission agrees with FINRA and those commenters that support the proposed rule change that it will provide customers with expanded options and flexibility to change case strategy if FINRA notifies them that a member or associated person has become inactive during a pending arbitration. Specifically, the proposed rule change would make several modifications to FINRA's rules to address the situation where a member firm becomes inactive during a pending arbitration, allowing customers to amend pleadings, postpone hearings, request default proceedings, and receive a refund of filing fees in that situation. In addition, the proposed rule

⁵⁹ See FINRA Letter; see also FINRA Rule 12303 (Answering the Statement of Claim).

⁶⁰ In approving this rule change, the Commission has considered the rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

⁶¹ 15 U.S.C. 78o-3(b)(6).

change would expand customers' options with respect to claims brought against associated persons. Specifically, the proposal would provide customers the same options during a case against inactive associated persons as they would have in a case against inactive members. It would also clarify the default rule to include an inactive associated person who does not answer a claim, regardless of the number of days since termination. As noted above, the Commission agrees that, similar to the current rules and procedures relating to claims filed against inactive members, these proposed changes would allow customers to evaluate the likelihood of collecting on an award and make an informed decision whether to proceed in arbitration, to file the claim in court or to take no action, regardless of whether the customer signed a predispute arbitration agreement.

With respect to one commenter's concern that the proposed rule change does not apply to intra-industry cases,⁶² the Commission notes that FINRA welcomes continued dialogue about the challenges of addressing issues related to collecting unpaid arbitration awards in its forum.⁶³

Similarly, the Commission acknowledges commenter's concern that the proposed rule change will create an imbalance in the arbitration process between claimants and respondents by: (1) denying a newly added respondent the opportunity to participate in the arbitrator panel selection process, and (2) precluding a newly added respondent the opportunity to object to being added.⁶⁴ The Commission notes FINRA's belief that the proposed rule change does not create such an imbalance because existing rules already provide procedures that offer sufficient

⁶² See SIFMA Letter.

⁶³ See FINRA Letter.

⁶⁴ See FSI Letter (stating "Providing arbitrator disclosure reports of the sitting panelists to an added party and permitting an added party to raise any conflicts they find with the panel is not equivalent to participating in the panel selection process....Permitting a claimant to submit a response to an amended pleading is not equivalent to providing an opportunity to be heard in response to a motion prior to being added as a party.").

protections for respondents added to an arbitration after the panel is appointed, including respondents who would be added as a result of the proposed rule change. In particular, FINRA notes that under existing FINRA rules a newly added respondent would receive reports summarizing the arbitrators' backgrounds and provide respondent with the opportunity to seek recusal of any arbitrator with a conflict of interest. In addition, FINRA notes that the proposed rule change does not change a party's ability to respond to an amended pleading by filing an answer and raising any available defenses.⁶⁵

The Commission acknowledges the commenter's concern that these are insufficient alternatives to respondents participating in the arbitrator selection process or having the ability to respond to a motion prior to being added as a party.⁶⁶ The Commission believes, however, that despite any potential imbalance it is important that claimants be able to add respondents upon learning that the member or associated person against which she bought the claim is inactive to help ensure that the claimant is able to collect should the claim go to award.⁶⁷ In addition, notwithstanding any potential imbalance, the Commission notes FINRA's position that the existing FINRA rules would provide respondents procedural protections in the limited circumstances in which such respondents would be added under to the proposal.

Finally, the Commission acknowledges several commenters' concerns that the proposed rule change will not, in their view, effectively resolve the problems related to unpaid arbitration awards and their proposed enhancements to the proposal, such as requiring a national recovery

⁶⁵ See FINRA Letter.

⁶⁶ See FSI Letter.

⁶⁷ See PIABA Letter (Supporting the aspect of the proposed rule change that would permit an amendment of the statement of claim, without leave of the arbitration panel because it would permit a customer claimant to pursue claims against potentially collectible respondents.

pool⁶⁸ or requiring firms to acquire insurance.⁶⁹ As FINRA noted, this the proposal represents only one step in the ongoing process of addressing these issues and that FINRA continues to evaluate further action.

Accordingly, because the proposed rule change will expand the options available to customers in pending arbitrations with claims against respondents who are unlikely to be able to pay, and promote consistency under FINRA's rules, the Commission believes that the proposed rule change is designed to protect investors and the public interest.

V. Conclusion

IT IS THEREFORE ORDERED pursuant to Section 19(b)(2) of the Exchange Act⁷⁰ that the proposal (SR-FINRA-2019-027), be and hereby is approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.⁷¹

Jill M. Peterson,
Assistant Secretary.

⁶⁸ See PIABA Letter.

⁶⁹ See Edwards Letter.

⁷⁰ 15 U.S.C. 78s(b)(2).

⁷¹ 17 CFR 200.30-3(a)(12).

[FR Doc. 2020-03771 Filed: 2/25/2020 8:45 am; Publication Date: 2/26/2020]