



May 17, 2011

Via E-Mail

Ms. Lourdes Gonzalez
Acting Co-Chief, Division of Trading and Markets
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

**Re: Supplemental reply to FINRA's response to requests
for data on motions to dismiss, dated April 19, 2011:
SR-FINRA-2007-021**

Dear Ms. Gonzales:

The Securities Industry and Financial Markets Association (SIFMA),¹ through its Arbitration Committee, submits this supplemental reply to the above-referenced letter from the Financial Industry Regulatory Authority (FINRA) to the Securities and Exchange Commission (SEC).² The purpose of this letter is to take exception with a particular statement in the FINRA Letter, to provide the SEC with additional information about the substance of the statement and finally, to continue to plead the case for clearing firm relief from the recently amended dispositive motions rules. The statement at issue in the FINRA Letter reads as follows:

*In light of court decisions recognizing that a broker dealer's status as a clearing firm does not necessarily immunize it from liability, and because the issue of liability generally requires a fact-based determination, FINRA believes dismissal of clearing firms before claimants have presented their case would be inappropriate.*³

¹ SIFMA brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association. For more information, visit www.sifma.org.

² Letter dated April 19, 2011 from FINRA to the SEC re: "Response to Requests for Data on Motions to Dismiss Filed in FINRA's Dispute Resolution Forum Post-Approval of SR-FINRA-2007-021" (the FINRA Letter). Copy attached.

³ FINRA Letter at p. 3.
Washington | New York

The introductory phrases of the foregoing statement are inaccurate and potentially misleading. As we explained in our 2008 comment letter on the dispositive motions rule proposal, the case law is crystal clear that clearing firms generally owe *no legal or fiduciary duty* to the claimant in terms of the investment activity effected in the claimant's account.⁴ In the typical case, the claimant alleges misconduct by an introducing firm, but nevertheless names the clearing firm as a respondent based solely on its role as a clearing firm. In such cases, the clearing firm must be dismissed because it owes *no legal or fiduciary duty* to the claimant. The law is clear – clearing firms cannot be held liable for the negligence or wrongful acts of the correspondent.

Here, we are concerned only with cases that name clearing firms based solely on their role as clearing firms (performing their routine and ministerial clearing functions), and that make no factual allegations of direct misconduct by the clearing firm. These types of cases,⁵ we again submit, are entirely appropriate for dispositive motions at the earliest stage.

As the FINRA Letter indicates, clearing firms may in certain cases be alleged to have engaged in their own separate misconduct, although such cases are extremely rare, given the routine and ministerial nature of the clearing functions, and raise an entirely separate and distinct issue that is not relevant here. Contrary to the assertion in the FINRA Letter, the issue of the clearing firm's liability does not and logically cannot require a "fact-based determination" when the statement of claims is entirely devoid of any specific factual allegations directed at the direct misconduct or knowing wrongful action or inaction by the clearing firm. When faced with such a statement of claims, the clearing firm should be permitted to move for summary dismissal under even the most minimal notions of fairness and due process.

It would be unfair and inappropriate to allow claimants to proceed against a clearing firm without alleging any legally or equitably cognizable basis.⁶ Rather, minimal due

⁴ See SIFMA comment letter dated April 7, 2008 at pp. 2-3 and cases cited therein, available at <http://www.sec.gov/comments/sr-finra-2007-021/finra2007021-32.pdf>.

⁵ Typical cases include, for example, failure to supervise a registered representative, and misrepresentations, unauthorized trading, and/or unsuitable transactions, by the broker.

⁶ Notably and consistently, FINRA's new Discovery Guide recognizes that discovery against clearing firms should be appropriately limited ("... not all firms have the same business operations model and certain items on the Lists may not apply to a particular case when the firm's business model (e.g., ...

process requires claimants to allege facts sufficient to raise an actionable right to relief. And in the case of clearing firms, it is not enough to avoid a motion to dismiss to simply name the firm (typically done only to include an additional potential source of recovery); in such cases, the law requires dismissal. The strength of a clearing firm's balance sheet is not reason enough to overcome the weakness of insufficiently alleged facts in a filed pleading.

As we detailed in our August 2009 letter to FINRA,⁷ the case data support our continuing assertion that FINRA's recent amendments to the dispositive motions rules place an unfair and undue burden on clearing firms by requiring them to defend against claims that are clearly subject to dismissal. In fact, the statistics show dismissal of the clearing firm has been appropriate 80% of the time. For this reason alone, it is clear that motions to dismiss brought by clearing firms are routinely appropriate.

Accordingly, we urge the SEC to permit a clearing firm named as a respondent, based solely on its role as a clearing firm, and not based upon any independent alleged misconduct, to file a motion to dismiss on the basis that the firm did not owe, and did not breach, any legal or regulatory duty to the claimant.

Sincerely,



Kevin M. Carroll
Managing Director & Associate General Counsel

cc: James A. Brigagliano, Deputy Director, Division of Trading and Markets, SEC
Alicia Goldin, Senior Special Counsel, Division of Trading and Markets, SEC
Linda D. Fienberg, President, FINRA Dispute Resolution
George H. Friedman, Executive Vice President, FINRA Dispute Resolution

clearing firm...) is taken into consideration"). See FINRA Discovery Guide 2011, available at <http://www.finra.org/ArbitrationMediation/Rules/RuleGuidance/DiscoveryGuide/>.

⁷ SIFMA letter to FINRA dated August 20, 2009 re: "Statistics on Motions to Dismiss Filed by Clearing Firms (2004-2008)." Copy attached.

FINRA

Financial Industry Regulatory Authority

FACSIMILE

TO Kevin Carroll
COMPANY SIFMA
FAX 202-962-7305
TEL 202-962-7382
DATE 4-19-11
NUMBER OF PAGES INCLUDING COVER 7

FROM Linda Fienberg
FAX 202-728-8833
TEL 202-728-8407

This fax transmittal is strictly confidential and is intended solely for the person or organization to whom it is addressed.

Comments:



Financial Industry Regulatory Authority

Linda D. Flenberg
President, Dispute Resolution
and Chief Hearing Officer

April 19, 2011

Ms. Lourdes Gonzalez
Acting Co-Chief Counsel, Division of Trading and Markets
United States Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: Response to Requests for Data on Motions to Dismiss Filed In FINRA's
Dispute Resolution Forum Post-Approval of SR-FINRA-2007-021

Dear Ms. Gonzalez:

On December 31, 2008, the U. S. Securities and Exchange Commission (SEC) approved the Financial Industry Regulatory Authority's (FINRA) proposal to establish procedures to govern motions to dismiss (hereafter motions to dismiss rules).¹ The amended Rules 12206 and 12504 of the Code of Arbitration Procedure for Customer Disputes (Customer Code) and Rules 13206 and 13504 of the Code of Arbitration Procedure for Industry Disputes (Industry Code) (together, Codes) limit significantly the number of motions to dismiss filed in the arbitration forum and impose strict sanctions against parties who engage in abusive motion practices. The rules became effective on February 23, 2009.²

Specifically, for motions to dismiss filed before the conclusion of a claimant's case-in-chief, the rules limit the grounds on which a motion to dismiss may be granted to the following three: 1) the non-moving party signed a settlement and release; 2) the moving party was not associated with the account, security, or conduct at issue; or 3) the claim does not meet the criteria of the eligibility rule. Moreover, the rules require a panel to assess costs and fees if it determines a motion to dismiss was filed frivolously and permits a panel to sanction a party if a motion to dismiss was filed in bad faith. These limits do not apply to motions to dismiss after the conclusion of a claimant's case-in-chief.

In its approval order, the SEC asked FINRA to undertake several actions.³ First, the SEC asked FINRA to request that the Securities Industry and Financial Markets Association (SIFMA) provide available statistics regarding motions to dismiss filed by clearing firms in the past through the rule changes' effective date. Second, the SEC asked FINRA to maintain statistics on motions to dismiss filed by clearing firms for a period of six months from the effective date of the rule change, to determine whether the

¹ See Securities Exchange Act Rel. No. 59189 (Dec. 31, 2008), 74 *Federal Register* 731 (Jan. 7, 2009) (File No. SR-FINRA-2007-021).

² See FINRA Regulatory Notice 09-07 (January 2009).

³ Note 1 at 742.

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rules impose any burdens on clearing firms.⁴ Third, the SEC asked FINRA to gather statistics prospectively to determine whether the rules encourage parties to engage in abusive motions practice later in the arbitration process. Last, the SEC asked FINRA to consider additional steps it could take to inform parties of the distinction between introducing and clearing brokers.

This letter responds to the SEC's requests and provides information on motions to dismiss filed in the forum after the approval of the motions to dismiss rules.

I. All Motions to Dismiss Filed after Approval of the Rules

In addition to collecting data to respond to the SEC requests, FINRA tracked all motions to dismiss filed in its arbitration forum for the first eighteen months of the rule's effectiveness.

Staff noted the number of motions to dismiss filed before the conclusion of a claimant's case-in-chief for the first eighteen months of the rule's effectiveness (February 23, 2009 to August 22, 2010). During this time, parties filed 427 motions to dismiss, compared to 1,249 motions to dismiss filed during the eighteen months prior to the rule's approval (August 23, 2007 to February 22, 2009), a 66% decrease. The substantial decrease in motions to dismiss indicates that claimants are having the merits of their claims heard in arbitration, which was the primary purpose of the rule change.

II. Motions to Dismiss Filed by Clearing Firms

SIFMA Data on Motions to Dismiss Filed by Clearing Firms Before the Approval of the Rules

In the Approval Order, the SEC asked FINRA to request that SIFMA provide available statistics regarding motions to dismiss filed by clearing firms prior to the effective date of the proposed rule change.

In our March 2009 letter to SIFMA,⁵ FINRA requested that SIFMA provide: 1) details on the instances in which arbitrators dismissed claims against clearing firms prior to issuing an award, and 2) identifying information on cases where claimants voluntarily dismissed claims against clearing firms and did not receive any form of compensation or remuneration from the clearing firm.

⁴ In its comment on the motions to dismiss proposal, SIFMA asserted that cases naming clearing firms based solely on their role as a clearing firm are appropriate for dispositive motions, because such firms do not owe a legal duty to the claimant. See letter from Edward G. Turan, Chair, SIFMA Arbitration Committee et al., to Ms. Nancy Morris, Secretary, Securities and Exchange Commission, dated April 7, 2008 (File No. SR-FINRA-2007-021).

⁵ Letter to T. Timothy Ryan, Jr., President and Chief Executive Officer, SIFMA from Linda D. Flenberg, President, FINRA Dispute Resolution, dated March 4, 2009 (Request for Statistics on Motions to Dismiss Filed by Clearing Firms).

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By letter dated August 20, 2009,⁶ SIFMA identified 54 cases responsive to our requests:

- twenty cases in which a clearing firm moved for dismissal of the claims against it, and the arbitrators granted dismissal of the claims against the clearing firm prior to the issuance of the award;
- eleven cases in which the arbitrators determined that claimants raised questions regarding the possible culpability of a clearing firm and thus denied the motion to dismiss; and
- twenty three cases in which claimants voluntarily dismissed claims against clearing firms and did not receive any form of compensation or remuneration from the clearing firm.

In 80% of the cases identified by SIFMA,⁷ the arbitrators or the claimants dismissed the claims against the clearing firm. In 20% of the cases, the arbitrators denied the clearing firm's motion to dismiss. SIFMA contends, based on these data, that the motion to dismiss rules burden clearing firms unfairly. SIFMA urges FINRA to expand the exception to the rule to permit a clearing firm named as respondent, based solely on its role as a clearing firm, and not based on any independent alleged misconduct, to file a motion to dismiss prior to the conclusion of a claimant's case-in-chief.⁸ Further, SIFMA argues that, based on the nature of their operations, clearing firms do not owe a legal duty to claimants and, therefore, cannot be held liable for the wrongful acts of the introducing firm.

FINRA recognizes the important benefits that clearing firms provide to the operation of the securities markets, and considered the impact the rules could have on their operations. FINRA concluded, however, that expanding the exceptions to the rule would negate its intent, which is to have clear, easily definable standards that do not involve fact-intensive issues. In light of court decisions recognizing that a broker dealer's status as a clearing firm does not necessarily immunize it from liability, and because the issue of liability generally requires a fact-based determination, FINRA believes dismissal of clearing firms before claimants have presented their case would be inappropriate.

⁶ Letter to Linda D. Fienberg, President, FINRA Dispute Resolution from Kevin M. Carroll, Managing Director & Associate General Counsel, SIFMA, dated August 20, 2009 (Statistics on Motions to Dismiss Filed by Clearing Firms 2004-2008).

⁷ From 2004 – 2008, there were 27,109 arbitration cases filed in the forum. During that time, based on SIFMA's data, 43 cases involved a clearing firm that either filed a motion to dismiss or was voluntarily dismissed from a case, which was less than 1% of the arbitration cases filed during that time. FINRA, Arbitration & Mediation, About FINRA Dispute Resolution, Dispute Resolution Statistics, available at http://www.finra.org/web/ldcplg?ldcService=GET_PROBLEM_PAGE&siteId=www.finra.org&siteRelativeUrl=/ArbitrationMediation/FINRADisputeResolution/Statistics/index.htm (last visited on March 18, 2011).

⁸ Note 6 at pp. 2-3.

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In this connection, the SEC agreed with FINRA's position in its approval order, stating that "claimants generally need to be able to develop the facts to argue the liability of a clearing firm in a particular dispute," and, therefore "it would be inappropriate for clearing firms to be eligible for prehearing dismissal based solely on their status as clearing brokers."⁹ The SEC also noted that "clearing firms will continue to be permitted to file motions to dismiss for any reason after the conclusion of the claimant's case in chief."¹⁰ In its findings, the SEC stated that "this strikes an appropriate balance between providing claimants an opportunity to resolve factual disputes and limiting clearing firms' needless involvement in disputes."¹¹

For these reasons, FINRA believes the current rule properly balances the rights and interests of the parties in the forum.

Motions to Dismiss Filed by Clearing Firms After the Approval of the New Rules

The SEC asked FINRA to maintain statistics on motions to dismiss filed by clearing firms for six months from the effective date of the rule; to have more complete data, however, FINRA collected statistics for the first twelve months of the rule's effectiveness (February 23, 2009 – February 22, 2010). The results of the analysis are as follows:

Before the Conclusion of a Party's Case-in-Chief

Staff found only two cases in which clearing firms filed motions to dismiss prior to the claimants' conclusion of their case-in-chief. In one case, the claimant withdrew the claims against the clearing firm before the arbitrators ruled on the motion. Staff does not know whether the claimant received any form of compensation or remuneration from the clearing firm in the form of a settlement. In the other case, the panel deferred a decision on the motion until the hearing on the merits and ultimately found the firm not liable.

After the Conclusion of a Party's Case-in-Chief

Staff found only two cases in which clearing firms requested to be dismissed from the case after the claimants presented their case-in-chief. In one case, the arbitrators denied the motion, but ultimately dismissed the claimant's claims and awarded the clearing firm attorney's fees in the final award. In the other case, the arbitrators denied the motion and held the clearing firm liable in the final award. However, the arbitrators in

⁹ Note 1 at 742.

¹⁰ Id.

¹¹ Id.

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that case also ordered the other respondents to reimburse the clearing firm pursuant to an indemnification agreement.

III. Pattern of Abusive Motion Practice

The SEC asked FINRA to gather statistics prospectively to determine whether the rules encourage parties to engage in abusive motions practice after claimants have completed their case-in-chief. FINRA agreed to gather and analyze relevant information to determine whether potentially abusive behavior developed, and to propose further amendments to the motion to dismiss rules or to take other appropriate action, if necessary.

Staff reviewed 517 customer awards served during the first year of the rule's effectiveness, and found 86 instances – or 17% of the awards – in which respondents moved to dismiss after the claimant had presented its case-in-chief. The arbitrators ruled to dismiss the case in its entirety in 10 of these cases, or 2% of the customer awards. Staff also reviewed all customer awards for evidence of any abusive motion practice, and determined that no sanctions or other such disciplinary orders were recorded in any of the awards during this time.

IV. Distinction between Introducing and Clearing Brokers

The SEC asked FINRA to consider what additional steps it could take to inform arbitration parties of the distinction between introducing and clearing brokers. We will review the explanations we currently provide on our website to investors on the role of clearing firms and work with other FINRA departments to enhance the available information.

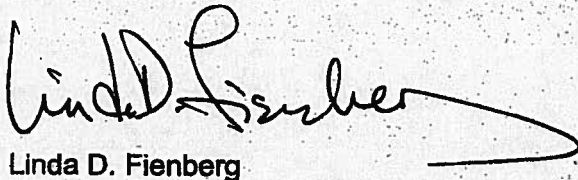
Conclusion

Based on an analysis of all the data, FINRA believes that the reduction in the number of motions to dismiss indicates that the new rules are working as designed, by curbing abusive motions practice and ensuring that investors maintain the right to have their arbitration claims heard. Further, the absence of awards with sanctions for abusive motion practice also demonstrates that the rule is effective. Moreover, FINRA believes that the rules do not place an unfair burden on clearing firms. For these reasons, FINRA does not believe the motion to dismiss rules should be amended at this time.

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Please do not hesitate to contact me if I can provide any further information.

Very truly yours,

A handwritten signature in black ink, appearing to read "Linda D. Fienberg", with a long, sweeping horizontal line extending to the right.

Linda D. Fienberg

cc:

James A. Brigagliano, Deputy Director, Division of Trading and Markets, United States Securities and Exchange Commission

Alicia Goldin, Senior Special Counsel, Division of Trading and Markets, United States Securities and Exchange Commission

Kevin Carroll, Managing Director and Associate General Counsel, Securities Industry and Financial Markets Association

August 20, 2009

Via E-Mail

Ms. Linda D. Fienberg
President, Dispute Resolution
& Chief Hearing Officer
FINRA Dispute Resolution
1735 K Street, NW
Washington, DC 20006-1506

Re: Statistics on Motions to Dismiss Filed By Clearing Firms (2004 – 2008)

Dear Linda:

In its order approving FINRA's recent amendments to the dispositive motions rule, the Commission staff requested that FINRA ask SIFMA to provide available statistics on motions to dismiss filed by clearing firms.¹ In response to the Commission's request, on March 4, 2009, you wrote to request that SIFMA provide details on the instances in which arbitrators dismissed claims against clearing firms prior to issuing an award, and cases where claimants voluntarily dismissed claims against clearing firms and did not receive any form of remuneration from the clearing firm.

In response to your request, we retained a researcher employed by the Securities Arbitration Commentator, Inc. (SAC) to help us identify the requested cases. For the period 2004 – 2008, we identified fifty-four (54) responsive cases, which we grouped into three categories. Following is a description of these cases which are listed by category on the attached three-page document:

- 1. Clearing BD Motion to Dismiss Granted (20 cases).** We identified twenty (20) cases in which a clearing firm moved for dismissal of the claims against it, and arbitrators granted dismissal of the claims against the clearing firm prior to the issuance of an award.
- 2. Clearing BD Motion to Dismiss Denied (11 cases).** We identified eleven (11) cases in which the clearing firm's motion to dismiss was denied prior to the hearing. In none of these cases was the clearing firm ultimately found liable in the award: (i) in five cases (01-07090, 03-01646, 03-05071, 04-01619, 07-01346), the claims against the clearing firm were denied at hearing; (ii) in four cases (99-01062, 03-02398, 05-04302, 05-04934), the claimants settled with the clearing firm prior to hearing; and (iii) in two

¹ Securities Exchange Act Rel. No. 59189 (Dec. 31, 2008), 74 Federal Register 731, 742 (Jan. 7, 2009) (File No. SR-FINRA-2007-021).

cases (01-03496, 06-04414), the clearing firm was voluntarily dismissed by the claimant following the panel's denial of the clearing firm's motion to dismiss, but prior to the hearing.

3. Clearing BD Voluntary Dismissals (23 cases). We identified twenty-three (23) cases² in which claimants voluntarily dismissed claims against clearing firms and did not receive any form of compensation or remuneration from the clearing firm. Thus, this list excludes any cases where the claimant and respondent reached a settlement.

Research Process and Qualifications

To the extent possible, we attempted to limit the universe of clearing firm cases to those cases in the SAC database that involved a claim against a clearing firm based solely on its role as a clearing firm performing its routine and ministerial clearing function, and not based upon any independent alleged misconduct.

- In cases involving firms that provide clearing services as well as other services, if we could not determine whether the firm was named solely in its capacity as a clearing firm, then we excluded the case.
- If a clearing firm was dismissed at the same time as non-clearing firms that also filed motions to dismiss, and the dismissal order did not state the reason for the dismissals, we assumed that the basis for the dismissal was something common to all of the firms and thus, we excluded these cases as well.
- In addition, if a clearing firm secured a dismissal but the case was settled without an award (or is still pending), it has not been included.

Each of the foregoing qualifications suggests that we have likely understated the number of arbitration cases that name clearing firms based solely on their role as clearing firms.

Conclusion

SIFMA's comment letter on the dispositive motions rule proposal asserted that cases naming clearing firms based solely on their role as clearing firms are often appropriate for dispositive motions.³ We observed that clearing firms' motions to

² The attached Excel spreadsheet lists twenty-five (25) cases in this category because it includes two (2) cases from the second category (01-03496 and 06-04414), in which the clearing firm was voluntarily dismissed by the claimant following the panel's denial of the clearing firm's motion to dismiss.

³ SIFMA's comment letter is available at <http://www.sec.gov/comments/sr-finra-2007-021/finra2007021-32.pdf>.

dismiss are routinely granted because such firms do not owe a legal duty to the claimant. We also observed that claimants recognize this fact and from time to time agree to voluntarily dismiss their claims against the clearing firm. While we cite ample support for each of these statements in our comment letter, the attached list of cases provides even stronger and more complete support and validation of these points.

The data support our continuing assertion that the recent amendments to the dispositive motions rules place an unfair and undue burden on clearing firms by requiring them to defend against claims that are clearly subject to dismissal. We continue to urge FINRA to eliminate unnecessary cost and delay in the arbitration process by permitting a clearing firm named as a respondent, based solely on its role as a clearing firm, and not based upon any independent alleged misconduct, to file a motion to dismiss on the basis that the firm did not owe, and did not breach, any legal or regulatory duty to the claimant.

If you have any questions regarding this matter, please feel free to contact me directly at (202) 962-7382.

Sincerely,

A handwritten signature in dark ink, reading "Kevin M. Carroll". The signature is fluid and cursive, with a long horizontal stroke at the end.

Kevin M. Carroll
Managing Director & Associate General Counsel

cc: George H. Friedman, Executive Vice President