



VIA ELECTRONIC MAIL

December 13, 2019

Ms. Vanessa Countryman
Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090

Re: **SEC Release No. 34-87557; File No. SR-FINRA-2019-027**
Notice of Filing of 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

Dear Ms. Countryman:

We are submitting this comment letter in response to a notice (the “Notice”)¹ issued by the Securities and Exchange Commission (the “SEC”) soliciting comments on a proposed rule change (the “Proposed Amendments”) to amend Financial Industry Regulatory Authority, Inc. (“FINRA”) Rule 12000 Series, as published in the Federal Register on November 22, 2019. The Proposed Amendments would expand customers’ options against firms that become inactive during arbitration. They would also expand customers’ options with respect to associated persons who are inactive when an arbitration is filed or who become inactive during a pending arbitration.

The Financial Services Institute² (FSI) appreciates the opportunity to comment on the Proposed Amendments. FSI largely supports the Proposed Amendments as set forth in the Notice and the corresponding rule text.

Background on FSI Members

The independent financial services community has been an important and active part of the lives of American investors for more than 40 years. In the US, there are approximately 167,000 independent financial advisors, which account for approximately 64.5% percent of all producing registered representatives.³ These financial advisors are self-employed independent contractors, rather than employees of the Independent Broker-Dealers (IBD).

¹ SEC, Notice of Filing of 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, 84 Fed. Reg. 64581, 64581 (Nov. 22, 2019) (the “Notice”).

² The Financial Services Institute (FSI) is an advocacy association comprised of members from the independent financial services industry, and is the only organization advocating solely on behalf of independent financial advisors and independent financial services firms. Since 2004, through advocacy, education and public awareness, FSI has been working to create a healthier regulatory environment for these members so they can provide affordable, objective financial advice to hard-working Main Street Americans.

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

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

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

Discussion

A. Background

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

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

- Permitting a customer to withdraw a claim 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;
- Deeming claims against inactive associated persons as ineligible for arbitration, unless the customer and the associated person are parties to a post-dispute arbitration agreement;
- Requiring FINRA to provide notice to a customer if a firm or associated person becomes inactive during a pending arbitration, and providing a 60-day window for the customer to withdraw a claim with or without prejudice;
- Permitting customers to amend their pleadings, including by adding new parties, upon learning that a firm or an associated person has become inactive;
- Allowing customers to postpone a hearing date where: i) the customer is notified that a firm or an associated person has become inactive, and ii) the scheduled hearing date is within sixty (60) days of the notice;

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

- Permitting a customer to request a default proceeding against a terminated associated person who fails to file an answer within the time provided regardless of the number of days since termination; and
- Granting customers the option to withdraw their claim and having their filing fees refunded upon learning that a firm or an associated person has become inactive.

B. FSI's Comments

i. The Proposed Amendments Are Not Likely to Address the Issue of Unpaid Arbitration Awards, But Instead Create an Imbalance in the Arbitration Process

The Notice states that “[m]ost unpaid customer arbitration awards are rendered against firms or individuals whose FINRA registration has been terminated, suspended, cancelled, or revoked, or who have been expelled from FINRA.”⁵ As a result, FINRA is proposing to amend FINRA Rule 12202 to expand a customer’s options in situations where a member or associated person becomes inactive either before a claim is filed or during a pending arbitration. FSI believes that, while the Proposed Amendments likely expand a customer’s options, they do not directly address the issue of unpaid arbitration awards. For example, the Proposed Amendments do not necessarily improve investors’ ability to collect arbitration awards against inactive FINRA members or reduce instances of unpaid arbitration awards by inactive FINRA members. Instead, the Proposed Amendments change the arbitration process to create an imbalance between claimants and respondents.

According to FINRA, arbitration cases decided by award in the forum operated by FINRA represent a small subset of all cases closed involving customer disputes, and the vast majority of customer cases instead close by settlement.⁶ Further, FINRA notes that a “claimant in the FINRA arbitration forum is in a similar position as if the claimant had brought an action in court and been awarded the same amount of damages.”⁷ FINRA also notes that (i) the responsibility to collect on an arbitration award lies with the claiming party, and (ii) FINRA’s arbitration forum does not ensure payment of damages awarded, just as the federal and state court systems and other arbitration systems do not ensure payment of awards.⁸ If a respondent fails to pay an arbitration award, the claimant may take the award to court, have the award converted to a judgment, and attempt to collect on the judgment using the court’s collection procedures.⁹ The reality seems to be that, regardless of the forum selected, there always exists a possibility that awards will go unpaid. FSI believes that FINRA should continue to protect a claimant’s right to an award within its jurisdictional limits to do so, including imposing suspensions from the brokerage industry for failure to pay arbitration awards. However, investor protection should not come at the expense of a respondent’s right to a fair and balanced arbitration proceeding.

⁵ The Notice at 64581.

⁶ FINRA, Statistics on Unpaid Customer Awards in FINRA Arbitration, <https://www.finra.org/arbitration-mediation/statistics-unpaid-customer-awards-finra-arbitration>.

⁷ FINRA, Statistics on Unpaid Customer Awards in FINRA Arbitration, <https://www.finra.org/arbitration-mediation/statistics-unpaid-customer-awards-finra-arbitration>.

⁸ FINRA, Statistics on Unpaid Customer Awards in FINRA Arbitration, <https://www.finra.org/arbitration-mediation/statistics-unpaid-customer-awards-finra-arbitration>.

⁹ FINRA, Statistics on Unpaid Customer Awards in FINRA Arbitration, <https://www.finra.org/arbitration-mediation/statistics-unpaid-customer-awards-finra-arbitration>.

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

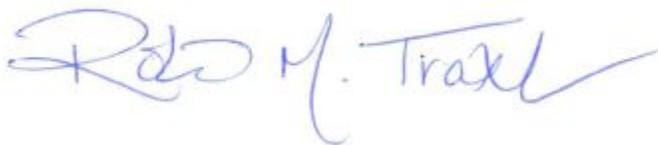
Currently, FINRA Rule 12309 permits a party to amend a pleading any time before the arbitration panel is appointed. FINRA Rule 12309 also provides that, once FINRA appoints a panel to a case, a party can amend a pleading only if the arbitrators grant a party's motion to do so. In addition, a party cannot add a new party to a 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. According to FINRA, Rule 12309 "ensures that a party added to an arbitration by amendment either will be able to participate in list selection, or will be able to object to being added."¹⁰ The protections provided under Rule 12309 for both claimants and respondents are critical, and do not become any less necessary solely because a respondent becomes inactive.

Under the Proposed Amendments, if FINRA notifies a customer that a member or associated person has become inactive, the claimant may amend its pleading to add a claim or party without the need for pre-approval by an arbitrator or panel. This also means that a newly added party would not be able to participate in the arbitration panel selection process if the amendment pleading to add a party occurs after panel appointment. FSI believes that all claimants and respondents should be afforded the opportunity to participate in the arbitration panel selection process, and respondents should be afforded the opportunity to object to being added. 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. Further, FSI believes that requiring an arbitrator or panel to grant a motion to add a party serves the important purpose of providing the party to be added with an opportunity to object to being added. 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. Critical aspects of fairness and balance are absent when the motion requirement is eliminated from the rules. For these reasons, FSI believes that the Proposed Amendments should not eliminate the existing motion requirement for adding a party or amending a pleading.

Conclusion

We are committed to constructive engagement in the regulatory process and welcome the opportunity to work with FINRA and the SEC on this and other important regulatory efforts. Thank you for considering FSI's comments. Should you have any questions, please contact me at [REDACTED].

Respectfully submitted,



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¹⁰ NASD, Notice to Members 07-07.