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July 11, 2025

Via E-Mail to Robert.Colby@finra.org

Robert L.D. Colby
Executive Vice President and Chief Legal Officer
FINRA
1700 K Street, NW
Washington, DC 20006

Re: Recommendations for FINRA Arbitration

Dear Mr. Colby:

The Securities Industry and Financial Markets Association ("SIFMA")[1] appreciates the opportunity to provide recommendations for improving the FINRA arbitration forum. SIFMA strongly supports efforts by FINRA to enhance the forum while also addressing our members' longstanding concerns.[2] We recognize that any changes must balance the interests of all stakeholders in FINRA arbitration, and, above all, ensure investor protection. We believe our recommendations achieve that balance by focusing on improving the overall fairness and efficiency of the forum.

[1] SIFMA is the leading trade association for broker-dealers, investment banks and asset managers operating in the U.S. and global capital markets. On behalf of our industry's one million employees, we advocate on legislation, regulation and business policy affecting retail and institutional investors, equity and fixed income markets and related products and services. We serve as an industry coordinating body to promote fair and orderly markets, informed regulatory compliance, and efficient market operations and resiliency. We also provide a forum for industry policy and professional development. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA).

[2] SIFMA identified FINRA arbitration reform as a top priority in our response to FINRA Regulatory Notice 25-04, which sought the identification of areas FINRA should prioritize in connection with its rule modernization review. *See* SIFMA Letter, *Regulatory Notice 25-04: Rule Modernization* (June 11, 2025), https://www.sifma.org/wp-content/uploads/2025/06/SIFMA-Comment-on-RN-25-04-June-11-2025.pdf. SIFMA also raised concerns with the FINRA arbitration process in a February 2024 letter regarding the adjudication of Form U5 defamation claims. *See* SIFMA Letter, *Form U5 Defamation Claims for Money Damages: Recommendations to improve the fairness of adjudication* (Feb. 20, 2024), https://www.sifma.org/wp-content/uploads/2024/02/SIFMA-Letter-to-FINRA-re-U5-defamation-claims-220.2024.pdf.

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Executive Summary

Nearly all disputes between broker-dealers and their customers and employees are resolved in FINRA's arbitration forum.[3] Thus, it is critical that the forum operates efficiently and ensures predictable and fair outcomes for member firms, customers, and employees alike. To accomplish this, it is incumbent on FINRA to make necessary reforms when presented with discrete issues that undermine the forum's efficiency and/or fairness.

This letter provides recommendations regarding five key areas that are ripe for reform.[4] Specifically, FINRA should:

- permit agreements to adjudicate certain narrow categories of claims in alternative forums;
- permit agreements to preclude or limit punitive damages awards where permitted by applicable law;
- improve the fairness of adjudicating Form U5 defamation claims;
- amend certain procedural rules governing arbitrations; and
- enhance requirements to improve arbitrator quality and accountability.

Our recommendations are intended not only to be responsive to FINRA's request to identify reforms that are fairly simple and straightforward (and thus could be implemented expeditiously), but also to improve the fairness and integrity of, and confidence in, the forum.

[3] FINRA Rules 12200 and 13200 give customers and employees, respectively, the ability to unilaterally compel member firms into FINRA arbitration. Virtually all member firms lock down that prospective choice –and help control their dispute resolution costs—by designating FINRA arbitration for dispute resolution in their customer and employee agreements. Member firms cannot enforce dispute resolution clauses specifying court-based litigation, or an arbitration forum other than FINRA, in their customer or employee agreements.

[4] Please note that these issues are not listed in priority order.

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I. FINRA Should Permit Agreements to Adjudicate Certain Narrow Categories of Claims in Alternative Forums

FINRA takes the position that Rule 12200 prohibits any limitation on a customer's right to request FINRA arbitration, and that the requirements of Rule 12200 supersede forum selection clauses in customer agreements.[5] FINRA asserts that allowing forum selection clauses in customer agreements undermines the principles of investor protection and public interest embodied in FINRA's arbitration rules, and that denying investors the benefits of FINRA's arbitration forum may have the result of "foreclos[ing] customers from asserting their claims, particularly small claims."[6]

With respect to a small subset of claims, however, we believe that FINRA should take a more permissive approach to forum selection clauses. Particularly, with respect to claims: (i) seeking damages over a certain, high dollar threshold (with a specific amount to be defined); or (ii) involving counterparties that are considered "institutional investors" pursuant to Rule 2210(a)(4), "small claim" or general investor protection concerns do not apply. Rather, these are precisely the types of claims that many stakeholders recognize are not best-suited for the FINRA arbitration forum.[7] Accordingly, we recommend that FINRA revise Rule 12200 to allow member firms to contractually agree to opt out of FINRA arbitration and arbitrate disputes in an alternative forum in the two, above-referenced, narrow and discrete circumstances.

We also recommend changes to the requirements for arbitrating industry disputes under Rule 13200. FINRA has taken the same approach to Rule 13200 as it has to Rule 12200, stating that it prohibits provisions in predispute agreements between member firms and associated persons that waive the requirement to arbitrate disputes in a FINRA forum.[8] Yet, in industry disputes, forum selection clauses obviously do not give rise to the same investor protection concerns, and FINRA has not identified any justification for treating these types of claims the same.[9] SIFMA

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[5] See FINRA Regulatory Notice 16-25, *Forum Selection Provisions Involving Customers, Associated Persons and Member Firms* (July 22, 2016) ("FINRA reminds member firms that customers have a right to request arbitration at FINRA's arbitration forum at any time and do not forfeit that right under FINRA rules by signing any agreement with a forum selection provision specifying another dispute resolution process or an arbitration venue other than the FINRA arbitration forum.").

[6] *Id.*

[7] *See* FINRA Dispute Resolution Task Force, *Final Report and Recommendations of the FINRA Dispute Resolution Task Force* (Dec. 2015), https://www.finra.org/sites/default/files/Final-DR-task-force-report.pdf, at 30 ("It is generally recognized that large and complex cases present 'special and often unique problems . . . which require greater procedural flexibility.' Two related concerns have been expressed about the increase in large claims: whether the forum is meeting the needs of the parties and whether these cases place a disproportionate burden on the forum.").

[8] *See* FINRA Regulatory Notice 16-25, *supra* note 5.

[9] *See id.* FINRA's only justification for prohibiting forum selection clauses under Rule 13200 is that "FINRA Rule 13200 specifically states that industry disputes must be arbitrated at FINRA, except as otherwise provided in the Industry Code."

therefore recommends that FINRA amend Rule 13200 to permit parties to enter into predispute arbitration agreements that waive the requirement to arbitrate in a FINRA forum and permit arbitration in an alternative forum.

II. FINRA Should Permit Agreements to Preclude or Limit Punitive Damages Awards Where Permitted by Applicable Law

FINRA Rule 2268(d)(4) prohibits member firms from putting *any* contractual limitations on the awards a FINRA arbitrator can provide in customer agreements.[10] Thus, firms cannot contractually preclude or limit punitive damages under FINRA rules, regardless of whether such limitations are permitted under applicable state law.[11]

Recent extreme outlier punitive damages awards issued by FINRA arbitration panels highlight the urgency for FINRA to allow firms to contract with their clients to preclude punitive damages awards where permitted by applicable law. Numerous policy and practical arguments support limiting the ability of FINRA arbitrators to impose punitive damages.

First, FINRA arbitration lacks the necessary procedural safeguards for awarding punitive damages. Punitive damages awards by FINRA arbitration panels are final and binding. There is no specific mechanism for seeking review or appeal of such awards. Moreover, the general grounds for appealing an arbitration award are extremely limited. Stated otherwise, it is nearly impossible to vacate even an obviously unreasonable arbitration award.

Second, punitive damages are intended to punish the wrongdoer and deter future misconduct. But FINRA arbitrators already have a sufficient—and arguably more effective—way of punishing wrongdoers and achieving deterrence: they can refer cases to FINRA Enforcement for disciplinary proceedings. More broadly, the highly-regulated nature of the securities industry further renders punitive damages unnecessary. Not only are firms regulated by FINRA, but they are also subject to extensive oversight by a multitude of federal and state regulators, which serves as a more than adequate deterrent to wrongful conduct.

Third, there is no compelling reason for FINRA's rules to prohibit parties from contractually excluding or limiting punitive damages awards in arbitration where such agreements are permitted by state law. There is nothing extraordinary about parties contracting out of punitive

[10] FINRA Rule 2268(d)(4) ("No predispute arbitration agreement shall include any condition that . . . limits the ability of arbitrators to make *any award*." (emphasis added)).

[11] Three states prohibit punitive damages awards outright: Michigan, Nebraska, and Washington. Additional states impose caps or other limitations on punitive damages awards. For example, in New York, arbitrators are not permitted to award punitive damages. *Garrity v. Lyle Stuart*, 40 N.Y.2d 354, 356 (1976). In Massachusetts, the general rule is that punitive damages are not available absent specific statutory authority. *Santana v. Registrars of Voters of Worcester*, 398 Mass. 862, 867 (1986).

damages in arbitration, and courts will generally enforce an agreement to do so if the agreement clearly expresses the parties' intent to exclude these claims from the arbitrator's purview.[12]

For these reasons, we recommend that FINRA amend Rule 2268(d)(4) to permit parties to agree in their predispute arbitration agreements to preclude or limit punitive damages in FINRA arbitration, so long as it is allowed under applicable state law.

Alternatively, at a minimum, FINRA should impose specific caps on punitive damages awards (e.g., requiring awards to be below a certain amount and/or tied to a multiple of any compensatory damages award).

III. FINRA Should Improve the Fairness of Adjudicating Form U5 Defamation Claims

In February 2024, we submitted a letter expressing our concerns with the adjudication of Form U5 defamation claims in FINRA's arbitration forum.[13] The letter highlighted the likelihood that FINRA arbitrators were using an incorrect legal standard to adjudicate expungement claims and award corresponding money damages, and it offered specific recommendations for addressing the issue. To date, FINRA has not disclosed any action taken in response to our recommendations.

Our letter raised significant concerns about the fairness of how Form U5 defamation claims are being resolved in FINRA arbitration. Specifically, firms are facing unfounded defamation claims by associated persons seeking both to expunge Form U5 information and an award of monetary damages against the firm. As the letter explained, arbitrators are likely resolving these claims using an incorrect legal standard that does not require the establishment of the requisite elements of a defamation claim. This problem is exacerbated by the fact that FINRA does not provide training or guidance on the proper standard to apply in these cases.

Form U5 defamation claims continue to proliferate in FINRA arbitration. In the first half of 2025, they were the fourth most common intra-industry claim.[14] Because this issue has not been

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[12] *See Mastrobuono v. Shearson Lehman Hutton*, 514 U.S. 52, 58 (1995) (stating that the Court's decision on whether a New York choice-of-law provision precluded an arbitral award of punitive damages came down simply to "what the contract has to say about the arbitrability of petitioners' claim for punitive damages"); *see also Flintlock Construction Services, LLC v. Weiss*, 122 A.D.3d 51, 54-56 (1st Dept. 2014) (stating that an arbitration agreement that expressly invokes New York's prohibition on arbitral punitive damages awards, or expressly excludes claims for punitive damages, would be enforceable).

[13] SIFMA Letter, *Form U5 Defamation Claims for Money Damages: Recommendations to improve the fairness of adjudications* (Feb. 20, 2024), https://www.sifma.org/wp-content/uploads/2024/02/SIFMA-Letter-to-FINRA-re-U5-defamation-claims-220.2024.pdf.

[14] FINRA Dispute Resolution Services Statistics, *Top 15 Controversy Types in Intra-Industry Arbitrations*, https://www.finra.org/arbitration-mediation/dispute-resolution-services-statistics.

addressed, firms are continuing to unfairly face high-dollar damages awards in these cases, including punitive damages.

SIFMA's prior letter set forth the following recommendations to improve the fairness of the adjudication of U5 defamation claims, which we continue to urge FINRA to consider:

- FINRA should provide guidance, training, and instructions to arbitrators on the substantive elements of defamation claims.

- Before making an award for monetary damages for U5 defamation, require an explicit finding by the arbitrators that: (1) the alleged defamatory statement is a false statement of fact; and (2) the statement was made in bad faith and with malice in fact.

- FINRA should amend Form U5 to replace required narrative fields with regulator-generated, drop-down menus of check-the-box disclosures. To the extent that a firm checks the appropriate boxes, FINRA could then instruct arbitrators that the firm is entitled to safe harbor protection from a U5 defamation claim related to such disclosures.

By implementing these baseline standards for defamation claims and training arbitrators on how to apply them, FINRA will encourage the fair and consistent adjudication of defamation claims in its arbitration forum.

IV. FINRA Should Amend Certain Procedural Rules Governing Arbitrations

Several procedural considerations undermine the quality and efficiency of the FINRA arbitration forum. Specifically, as set forth below, FINRA processes relating to: (i) the filing of motions to dismiss; (ii) discovery; and (iii) hearing oversight should be amended.

1. Motions to Dismiss

FINRA's current arbitration rules only permit motions to dismiss to be filed after an answer is filed. FINRA Rules 12504(a) and 13504(a) state that motions to dismiss a claim prior to the conclusion of a party's case in chief are "discouraged," and such motions are permitted only in limited circumstances after a pre-hearing conference on the motion is held or waived by all parties.[15] Motions to dismiss based on the eligibility rule under FINRA Rules 12206 and 13206 have the same pre-hearing conference requirements. As a result, currently, claims that are ineligible for FINRA arbitration and that should be dismissed as a threshold matter instead survive longer into the arbitration process, which hinders the forum's efficiency in resolving disputes.

[15] FINRA Rules 12504(a) and 13504(a).

SIFMA recommends that FINRA amend its rules to allow parties to file a motion to dismiss prior to filing an answer when based on the specific circumstances permitted under Rules 12504(a)(6) and 13504(a)(6) and based on the eligibility rule under Rules 12206 and 13206. In these cases, SIFMA also recommends that FINRA toll the answer deadline until the motion to dismiss deadline has been resolved and prioritize expeditious hearings on such motions. This will ensure that critical issues are handled much earlier in the dispute and that claims outside of FINRA's jurisdiction do not unnecessarily utilize resources.

2. **Discovery**

The landscape of e-discovery is constantly evolving due to technological advancements and the widespread availability of electronically stored information. Yet FINRA's arbitration rules and guidance have not been updated to adequately address modern e-discovery challenges, and FINRA arbitrators often lack the expertise to resolve e-discovery issues in a fair, efficient, and cost-effective manner.

We strongly recommend that FINRA consider establishing processes through which arbitrators can escalate discovery issues and receive assistance in resolving them, and that FINRA also consider making such processes mandatory for claims over a certain amount. For example, FINRA could allow the appointment of a special discovery master, as is often done in litigation, to advise the arbitration panel or resolve certain discovery disputes. In addition, there are many instances where parties seek discovery of information that is subject to an assertion of attorney-client privilege protection. Given the extreme sensitivity around such information, FINRA could appoint a specialized person or group who is available to advise the arbitration panel on privilege issues.

Likewise, SIFMA recommends that FINRA impose stricter guidelines around the discovery process to ensure cases proceed in an efficient and cost-effective manner, including:

- Requiring meet and confers at the outset of a case to discuss discovery issues.
- Imposing a maximum number of document requests on each party and reasonable limitations on the scope of such requests.
- Requiring arbitrators to set and enforce mandatory discovery calls and discovery cut-off dates, with deadlines for compliance and for filing objections and responses.
- Implementing a higher standard for establishing need if requesting documents outside of those listed in the Discovery Guide.[16]

[16] FINRA Discovery Guide (2013), at pp. 7-15, https://www.finra.org/sites/default/files/ArbMed/p394527.pdf.

3. **Hearing Oversight**

Similar to the recommendations above related to discovery, many FINRA arbitrators also lack the expertise to resolve issues that arise during arbitration hearings. As a result, arbitration hearings are not conducted in an efficient or orderly manner, which erodes confidence in the FINRA arbitration forum.

We recommend that FINRA consider establishing a central contact point to assist arbitrators who encounter procedural or evidentiary questions during proceedings. This would significantly improve the efficiency of the proceedings.

We also recommend that FINRA establish more stringent parameters for arbitrator oversight of hearings. At a minimum, these should include:

- Requiring the creation of a case schedule with set deadlines.
- Requiring the conclusion of a hearing no later than the scheduled end date, with each party being allocated an equal proportion of time to present their case (through the use of a "chess clock" or similar time management method).
- Implementing rules that limit the number of witnesses each party can call and the length of time they can testify.

The above recommendations for discovery and hearing oversight are critical to maintaining the advantages of efficiency and reduced cost offered by FINRA arbitration, and we urge FINRA to act quickly to implement solutions and provide arbitrators with appropriate guidance in these areas.

V. FINRA Should Enhance Requirements to Improve Arbitrator Quality and Accountability

SIFMA has been supportive and appreciative of FINRA's previous efforts to enhance the training, expertise and overall quality of individuals serving as arbitrators. Notwithstanding these helpful efforts, we remain concerned that certain arbitrators continue to fall short in executing their required responsibilities. We have observed a spectrum of issues, ranging from arbitrators permitting hearings to continue for days past their scheduled end date or failing to issue timely decisions, to arbitrators who routinely fall asleep during proceedings. Thus, we believe additional steps would be helpful to continue to improve the quality of FINRA arbitrators.

Our recommendations on this topic fall into two categories: (1) arbitrator quality, which focuses on ways to improve the caliber of individual arbitrators; and (2) arbitrator accountability, which focuses on FINRA oversight of its arbitrators. We need reform in both categories to achieve meaningful improvement in this area, particularly in light of the specific concerns raised by our members.

1. **Arbitrator Quality**

- *Expanding Arbitrator Qualifications.* FINRA arbitrators are tasked with enormous responsibility. In effect, they serve as both judge and jury in the FINRA arbitration forum, and their qualifications should be commensurate with that responsibility. SIFMA commends FINRA's recent rule changes that raise the required employment and educational qualifications for arbitrators,[17] as increasing these qualifications reflects a commonsense approach for improving the quality and fairness of the FINRA arbitration forum going forward. We therefore urge FINRA to consider additional steps to increase the number of arbitrators with process and subject matter expertise.

- *Implementing Enhanced Training and Continuing Education Requirements.* SIFMA recommends revising the FINRA arbitrator training program to help ensure arbitrators can adequately perform their responsibilities. The program should include required training on topics related to: (i) the arbitration process, including FINRA's Discovery Guide, and the hearing oversight issues discussed above; (ii) the securities industry; (iii) substantive elements of law that are critical to many arbitrations, for example, attorney-client privilege; and (iv) the overarching obligation to maintain a neutral adjudicatory position and avoid assuming, or creating the appearance of assuming, an advocacy position in favor of one party or the other. Training should incorporate a testing mechanism to ensure that arbitrators understand the subject matter.

  We also recommend implementing a continuing education requirement requiring all FINRA arbitrators to complete certain categories of training on a periodic basis, which should be continuously updated to respond to trends and issues in FINRA arbitration. Likewise, there should be mandatory additional training required for arbitrators with poor evaluation records and for arbitrators who have not served on a panel within a certain time period.

[17] Effective May 24, 2025, FINRA Dispute Resolution Services changed the employment and educational qualifications for new arbitrators by raising: (i) the education standard to a 4-year degree (from 2 years of college-level credits); and (ii) the employment requirement to "5 years of professional work experience," which is defined as employment requiring advanced training and education (from "5 years of paid business and/or professional experience").

- *Expanding the Panel Selection Process.* SIFMA recommends revising Rule 12403, which permits customers to select all-public arbitrator panels in cases with three arbitrators. Individuals designated as public arbitrators do not have any relevant experience in the securities industry, as FINRA's definition of public arbitrator excludes a wide range of professionals, including many that have only attenuated connections to the industry. This definition has the effect of eliminating many highly qualified individuals with subject matter expertise from the pool of public arbitrators, based on standards that go far beyond what should reasonably address perceptions of bias.

- *Increasing Arbitrator Compensation.* SIFMA recommends increasing arbitrator compensation to attract more qualified individuals to serve as FINRA arbitrators. These compensation changes could be limited to specific circumstances, for example, payments for hearing preparation time, higher compensation based on experience level, and higher compensation for arbitrator panels assigned to high-value claims.

2. **Arbitrator Accountability**

- *Enhanced FINRA Oversight of Arbitrators.* We recommend that FINRA Dispute Resolution staff attend more arbitration proceedings for observation. While participants can report arbitration issues to FINRA, the primary method for raising issues cannot be completed until the conclusion of a proceeding when evaluation forms are available. This is insufficient. Having FINRA Dispute Resolution staff more regularly attend proceedings would present a significantly more effective way for FINRA to identify and address arbitration issues in real time.

- *Enhanced Process to Address Poorly Performing Arbitrators.* We recommend that FINRA implement a more transparent process for identifying and removing FINRA arbitrators who are not adhering to applicable rules or adequately performing their duties. At the conclusion of their case, participants submit evaluation forms that rate arbitrator performance. Yet it is unclear what, if any, corrective measures FINRA takes to address negative evaluations, or any other complaints firms raise about FINRA arbitrators outside of the evaluation process.

VI. Conclusion

SIFMA appreciates the opportunity to provide our recommendations for your consideration. We look forward to your response and to a continued dialogue with you on these issues. Please do not hesitate to contact us.

Sincerely,

Alyssa Pompei
Vice President & Assistant General Counsel

Kevin Carroll
Deputy General Counsel

CC: Richard Berry, Executive Vice President and Director, FINRA DRS