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June 2, 2017

Via E-Mail to pubcom@finra.org

Jennifer Piorko Mitchell
Vice President and Deputy Corporate Secretary
Office of Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506

Re: Special Notice – Engagement Initiative, dated March 21, 2017 (the "Notice")
SIFMA comment on the transparency of FINRA's dispute resolution program

Dear Ms. Mitchell:

The Securities Industry and Financial Markets Association ("SIFMA")[1] appreciates the opportunity to submit this supplemental comment on the Notice. This letter responds specifically to your request for comment on the transparency of FINRA's dispute resolution program and how FINRA might enhance the forum's operational transparency.[2]

A perennial issue with significant transparency implications for the FINRA arbitration forum is that of unpaid arbitration awards. In 2013, for example, there were 225 cases with money damage awards issued in favor of the claimant totaling $257 million; of those cases, 75 awards totaling $62 million went unpaid.[3] More recently, in 2015, there were 190 cases with money damage awards in favor of the claimant totaling $203 million; of those cases, 42 awards totaling $26 million went unpaid.

[1] SIFMA is the voice of the U.S. securities industry. We represent the broker-dealers, banks and asset managers whose nearly 1 million employees provide access to the capital markets, raising over $2.5 trillion for businesses and municipalities in the U.S., serving clients with over $18.5 trillion in assets and managing more than $67 trillion in assets for individual and institutional clients including mutual funds and retirement plans. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit http://www.sifma.org.

[2] Notice, available at http://www.finra.org/sites/default/files/notice_doc_file_ref/Special-Notice-032117.pdf, at 23.

[3] Final Report and Recommendations of the FINRA Dispute Resolution Task Force, dated December 16, 2015, available at http://www.finra.org/arbitration-and-mediation/finra-dispute-resolution-task-force, at 50. *See also* PIABA Report on Unpaid Arbitration Awards, dated February 25, 2016, available at https://piaba.org/piaba-newsroom/report-unpaid-arbitration-awards-problem-industry-created-problem-industry-must-fix-f.

While the data for years 2013 and 2015 are helpful, they raise more questions than they answer about the issue of unpaid awards. For example, it is unclear what percentage or number of these unpaid awards were subsequently satisfied, in whole or in part, through a court action or settlement, which would presumably lower the overall number. It is equally unclear whether the data for years 2013 and 2015 are outliers or are representative of most years. Finally, it is unclear which respondents were responsible for these unpaid awards and whether there is a pattern of these unpaid awards being attributable to a small number of undercapitalized or defunct firms. To gage the scope and magnitude of the unpaid awards issue, we would need the benefit of consistent, year over year data. Finally, the available data does not provide us with any information about the scope or scale of unpaid awards in intra-industry cases.

Accordingly, in order to enhance the transparency and integrity of FINRA's arbitration forum with respect to unpaid arbitration awards, we offer the following recommendations:

FINRA should publish and track annual data on unpaid arbitration awards.

We recommend that FINRA enhance its Dispute Resolution Statistics webpage[4] by publishing the following additional data points on an annual basis:

1) The total number of cases where a customer claimant was awarded money damages;[5]
2) The total dollar value of the money damages awarded in those cases;
3) The total number of those awards that were paid;
4) The total dollar value of the awards that were paid;
5) With respect to each unpaid award: a) the identity of the respondent(s), b) whether the respondent(s) is/are still registered, c) the type of claim(s), d) whether a motion to vacate is pending, and e) whether the award was subsequently settled or otherwise satisfied.
6) The same information in 1 – 5 with respect to intra-industry disputes.

We believe that such data would provide a useful tool for both regulators and industry participants to help spot trends, track changes, and shed some much-needed light on this poorly understood issue. We expect the data would show that: most awards are paid in full and on time; the firms that do not pay their awards are by and large not SIFMA member firms, which take their financial obligations seriously; and the real issue is not the arbitration process or forum, but bad or undercapitalized actors who refuse or fail to pay their obligations.

Assuming the data for years 2013 and 2015 are representative of most years, it would not appear to be a terribly costly or time-consuming undertaking to collect, post and maintain data on such a relatively modest number of cases on an annual basis. Finally, it is just as important to focus on intra-industry awards as customer awards because the underlying issue is precisely the same. Specifically, an associated person or member firm who avoids paying a valid arbitration award (to whomever) creates regulatory, compliance, and investor protection risks that undermine the integrity of both our industry

[4] *See* http://www.finra.org/arbitration-and-mediation/dispute-resolution-statistics.

[5] This information is currently posted on FINRA's webpage for years 2012 – 2017.

and FINRA's arbitration forum.[6]

FINRA should eliminate the inability to pay defense in intra-industry disputes.

Whatever the data for unpaid intra-industry awards may show, one sure-fire way to improve the transparency and reduce the number of such awards would be to eliminate the inability to pay defense in intra-industry disputes. Today, when an associated person or member firm ("industry respondent") obtains an arbitration award against another industry respondent, who then fails to pay the award, FINRA may bring an expedited proceeding under FINRA Rule 9554 to suspend the respondent. To avoid suspension, the respondent may claim he or she has the inability to pay the award. If FINRA finds that the respondent has sufficiently demonstrated a financial inability to pay the award, then the respondent avoids not only the suspension that would have been imposed, but also the reporting of the suspension on his or her CRD record.

In July 2010, FINRA amended Rule 9554 to preclude a respondent from raising the inability to pay defense against a *customer* claimant (without addressing *industry* claimants). All of the arguments that FINRA made in favor of eliminating the inability to pay defense against customer claimants apply equally to industry claimants. FINRA offered no explanation why the defense should be eliminated only with respect to customer claimants, but not industry claimants.

The primary argument is that the defense limits FINRA's leverage to suspend an industry respondent, and thereby induce his or her payment of the arbitration award. Another reason is that the defense provides industry respondents with a ready means to purposefully avoid paying an arbitration award, in violation of FINRA's just and equitable principles rule. Finally, even if the industry respondent has a bona fide inability to pay, it would hardly be equitable or just to allow such person – who has a demonstrated issue with managing his or her own financial affairs – to avoid suspension and continue to advise retail clients. As the SEC once cautioned, "allowing members or their associated persons that fail to pay arbitration awards to remain in the securities industry presents regulatory risks and is unfair to harmed customers."[7]

For the foregoing reasons, we urge FINRA to amend Rule 9554 to preclude respondents from raising the inability-to-pay defense in intra-industry cases.

Otherwise, FINRA should require CRD disclosure regarding the inability to pay defense.

As explained above, when an industry respondent successfully raises the inability to pay defense, he or she is able to avoid not only the suspension that would have been imposed under Rule 9554, but also the reporting of such suspension on his or her CRD record. This situation represents a significant

[6] For that reason, we support expanded Form U4 disclosure by registered representatives who fail to pay their arbitration awards. We understand that the SIFMA Board recently authorized FINRA to publish a Regulatory Notice addressing this specific issue, among others. *See* http://www.finra.org/industry/update-finra-board-governors-meeting-051017. We look forward to commenting on FINRA's proposed amendments upon publication of the Notice.

[7] 75 Fed. Reg. at 32,525.

disclosure, transparency, and investor protection problem. The fact that the respondent 1) has an unpaid arbitration award, and 2) claims that he or she cannot pay it in a suspension proceeding, would certainly be highly relevant and beneficial information to, among others: a) a retail customer who contemplates doing business with such respondent, b) a member firm that may seek to hire such respondent, and c) a regulator who oversees such respondent.

Accordingly, if FINRA is not inclined to eliminate the defense in intra-industry cases, then at a minimum, FINRA should require CRD disclosure when an industry respondent successfully raises the defense – for the benefit and protection of retail customers, prospective employers, and regulators alike.

* * *

We also offer the following additional recommendations to enhance FINRA's arbitration forum:

FINRA should give non-party firms directed to appear as witnesses or to produce documents more time to respond.

Under the FINRA Code of Arbitration Procedure, upon motion of a party, the panel may order the appearance of a non-party, employee or associated person of a FINRA member, or the production of documents by such persons or member firms. At the time the motion is made, the non-party firm (which is often a clearing firm) is not served with a copy of the motion or otherwise put on notice. Once an order is issued, the non-party firm is served with a copy of the order by mail, which is effective upon mailing, and *not* upon receipt of the order. Thereafter, the non-party firm is given only ten calendar days from service of the order to file a written objection to the scope or propriety of the order (e.g., the order is unreasonably onerous, or would require the production of proprietary, competitively-sensitive, or non-public personal information).

Frequently, the individual at the non-party firm who is responsible for responding to the order (i.e., legal staff) may not actually receive a copy of the order until after the tenth day from mailing has passed – thereby waiving the firm's ability to object to the order. To remedy this situation, and ensure that the responding, non-party firm has sufficient time to object in writing, the ten-calendar-day timeframe should be extended. We recommend that service should be effective upon the date of the non-party firm's receipt (rather than the mailing) of the order.

FINRA should keep open the FINRA DR Portal page for an arbitration matter for a reasonable period following the dismissal of the matter.

We have observed that FINRA terminates access to the FINRA DR Portal page for an arbitration matter (which houses the documents, pleadings, correspondence etc.) immediately upon receiving a notice of dismissal of the matter. As the Portal page essentially serves as the official docket for a matter, however, it would be helpful to member firms if the Portal page could continue to be accessible for a reasonable period following the dismissal of a case in order to provide firms with sufficient time to compare their records and confirm that they are complete and consistent with FINRA's records. We suggest that three months following the dismissal of a matter would provide sufficient time to complete this process.

* * *

Thank you for the opportunity to share the foregoing recommendations to enhance the transparency and integrity of FINRA's arbitration forum. If you have any questions or would like to further discuss these issues, please contact the undersigned at 202.962.7382 or kcarroll@sifma.org.

Sincerely,

Kevin M. Carroll
Managing Director and
Associate General Counsel

cc: ***via e-mail to*:**
Robert L.D. Colby, Chief Legal Officer, FINRA
Richard W. Berry, Executive Vice President and Director FINRA-DR