

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-98703; File No. SR-FINRA-2023-013)

October 6, 2023

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of a Proposed Rule Change to Amend the FINRA Codes of Arbitration Procedure and Code of Mediation Procedure to Revise and Restate the Qualifications for Representatives in Arbitrations and Mediations

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on October 5, 2023, the Financial Industry Regulatory Authority, Inc. (“FINRA”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by FINRA. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

FINRA is proposing to amend FINRA Rule 12208(b) through (d) of the Code of Arbitration Procedure for Customer Disputes (“Customer Code”), FINRA Rule 13208(b) through (d) of the Code of Arbitration Procedure for Industry Disputes (“Industry Code”) and FINRA Rule 14106(b) through (d) of the Code of Mediation Procedure (“Mediation Code” and collectively, “Codes”), to revise and restate the qualifications for representatives in arbitrations and mediations in the forum administered by FINRA Dispute Resolution Services (“DRS”); to disallow compensated representatives who are not attorneys from representing parties in the DRS forum; to codify that a student

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

enrolled in a law school participating in a law school clinical program or its equivalent and practicing under the supervision of an attorney may represent investors in the DRS forum; and to clarify the circumstances in which any person, including attorneys, would be prohibited from representing parties in the DRS forum.

The text of the proposed rule change is available on FINRA's website at <http://www.finra.org>, at the principal office of FINRA and at the Commission's Public Reference Room.

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, FINRA included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. FINRA has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose  
Background

The Codes currently permit parties to arbitrations and mediations in the DRS forum to represent themselves, to be represented by an attorney at law in good standing or to be represented by a non-attorney representative ("NAR").<sup>3</sup> Some NARs receive compensation in connection with their representation of parties ("compensated NARs"). Compensated NARs receive monetary or non-monetary compensation in connection with

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<sup>3</sup> See FINRA Rules 12208, 13208 and 14106.

the representation of parties — including, for example, advance fees, consulting fees, payments in kind, referral fees or fees pursuant to a contingent fee arrangement. Other NARs, often friends or relatives of a party, may assist parties with their cases without compensation (“uncompensated NARs”). In addition, although not specifically provided for in the Codes, law students typically represent parties pro bono while practicing under the supervision of an attorney through securities arbitration clinics (“SACs”).<sup>4</sup>

In response to forum users’ concerns regarding the conduct of compensated NARs,<sup>5</sup> FINRA has reviewed their representation of parties in arbitration and mediation in the DRS forum.<sup>6</sup> FINRA observes that compensated NARs represent customers in a small percentage of the customer cases in the DRS forum—one percent—and that only a few compensated NARs regularly operate in the DRS forum today.<sup>7</sup> Compensated NARs often possess a background in the securities industry and primarily represent individuals in arbitration or mediation claims against broker-dealers and their associated persons.<sup>8</sup>

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<sup>4</sup> SACs are affiliated with law schools and are typically staffed by second- or third-year law students. SACs provide pro bono legal representation to individual customers who seek to arbitrate or mediate claims under \$100,000 and who cannot find or afford an attorney to represent them. Generally, SACs require that potential clients not exceed specified household income and asset requirements. Currently, 10 SACs operate in the District of Columbia, Florida, Illinois, New Jersey, New York and Pennsylvania. For more information on SACs, see <https://www.finra.org/arbitration-mediation/how-find-attorney>.

<sup>5</sup> The suggestion to study the role of compensated NARs in arbitration and mediation originated from the FINRA Dispute Resolution Task Force (“Task Force”). The Task Force was formed to suggest strategies to enhance the transparency, impartiality and efficiency of the DRS forum and included representatives from the industry and the public with a broad range of interests in securities dispute resolution. See Final Report and Recommendations of the FINRA Dispute Resolution Task Force, <https://www.finra.org/sites/default/files/Final-DR-task-force-report.pdf>.

<sup>6</sup> In Regulatory Notice 17-34 (October 2017) (“Notice”), FINRA sought responses to questions related to forum users’ experiences with compensated NARs and whether it would be prudent to further restrict their representation of parties. See infra Item II.C. (discussing the Notice and summarizing comments).

<sup>7</sup> See infra Item II.B. (discussing Economic Impact Assessment).

<sup>8</sup> See infra note 87 and accompanying text.

Less commonly, they may represent associated persons in expungement claims brought against broker-dealers. Compensated NARs often associate with companies (“NAR firms”) that are in the business of bringing these claims and providing related services, such as evaluations of customer account activity.

Despite the low number of compensated NARs, FINRA’s review identified several recent allegations of improper conduct by compensated NARs in connection with their representation of parties in the DRS forum. In contrast, FINRA has not identified any allegations of improper conduct by uncompensated NARs or law students. Unlike compensated NARs, uncompensated NARs (often friends or relatives of a party) lack a direct pecuniary incentive to engage in misconduct when seeking new client relationships or bringing claims in the DRS forum. In addition, unlike uncompensated NARs, law students seeking educational opportunities to gain legal experience participate in SACs under the supervision of attorneys and typically represent parties pro bono. Thus, FINRA’s focus at this time is on the representation of parties in the DRS forum by compensated NARs. For example, the State of California recently brought a civil enforcement action against several compensated NARs for engaging in the unauthorized practice of law, in part in the DRS forum; falsely promising to help customers recover their past failed investments through, in part, arbitration in the DRS forum; and charging advance fees in violation of California law.<sup>9</sup> Another compensated NAR was criminally

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<sup>9</sup> See Complaint for Injunctive Relief, Civil Penalties and Other Ancillary Relief, People v. Chambliss Corp., No. 18STCV05586 (Cal. Super. Ct. filed Nov. 19, 2018); see also People v. Chambliss Corp., No. 18STCV05586, 2020 Cal. Super. LEXIS 72668 (Cal. Super. Ct. Nov. 12, 2020) (order granting stipulated judgment against Defendant Casey C. Mielnik, a compensated NAR, for violations of false advertising, unfair competition law, and telephonic sellers law); Chambliss Corp., No. 18STCV05586 (Cal. Super. Ct. Nov. 24, 2020) (order regarding Defendant National Advisory Network, Inc. and granting default judgment against 11 defendants, nine compensated NARs and two nonlegal corporations, for false advertising, unfair competition law, telephonic sellers law, and unauthorized practice of law); Chambliss Corp., No. 18STCV05586

sentenced in New York for felony grand larceny, engaging in a scheme to defraud, and falsification of business records in connection with proceedings that the compensated NAR initiated in the DRS forum. A different compensated NAR misrepresented his identity in order to represent parties in DRS proceedings even though he was not qualified to do so. In addition, forum users have asserted that compensated NARs cold call investors with aggressive sales tactics;<sup>10</sup> pursue frivolous claims;<sup>11</sup> misrepresent or willfully fail to disclose important facts relating to their background;<sup>12</sup> achieve worse outcomes or awards for their clients or settle cases for lower amounts than attorneys;<sup>13</sup> and work in coordination with persons who are suspended or barred from the securities industry.<sup>14</sup>

FINRA is concerned about these serious allegations and the potential harm to parties represented by compensated NARs, particularly to customers. This concern is heightened because parties are compensating these NARs to represent them in the DRS forum, yet there is no direct regulation of compensated NAR conduct. Although

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(Cal. Super. Ct. Nov. 24, 2020) (order regarding Defendants Jay R. Jeskie, Eric D. Harris, Elijah Schnell, Matthew J. Cano, John W. Martynec, Gordon A. Herman and granting default judgment against 11 defendants, nine compensated NARs and two nonlegal corporations, for false advertising, unfair competition law, and telephonic sellers law); Chambliss Corp., No. 18STCV05586 (Cal. Super. Ct. Jan. 13, 2021) (order granting motion for summary adjudication against Defendant Amanda L. Langer, a compensated NAR, for violating unfair competition law, unauthorized practice of law, and telephonic sellers law); People v. Chambliss Corp., No. 18STCV05586, 2022 Cal. Super. LEXIS 86977 (Cal. Super. Ct. Sept. 29, 2022) (judgment against attorney Peter A. Bumerts for the unauthorized practice of law, false advertising, unfair competition law, and aiding and abetting the unauthorized practice of law).

<sup>10</sup> See infra note 88 and accompanying text.

<sup>11</sup> See infra note 89 and accompanying text.

<sup>12</sup> See, e.g., PIABA, infra note 115.

<sup>13</sup> See David E. Robbins, 1 Sec. Arb. Proc. Manual § 6-2, Release No. 26 (5<sup>th</sup> ed. 2022); infra note 90 and accompanying text.

<sup>14</sup> See infra note 87 and accompanying text.

compensated NARs may be subject to state laws governing general business practices,<sup>15</sup> they are not subject to the specific and extensive professional qualification requirements, ethical rules, disciplinary processes and client protections that the states and other U.S. jurisdictions apply to attorneys who represent parties in the DRS forum.<sup>16</sup> FINRA is concerned that compensated NARs' interactions with customers are not subject to regulation like the state disciplinary rules on lawyer advertising and solicitation,<sup>17</sup> and that this also is not an area that FINRA regulates. Although they are engaged in the business of representing parties in the DRS forum, compensated NARs also are not required to purchase malpractice insurance and their clients are not protected by

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<sup>15</sup> See, e.g., Cal. Bus. & Prof. Code § 17200 (amended 1992) (prohibiting any unlawful, unfair or fraudulent business act or practice and unfair, deceptive, untrue or misleading advertising).

<sup>16</sup> Generally, licensed attorneys are required to have: (1) completed a bachelor's degree program (or its equivalent) and a legal education as required by a licensing state; (2) passed a state bar exam; (3) passed the Multistate Professional Responsibility Examination; (4) passed a licensing state's character and fitness review, which includes questions about academic conduct at law school, criminal history, social conduct in general and any applicable disciplinary actions; and (5) taken a legal binding oath with a licensing state's supreme court or high-court equivalent. In addition, many states require attorneys to complete continuing legal education, including ethics credits, to maintain a law license. For more information on state-by-state requirements to become a lawyer, see generally <https://www.lawyeredu.org>.

In addition, all jurisdictions require lawyers to abide by rules of professional conduct, which are enforced through state disciplinary processes. See Peter A. Joy, Making Ethics Opinions Meaningful: Toward More Effective Regulation of Lawyers' Conduct, 15 GEO. J. LEGAL ETHICS 313, 317 (2002).

<sup>17</sup> See, e.g., Cal. Rules of Prof'l Conduct R. 7 (2018) (ensuring that attorney advertisements or solicitations are not misleading, clearly identifiable as advertisements; ensuring the advertiser's accountability; and mitigating the use of any undue duress or pressure by prohibiting, for example, solicitation of a potential client through in-person, telephone or real-time electronic communication); N.Y. Rules of Prof'l Conduct R. 7.3 (amended 2017) (prohibiting attorneys from engaging in solicitation or advertisement by in-person or telephone contact or by real-time or interactive computer-accessed communication unless the recipient is a close friend, relative, former client or existing client; providing examples of prohibited forms of solicitations and advertisements); Restatement (Third) of The Law Governing Lawyers § 1 cmt. b (2000) (providing that federal courts often apply the ethical rules and standards adopted by the state in which the court sits). NARs may be subject to more general state marketing regulations. See, e.g., Cal. Bus. & Prof. Code § 17511 (amended 2023) (requiring telephone solicitors to register prior to doing business in California).

statewide client protection funds.<sup>18</sup> In contrast, all U.S. jurisdictions require attorneys to finance client protection funds through association dues, lawyer registration fees or annual assessments. Because customers of compensated NARs do not benefit from the client protections and disciplinary processes that apply to attorneys, they may have limited recourse if they are harmed by the misconduct of compensated NARs.<sup>19</sup>

FINRA also is concerned that parties may be harmed due to the lack of recourse when compensated NARs are found to be engaged in the unauthorized practice of law pursuant to the law of the relevant U.S. jurisdiction. Compensated NARs have, for example, been enjoined from continuing their representation of parties during pending arbitrations after courts determined that the representation constituted the unauthorized practice of law.<sup>20</sup> DRS arbitrators have also issued awards dismissing claims, or finding against investors, after determining that a compensated NAR's representation of the investor constituted the unauthorized practice of law in the jurisdiction.<sup>21</sup> The

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<sup>18</sup> A "client protection fund" is a pool of money funded and maintained by a bar association or regulatory agency, the purpose of which is to reimburse clients who have suffered financial loss due to the dishonest acts of lawyers. See American Bar Association ("ABA"), A History of Client Protection Rules, [https://www.americanbar.org/groups/professional\\_responsibility/resources/client\\_protection/history](https://www.americanbar.org/groups/professional_responsibility/resources/client_protection/history); see also ABA Center on Professional Responsibility, Survey of Lawyers' Funds for Client Protection 2017-2019, at 8 (2020), [https://qa.americanbar.org/content/dam/aba/administrative/professional\\_responsibility/2017-2019-cp-survey.pdf](https://qa.americanbar.org/content/dam/aba/administrative/professional_responsibility/2017-2019-cp-survey.pdf).

<sup>19</sup> FINRA notes that it does not have direct authority to investigate or discipline representative misconduct in the DRS forum. Cf. FINRA Rule 8310 (allowing FINRA to impose sanctions on member firms and persons associated with member firms). Currently, if an attorney is allegedly engaging in misconduct in the DRS forum, FINRA may make a referral to the attorney's disciplinary agency, which has processes to respond to misconduct of attorneys subject to its jurisdiction. If a compensated NAR is allegedly engaging in misconduct in the DRS forum, FINRA may make a referral to law enforcement or an appropriate state agency.

<sup>20</sup> See, e.g., Empire Asset Mgmt. Co. v. Sherer, 19-555-CB (Mich. 5th Cir. Ct. Feb. 7, 2020); see also Disciplinary Counsel v. Alexicole, Inc., 822 N.E.2d 348, 350 (Ohio 2004) (finding that the representation of parties in securities arbitration by non-attorneys constituted the unauthorized practice of law).

<sup>21</sup> See, e.g., Simon v. Aegis Cap. Corp., FINRA Disp. Resol. Case No. 15-02865 (2016) (Parker, Arb.) (finding that customer claimant was not entitled to an award and was responsible for the

compensated NAR's unauthorized practice of law may also be part of a broader pattern of misconduct that harms customers.<sup>22</sup>

The current rule's prohibition on representing a party if state law prohibits the representation does not fully address the concern with the unauthorized practice of law by compensated NARs, because it is not always clear in advance of the arbitration or mediation whether a compensated NAR's representation of a party in arbitration or mediation in a particular jurisdiction is legally permissible.<sup>23</sup> FINRA is not aware of any U.S. jurisdiction that explicitly allows parties to be represented by compensated NARs in the DRS forum by statute or rule. Only a few U.S. jurisdictions' unauthorized practice of law or professional conduct committees have specifically addressed compensated NAR representation of parties in arbitration or mediation in the DRS forum, and those that have done so concluded that their representation in the DRS forum constitutes the unauthorized practice of law.<sup>24</sup> Many other U.S. jurisdictions' standards may be less

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DRS forum fees, either because the claimant's submissions were invalidated by the compensated NAR's unauthorized practice of law, or because the claimant had not sustained his burden of proof); *Halling v. Cape Sec. Inc.*, FINRA Disp. Resol. Case No. 16-00519 (2017) (Brahin, Arb.) (finding that representation by compensated NARs in the DRS forum was not legally permissible in Kansas, and striking customer claimant's pleadings); see also *Wells v. Worden Cap. Mgmt., LLC*, FINRA Disp. Resol. Case No. 19-02241 (2020) (Carvell, Arb.) (ordering claimant to proceed pro se or retain an attorney following compensated NAR's withdrawal in response to respondents' motion to strike the statement of claim on the basis that claimant's compensated NAR engaged in the unauthorized practice of law by filing the claim); *Neuss v. Wells Fargo Inv., LLC*, FINRA Disp. Resol. Case No. 10-01320 (2011) (Albini, Arb.) (partially granting respondents' motion in limine to disqualify claimants' compensated NAR, and denying claimants' motion to suspend the hearing and dismiss claims without prejudice); *Best v. Columbus Advisory Group, Ltd.*, FINRA Disp. Resol. Case No. 18-03337 (2020) (Putnam, Arb.) (dismissing claimant's case with prejudice as a sanction for material and intentional failure to comply with the arbitrator's order issued during the compensated NAR's representation of the claimant).

<sup>22</sup> See Chambliss, supra note 9 and accompanying text. A number of commenters raised other concerns about compensated NARs' unauthorized practice of law. See infra notes 96-99 and accompanying text.

<sup>23</sup> See FINRA Rules 12208(c), 13208(c) and 14106(c).

<sup>24</sup> Unauthorized practice of law or professional conduct committees in Florida, Illinois and Ohio have concluded that compensated NAR representation of parties in securities arbitration constitutes the unauthorized practice of law. See Fla. Bar Re Advisory Op. on Nonlawyer



clear, but could potentially be interpreted as prohibiting compensated NARs from representing parties in the DRS forum.<sup>25</sup> In New York, compensated NARs rely on trial-level court opinions to represent parties in the DRS forum.<sup>26</sup>

### Proposed Rule Change

FINRA Rules 12208(c), 13208(c) and 14106(c) currently prohibit compensated and uncompensated NARs from representing parties in arbitration and mediation if: (1) state law prohibits such representation; (2) the person is currently suspended or barred from the securities industry in any capacity; or (3) the person is currently suspended from

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Representation in Sec. Arbitration, 696 So. 2d 1178, 1180 (Fla. 1997) (concluding that compensated non-attorney representation of customers in securities arbitration constitutes the unauthorized practice of law and enjoining non-attorneys from representing customers for compensation in securities arbitration proceedings); Ill. State Bar Ass'n Standing Comm'n on Prof'l Conduct, Advisory Op. 13-03, at 7 (2013), <https://www.isba.org/sites/default/files/ethicsopinions/13-03.pdf> (stating that non-attorney representation in a FINRA arbitration generally constitutes the unauthorized practice of law and suggesting that FINRA arbitrators notify FINRA and the Illinois Attorney Registration and Disciplinary Committee if a non-attorney represents a party in FINRA arbitration); Disciplinary Counsel v. Alexicole, Inc., 822 N.E.2d 348, 350 (Ohio 2004) (finding that the representation of parties in securities arbitration and mediation by non-attorneys constitutes the unauthorized practice of law); see also Sara Rudolph Cole, Blurred Lines: Are Non-Attorneys Who Represent Parties in Arbitrations Involving Statutory Claims Practicing Law? 48 U.C. DAVIS L. REV. 921, 948-958 (2015) (noting that unauthorized practice of law or professional conduct committees in Florida, Illinois and Ohio have concluded that compensated NAR representation of parties in securities arbitration constitutes the unauthorized practice of law). In addition, two committees of the Illinois State Bar Association sent three comment letters to the Notice in support of prohibiting compensated NARs and argued that their representation of parties in the DRS forum constituted the unauthorized practice of law. See infra note 83 and accompanying text.

<sup>25</sup> See, e.g., Tex. Gov't Code § 81.101 (amended 1999) (stating that practice of law includes “a service rendered out of court, including the giving of advice or the rendering of any service requiring the use of legal skill or knowledge,” and that this definition was “not exclusive and does not deprive the judicial branch of the power and authority under both this chapter and the adjudicated cases to determine whether other services and acts not enumerated may constitute the practice of law”); Ky. SCR Rule 3.020 (amended 1978) (defining the practice of law as “any service rendered involving legal knowledge or legal advice, whether of representation, counsel or advocacy in or out of court, rendered in respect to the rights, duties, obligations, liabilities, or business relations of one requiring the services.”).

<sup>26</sup> See DePalo v. Lapin, Index No. 114656/2008 (Sup. Ct. NY June 30, 2009); but cf. Aegis J. Frumento & Stephanie Korenman, Rethinking Non-Lawyer Advocacy in FINRA Customer Arbitrations, Sec. Arb. Commentator, March 17, 2017, at 1 (noting that the New York state court in Lapin only considered the status of a non-lawyer advocate in the context of deciding that his status as a non-lawyer did not render his statements any less privileged than those of any of the other participants in the arbitration).

the practice of law or disbarred. FINRA Rules 12208(d), 13208(d) and 14106(d) further provide that issues regarding the qualifications of a person to represent a party in arbitration or mediation are governed by applicable law and may be determined by an appropriate court or other regulatory agency.

FINRA is proposing to amend the Codes to revise and restate the qualifications for representatives of parties using the DRS forum, and, for the reasons discussed above and below, to disallow compensated NARs from representing parties in the DRS forum.<sup>27</sup> In addition, the proposed amendments would codify that a student enrolled in a law school participating in a law school clinical program or its equivalent and practicing under the supervision of an attorney may represent investors in the DRS forum.<sup>28</sup> The proposed amendments would also clarify the circumstances in which any person, including attorneys, would be prohibited from representing a party in the DRS forum,<sup>29</sup> and that a challenge to the qualifications of a representative made outside of the proceeding would not stay or otherwise delay the proceeding without a court order.<sup>30</sup>

#### A. Disallowing Compensated NARs in the DRS Forum

The proposed rule change would disallow a person who is not an attorney and who may receive compensation in any manner in connection with the representation (i.e., a compensated NAR) from representing a party at any stage of an arbitration or mediation

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<sup>27</sup> See proposed Rules 12208(b)(1), 13208(b)(1) and 14106(b)(1). The proposed rule change would apply to all members, including members that are funding portals or have elected to be treated as capital acquisition brokers (“CABs”), given that the funding portal and CAB rule sets incorporate the impacted FINRA rules by reference.

<sup>28</sup> See proposed Rules 12208(b)(1)(B), 13208(b)(1)(B) and 14106(b)(1)(B).

<sup>29</sup> See proposed Rules 12208(b)(2), 13208(b)(2) and 14106(b)(2).

<sup>30</sup> See proposed Rules 12208(c), 13208(c) and 14106(c).

proceeding held in a U.S. hearing location.<sup>31</sup> This prohibition would apply if any form of monetary or non-monetary compensation would be received by the NAR in connection with the representation.

As noted above, compensated NARs represent customers in one percent of customer cases and only a few compensated NARs regularly practice in the DRS forum today.<sup>32</sup> Despite the infrequency of compensated NAR representation, as discussed above, FINRA's review identified multiple allegations of improper conduct by compensated NARs, whose clients are not protected by the professional qualification requirements, ethical rules, disciplinary processes and client protections that apply when parties retain licensed attorneys.<sup>33</sup> Moreover, parties may be harmed due to the lack of recourse when compensated NARs are found to be engaged in the unauthorized practice of law.<sup>34</sup> These concerns are heightened due to the pecuniary incentives of compensated NARs when seeking new customer relationships or bringing claims in the DRS forum, such as engaging in aggressive sales techniques to obtain their business, pursuing frivolous claims, and charging clients non-refundable processing or investigation fees.

Accordingly, FINRA believes that it is appropriate to disallow their representation of parties in proceedings in the DRS forum.

FINRA understands that some parties with claims of \$100,000 or less may have difficulty obtaining legal counsel. An attorney may, for example, believe that their share of a potential award might be too small to justify the effort. In addition, not all investors

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<sup>31</sup> See proposed Rules 12208(b)(2)(D), 13208(b)(2)(D) and 14106(b)(2)(D); see also proposed Rules 12208(b)(1)(C), 13208(b)(1)(C) and 14106(b)(1)(C).

<sup>32</sup> See supra note 7 and accompanying text.

<sup>33</sup> See supra Item II.A.1. (discussing Background).

<sup>34</sup> See supra notes 20 and 21 and accompanying text.

will qualify for assistance by, or are able to be serviced by, SACs.<sup>35</sup> FINRA recognizes that some parties with smaller claims who might otherwise consider representation by a compensated NAR may not be able to obtain representation as a result of the proposed rule change.<sup>36</sup>

B. Required Statement of No Compensation for Uncompensated NAR Representation

Proposed Rules 12208(b)(1)(C), 13208(b)(1)(C) and 14106(b)(1)(C) would provide that a party could be represented in arbitration or mediation by an uncompensated NAR, provided that prior to the representation, the uncompensated NAR or party files the required written statement with the Director through the Party Portal.<sup>37</sup>

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<sup>35</sup> See supra note 4; see also infra Item II.C.(B) (summarizing comments, including from SACs, about the limitations on the availability of representation in the DRS forum).

<sup>36</sup> FINRA notes that it makes available efficient and cost-effective alternative processes to a full arbitration proceeding for certain smaller claims. For example, claimants may proceed “on the papers,” where a chair-qualified arbitrator will make a decision based solely on the documents submitted. See FINRA Rules 12800 and 13800; see also Simplified Arbitrations: Three Ways to Present Your Case to Arbitrators, <https://www.finra.org/arbitration-and-mediation/simplified-arbitrations>.

FINRA has also introduced several incentives to encourage parties with smaller claims to resolve their disputes through FINRA mediation. For example, FINRA may offer mediation by telephone at no cost or at a significantly reduced hourly fee to parties arbitrating certain smaller claims. FINRA also encourages parties in arbitration to mediate by waiving the fee to postpone a hearing, except in cases of late postponement requests. See FINRA’s Mediation Program for Small Arbitration Claims, <https://www.finra.org/arbitration-mediation/finras-mediation-program-small-arbitration-claims>.

<sup>37</sup> Under the Customer and Industry Codes, the term “Director” means the Director of DRS. See FINRA Rules 12100(m), 12103, 13100(m) and 13103. Under the Mediation Code, the term “Director” refers to the Director of Mediation of DRS. See FINRA Rules 14100(d) and 14103. The Party Portal provides forum users with a secure, online location for claim filing and interactions relating to case administration. Parties use the Party Portal to, among other things, file claims, pay filing fees, receive documents from and send documents to DRS, receive service of claims, submit answers to claims, submit additional case documents, view the status of cases, select arbitrators, schedule hearings and send documents to other Party Portal case participants. See, e.g., FINRA Rules 12300, 12302, 12402, 12403, 13300, 13302 and 13404. Since mediation is voluntary in all instances, DRS permits parties to a mediation proceeding to use the Party Portal on a voluntary basis to submit and view their mediation case information and documents. See FINRA Rule 14109(b) and (h).

The written statement would have to be signed by the uncompensated NAR and the party and attest that the uncompensated NAR has not received, and will not receive, compensation in connection with the representation.<sup>38</sup> The proposed amendment would help ensure that the NAR is truly uncompensated.

FINRA believes that it would generally be appropriate to allow persons who wish to assist a party without receiving compensation, such as relatives or friends, to represent them in the proceeding. FINRA has not become aware of any concerns with uncompensated NARs' conduct. On the other hand, as discussed above and below, forum users have asserted that compensated NARs cold call investors with aggressive sales tactics;<sup>39</sup> pursue frivolous claims;<sup>40</sup> misrepresent or willfully fail to disclose important facts relating to their background;<sup>41</sup> achieve worse outcomes or awards for their clients or settle cases for lower amounts than attorneys;<sup>42</sup> and work in coordination with persons who are suspended or barred from the securities industry.<sup>43</sup> The proposed rule change would prohibit compensated NARs from representing parties in the DRS forum, decreasing the risk of potential harm to parties. Unlike compensated NARs, uncompensated NARs lack a direct pecuniary incentive to engage in misconduct when seeking new client relationships or participating in arbitrations or mediations in the DRS forum. However, uncompensated NARs would continue to be disallowed from

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<sup>38</sup> See proposed Rules 12208(b)(1)(C), 13208(b)(1)(C) and 14106(b)(1)(C).

<sup>39</sup> See *infra* note 88 and accompanying text.

<sup>40</sup> See *infra* note 89 and accompanying text.

<sup>41</sup> See, e.g., PIABA, *infra* note 115.

<sup>42</sup> See David E. Robbins, 1 Sec. Arb. Proc. Manual § 6-2, Release No. 26 (5<sup>th</sup> ed. 2022); *infra* note 90 and accompanying text.

<sup>43</sup> See *infra* note 87 and accompanying text.

representing a party if the laws of the relevant U.S. jurisdiction prohibits the representation.<sup>44</sup>

### C. Codifying the Role of Law Students and SACs

FINRA also is proposing to amend the Codes to codify the current practice whereby a party may be represented by a student enrolled in a law school participating in a law school clinical program or its equivalent and practicing under the supervision of an attorney.<sup>45</sup> Currently, the Codes do not specifically address the representation of parties in the DRS forum by law students. Currently, 10 SACs operate in five states and the District of Columbia.<sup>46</sup> SACs and the law students who participate in these programs provide an inexpensive option for customers who qualify and may not be able to find or afford an attorney. Moreover, these representations may be regulated by state rules that govern the performance of legal services by law students and the attorneys who supervise them.<sup>47</sup> Accordingly, FINRA believes that it would be appropriate to codify the role of law students—who would otherwise technically be considered NARs under the proposed rule change—in providing representation to investors through SACs.

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<sup>44</sup> See *infra* note 49 and accompanying text.

<sup>45</sup> See proposed Rules 12208(b)(1)(B), 13208(b)(1)(B) and 14106(b)(1)(B).

<sup>46</sup> See *supra* note 4.

<sup>47</sup> See, e.g., N.Y. CLS Rules Sup. Ct. 805.5 (amended 2019); Cal. R. Ct. 9.42 (amended 2019); Fla. Bar Reg. R. 11 (amended 2023); Kan. Sup. Ct. R. 715 (adopted 2022); D.C. Ct. App. R. 48 (amended 2014); O.C.G.A. Title 15, Ch. 20 (amended 1994); *see also* Peter A. Joy & Robert R. Kuehn, Conflict of Interest and Competency Issues in Law Clinic Practice, 9 CLINICAL L. REV. 493 (2002) (describing the ethical obligations of law students and supervising attorneys).

#### D. Persons Prohibited from Representing Parties in the DRS Forum

The Codes currently provide that non-attorneys may not represent a party if state law prohibits such representation, the person is currently suspended or barred from the securities industry in any capacity or the person is currently suspended from the practice of law or disbarred.<sup>48</sup> The proposed rule change would retain the substance of these provisions, while clarifying that the laws of U.S. jurisdictions that are not states may also disqualify the person from representing a party.<sup>49</sup> In addition, because FINRA believes that all persons should be prohibited from practicing in the DRS forum for these reasons, the proposed amendments would also apply these prohibitions generally to all persons including attorneys.<sup>50</sup>

The proposed rule change would also specify that a person who is currently suspended from or denied the privilege of appearing or practicing before the Commission may not represent a party in the DRS forum.<sup>51</sup> FINRA believes that incorporating these

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<sup>48</sup> See FINRA Rules 12208(c), 13208(c) and 14106(c).

<sup>49</sup> See proposed Rules 12208(b)(2)(A), 13208(b)(2)(A) and 14106(b)(2)(A).

<sup>50</sup> See proposed Rules 12208(b)(2)(C), 13208(b)(2)(C) and 14106(b)(2)(C). If the SEC approves the proposed rule change, the prohibitions would not apply retroactively to attorneys who were suspended or barred from the securities industry prior to the effective date of the proposed rule change.

<sup>51</sup> See proposed Rules 12208(b)(2)(D), 13208(b)(2)(D) and 14106(b)(2)(D). If the SEC approves the proposed rule change, this prohibition would not apply retroactively to persons who were suspended or denied the privilege of appearing or practicing before the Commission prior to the effective date of the proposed rule change. Pursuant to SEC Rule of Practice 102(e), the Commission may (1) deny the privilege of appearing or practicing before it to any person about whom the Commission has made certain findings after notice and opportunity for hearing in the matter; (2) suspend professionals from appearing or practicing before it upon their disbarment, license revocation or suspension, or conviction of a crime involving moral turpitude; or (3) temporarily suspend from appearing or practicing before it professionals who become subject to certain permanent injunctions or findings. See 17 CFR 201.102(e) (amended 2005). The rule was adopted “to protect the integrity and quality of [the Commission’s] system of securities regulation and, by extension, the interests of the investing public.” See Securities Exchange Act Release No. 40567 (October 19, 1998), 63 FR 57164, 57165 (October 26, 1998) (Order Approving File No. S7-16-98) (adopting amendments to Rule 102(e)(1)). In addition, pursuant to Section 205.6(b) of the Standards of Professional Conduct for Attorneys Appearing and Practicing Before the Commission in the Representation of an Issuer, the Commission may also deny attorneys the

standards into the proposed rule change would help protect the integrity and quality of the DRS forum and protect investors.

#### E. Determinations of Qualifications of Representatives

The Codes currently provide that issues regarding the qualifications of a person to represent a party in arbitration or mediation are governed by applicable law and may be determined by an appropriate court or other regulatory agency, and that in the absence of a court order, the proceeding shall not be delayed, or an arbitration stayed, pending resolution of such issues.<sup>52</sup> The proposed rule change would retain the substance of the current provision, which prevents delay while a challenge to the qualifications of a person to represent a party is resolved outside of the DRS forum. However, the proposed rule change would make some clarifying changes to the current provision. Specifically, the proposed rule change would state that a challenge to the qualifications of a representative made outside of the arbitration proceeding shall not stay or otherwise delay the proceeding in the absence of a court order.<sup>53</sup> The proposal would remove the explicit reference to courts and regulatory agencies' separate authority to determine issues regarding the qualifications of a person to represent a party in arbitration (by, for example, determining that doing so would constitute the unauthorized practice of law) as unnecessary and to simplify the language.

If the Commission approves the proposed rule change, FINRA will announce the effective date of the proposed rule change in a Regulatory Notice. If approved, the

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privilege of appearing or practicing before the Commission if they violate minimum standards of professional conduct in connection with the representation of an issuer. See 17 CFR 205.6(b) (2003).

<sup>52</sup> See FINRA Rules 12208(d), 13208(d) and 14106(d).

<sup>53</sup> See proposed Rules 12208(c), 13208(c) and 14106(c).



amendments would be effective for arbitrations and mediations filed in the DRS forum on or after the effective date.

## 2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,<sup>54</sup> which requires, among other things, that FINRA rules must 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. The proposed rule change balances the need for parties, including investors, to be able to avail themselves of representation in the DRS forum with protecting those parties, the integrity of the DRS forum, and the public interest generally from the potential harmful conduct and lack of recourse that may come from representation by compensated NARs.

FINRA believes that by disallowing compensated NARs from representing parties in the DRS forum, the proposed rule change will reduce the risk that parties, including investors, may be harmed by the activities of compensated NARs, only a few of which currently practice in the DRS forum. Although compensated NARs represent customers in one percent of the customer cases in the DRS forum, their actions may result in significant harm to those customers. This risk of harm is especially concerning because there is no direct regulation of compensated NAR conduct. As discussed above, FINRA's review identified multiple allegations of improper conduct by compensated NARs, who are not subject to the specific and extensive professional qualification

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<sup>54</sup> 15 U.S.C. 78q-3(b)(6).

requirements, ethical rules, disciplinary processes and client protections that apply to attorneys.<sup>55</sup>

These concerns are heightened due to the pecuniary incentives of compensated NARs when seeking new customer relationships or bringing claims in the DRS forum, such as engaging in aggressive sales techniques to obtain their business,<sup>56</sup> pursuing frivolous claims,<sup>57</sup> and charging clients non-refundable processing or investigation fees.<sup>58</sup>

Unlike compensated NARs, uncompensated NARs (often friends or relatives of a party) lack this direct pecuniary incentive to engage in misconduct when seeking new client relationships or bringing claims in the DRS forum. In addition, unlike uncompensated NARs, law students seeking educational opportunities to gain legal experience participate in SACs under the supervision of attorneys and typically represent parties pro bono. Accordingly, FINRA believes that to protect investors and the public interest, it is appropriate to disallow compensated NARs' representation of parties in the DRS forum.

The proposed amendments will also protect investors and the public interest by requiring uncompensated NARs, or the party they are representing, to submit a written statement that the NAR has not received, and will not receive, compensation in connection with the arbitration or mediation. This will help ensure that the NAR is truly uncompensated.

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<sup>55</sup> See supra Item II.A.1. (discussing Background).

<sup>56</sup> See infra note 88 and accompanying text.

<sup>57</sup> See infra note 89 and accompanying text.

<sup>58</sup> See infra note 91 and accompanying text.

The proposed rule change will also help protect investors and the public interest by codifying the ability of parties to be represented by law students through SACs.<sup>59</sup> SACs provide an inexpensive option for customers who qualify and may not be able to find or afford an attorney. Codifying the ability of customers to be represented by law students through SACs may also make customers more aware of this alternative option for representation.

The proposed rule change will also protect investors and the public interest by explicitly prohibiting any person, including attorneys, from representing a party if they are prohibited from doing so by the laws of the relevant U.S. jurisdiction; if they are currently suspended or barred from the securities industry; suspended or disbarred from the practice of law; or currently suspended or denied the privilege of appearing or practicing before the Commission.

Finally, the proposed rule change will help ensure the fair, orderly and efficient administration of the DRS forum by providing that a challenge to the qualifications of a representative made outside of the arbitration or mediation proceeding shall not delay the proceeding in the absence of a court order.

B. Self-Regulatory Organization's Statement on Burden on Competition

FINRA does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act. A discussion of the economic impacts of the proposed rule change follows.

Economic Impact Assessment

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<sup>59</sup> See supra note 45 and accompanying text.

## 1. Regulatory Need

A large body of literature on the economics of expert services considers the necessity of professional standards and other restrictions on service providers when individuals have little ability to evaluate the quality of the service that they receive.<sup>60</sup> This literature suggests that in the DRS forum, parties with little prior experience seeking representation would be vulnerable, absent sufficient restrictions, to retaining lower-quality services.

Allegations relating to the conduct of compensated NARs in the DRS forum suggest that these concerns are not just hypothetical.<sup>61</sup> Compensated NARs are not subject to the client protections and disciplinary processes that apply to attorneys. Parties in the DRS forum may have little prior experience bringing claims and seeking representation.<sup>62</sup> The result may be that these parties are not sufficiently protected by competition, the reputation of providers, and the client protections and disciplinary procedures that apply to attorneys. In addition, harm may be incurred not only by the parties who retain compensated NARs but also by the other parties to the dispute.

To address this risk of harm, the proposed rule change would prohibit compensated NARs from representing parties in the DRS forum. The proposed rule

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<sup>60</sup> A general survey is in Uwe Dulleck & Rudolf Kerschbamer, On Doctors, Mechanics, and Computer Specialists: The Economics of Credence Goods, 44(1) J. ECON. LITERATURE, 5–42 (2006); see also Organization of Economic Cooperation and Development [OECD], Competitive Restrictions in Legal Professions, (April 27, 2009), <https://www.oecd.org/regreform/sectors/40080343.pdf> (discussing the regulation of legal services); Camille Chaserant & Sophie Harnay, The Regulation of Quality in the Market for Legal Services: Taking the Heterogeneity of Legal Services Seriously, 10(2) EUR. J. COMPAR. ECON. 267, 267–291 (2013) (reviewing the public and private interest approaches to the regulation in the market for legal services).

<sup>61</sup> See infra note 71 (discussing the harm that may relate to the pecuniary incentives of compensated NARs); see also supra notes 9-14 and accompanying text.

<sup>62</sup> FINRA has taken a number of steps to make arbitration and mediation accessible and affordable to parties. See supra note 36.

change, however, would not prohibit representation by uncompensated NARs or law students, as discussed further below.

## 2. Economic Baseline

The economic baseline for the proposed rule change is the current provisions of the Codes. The economic baseline also includes the laws of the relevant U.S. jurisdiction relating to the representation of parties. The proposed rule change is expected to affect compensated and uncompensated NARs, SACs and attorneys who may represent parties in the DRS forum. The proposed rule change also is expected to affect the parties to arbitrations and mediations including customers, member firms and associated persons.

Customers in the DRS forum retain compensated NARs and SACs in a relatively small number of cases.<sup>63</sup> From January 2017 to December 2021 (the “sample period”), 12,024 cases with a customer as a claimant were closed in the DRS forum.<sup>64</sup> A customer was represented by a compensated NAR in 119 of the 12,024 cases (one percent),<sup>65</sup> and

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<sup>63</sup> FINRA can reasonably estimate, through a search and textual match of representative and organizational names, the number of compensated NARs and SACs that have represented parties in the DRS forum. This methodology, however, may not identify all such cases. The estimates herein describing the number of cases in which a party was represented by compensated NARs or SACs can, therefore, be considered a lower bound of the number of cases in which compensated NARs and SACs represented parties during the sample period (defined below). In general, information is not available for FINRA to reasonably estimate the number of uncompensated NARs who have represented parties in the DRS forum.

<sup>64</sup> FINRA did not identify any cases during the sample period where a customer who was a respondent was represented by a compensated NAR or SAC. Cases in the DRS forum are typically filed in arbitration rather than mediation. Of the 12,024 cases that were closed in the DRS forum, 9,824 cases were filed and closed in arbitration (82 percent), 2,069 cases were filed in arbitration but resulted in a mediation (17 percent), and 131 cases were both filed and closed in mediation (one percent). FINRA also identified 373 instances where customers initiated a pre-arbitration mediation but no mediation took place, often because the opposing party did not agree to mediate the dispute or the matter was not eligible for mediation. In most of these instances, customers initiated the mediation without representation.

<sup>65</sup> FINRA identified 52 cases filed during the sample period where a compensated NAR represented a customer as claimant at the time of the filing, but was then not retained for the duration of the arbitration.

by a SAC in 67 of the 12,024 cases (less than one percent). Four different compensated NAR firms represented customers in the sample period, with two of the firms representing customers in 102 of the 119 cases (86 percent).<sup>66</sup> Fifteen SACs also represented customers during the sample period.<sup>67</sup> In the remaining cases, the customer was represented by an attorney in 10,620 cases (88 percent), and appeared pro se in 1,218 cases (10 percent).<sup>68</sup>

The customers who were represented by compensated NARs or SACs had a higher percentage of smaller claims than customers who were represented by attorneys. The following table describes the size of claims by representation type.

Amount of Damages Claimed by Customer Representation Type								
Claim Size	Compensated NARs		SACs		Attorneys		Pro Se	
	N	%	N	%	N	%	N	%
< \$100K	51	43%	47	70%	1,366	13%	665	55%
≥ \$100K	62	52%	19	28%	7,451	70%	282	23%
Not Specified	6	5%	1	1%	1,803	17%	271	22%
Total	119	100%	67	100%	10,620	100%	1,218	100%

The subsequent table describes case outcomes by representation type. In the table below, FINRA identified case outcomes as resulting in settlement (Settlements), closed by hearing or “on the papers” (Awards), withdrawn (Withdrawn), or closed by other

<sup>66</sup> FINRA identified one case among the 12,024 sample customer cases in which a compensated NAR represented an associated person. To simplify the analysis, the Economic Impact Assessment focuses on compensated NAR representation of customers only. FINRA also identified one compensated NAR who represented associated persons in multiple expungement claims brought against broker-dealers in 2020 and 2021.

<sup>67</sup> Currently, 10 SACs provide representation to parties in the DRS forum. See supra note 4.

<sup>68</sup> The 10,620 cases may include some instances in which customers were represented by uncompensated NARs rather than an attorney. However, in the experience of FINRA staff, few customers are represented by uncompensated NARs.

means (All Others).<sup>69</sup> For the cases closed by hearing or “on the papers,” FINRA also identified the number of cases where customers were awarded damages (Award > \$0). The relative outcomes for compensated NARs (e.g., that they settle a smaller proportion of cases) may neither support nor contradict the anecdotal evidence that compensated NARs achieve worse outcomes or awards for their clients than attorneys, but may instead reflect the characteristics of the claims.

Case Outcomes by Customer Representation Type								
	Compensated NARs		SACs		Attorneys		Pro Se	
	N	%	N	%	N	%	N	%
How Cases Closed (as the Percent of Cases)								
Settlements	58	49%	41	61%	8,226	77%	425	35%
Awards	34	29%	15	22%	1,068	10%	443	36%
Withdrawn	22	18%	10	15%	997	9%	132	11%
All Others	5	4%	1	1%	329	3%	218	18%
Customers Awarded Damages (as the Percent of Awards)								
Award > \$0	16	47%	6	40%	502	47%	91	21%

### 3. Economic Impact

#### A. Overview

In general, the proposed rule change would address the representation of parties by NARs and law students through SACs. The economic effects relating to these proposed amendments are discussed below.<sup>70</sup>

<sup>69</sup> The cases that closed by other means include claims that were deficient and therefore not served on respondents, claims where the use of the DRS forum was not permitted, and claims that were combined with separate but related claims.

<sup>70</sup> FINRA anticipates the other proposed amendments would not result in material economic impacts. For example, the proposed rule change would clarify that the laws of U.S. jurisdictions that are not states may also disqualify attorneys or non-attorneys from representing parties, and prohibit attorneys from representing a party if they are currently suspended or barred from the securities industry. FINRA is not aware of previous instances where these amendments would impact the

## B. Anticipated Benefits

Prohibiting compensated NARs from representing parties in the DRS forum ensures that no party faces the risk of harm that has been associated with compensated NARs.<sup>71</sup> The parties who may benefit include those who would have retained a compensated NAR (with the associated risks) and that achieve the same or superior arbitration outcome with different representation net of any additional financial cost. The other parties to the arbitration or mediation may benefit if there is a reduction in frivolous claims or arguments, thereby reducing the costs (e.g., the legal expense and time that would otherwise be used for other business) to resolve disputes. Parties with fewer resources to resolve disputes (e.g., small firms) may benefit more from the reduction in frivolous claims or arguments than parties with greater resources.<sup>72</sup>

Parties may also benefit from increased certainty, at the outset of the proceeding, as to whether a party's representative is permitted to represent a party in the DRS forum. For example, the laws that govern the representation of parties differ from state to state, and it may be unclear whether compensated NARs can represent parties in the DRS forum or are engaged in the unauthorized practice of law.<sup>73</sup> Parties would not incur the

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representation of parties in the DRS forum or result in its associated benefits or costs. These other proposed amendments are not discussed below.

<sup>71</sup> The risk of harm would relate to the pecuniary incentives of compensated NARs when seeking new client relationships (e.g., aggressive sales techniques such as cold calling) or bringing claims in the DRS forum. See infra notes 88, 89 and 91 and accompanying text. FINRA cannot quantify the extent to which the absence of client protections and disciplinary processes that apply to attorneys may influence the conduct of compensated NARs or the effectiveness of those disciplinary processes on the conduct of attorneys. Survey evidence from 43 states and the District of Columbia reported by the ABA suggests that in 2019 approximately 0.2 percent of all practicing attorneys were publicly disciplined for misconduct. See ABA Profile of the Legal Profession 2022, <https://www.americanbar.org/content/dam/aba/administrative/news/2022/07/profile-report-2022.pdf>.

<sup>72</sup> See M. Kaplan, infra note 89.

<sup>73</sup> See supra notes 24-26 and accompanying text.



costs associated with retaining a compensated NAR who is later determined to be engaging in the unauthorized practice of law. In these instances, compensated NARs may be enjoined from continuing their representation of parties during pending arbitrations, and parties may incur the costs to seek and retain new representation.<sup>74</sup> Arbitrators may also issue awards dismissing claims, or finding against parties, if they determine that a compensated NAR's representation of the party constitutes the unauthorized practice of law in the jurisdiction.<sup>75</sup> Parties would also have reasonable certainty that NAR representation is uncompensated and permitted under the Codes, subject to specified conditions.

Lastly, customers to an arbitration or mediation may benefit from the codification of the role of law students and SACs in the DRS forum. Parties would have reasonable certainty that the law students enrolled in law school are under the supervision of an attorney and permitted to represent parties in the DRS forum. To the extent that customers may become more aware of the availability of SACs as a result of the proposed rule change, and SACs have the capacity to represent them, customers who have determined the need for representation may incur fewer costs.

### C. Anticipated Costs

The proposed rule change also could impose costs on some parties who may be more likely to consider compensated NARs for representation under the baseline (e.g., parties with smaller claims). Some of these parties may choose compensated NARs who

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<sup>74</sup> See supra note 20.

<sup>75</sup> See supra note 21. As discussed below in Item II.B.3.D., "Anticipated Competitive Effects," parties may benefit from an increase in DRS forum efficiency (relating to the operation of forum proceedings) resulting from a decrease in the number of challenges to compensated NAR representation.

do not engage in misconduct. Under the proposed rule change, parties who have determined to seek representation, and would otherwise retain compensated NARs who do not engage in misconduct, may incur additional costs (e.g., higher fees) to retain alternative representation (e.g., attorneys) or may forgo representation and appear pro se. Given the limited data, however, it is not clear whether the cost of attorney services may increase as a result of the proposal in states where compensated NARs currently provide services, but any effect would likely be small given the small number of matters handled by compensated NARs in any year. Parties alternatively may forgo representation and appear pro se. These parties may be less experienced in the DRS forum and as a result may be inconvenienced or possibly obtain worse outcomes or awards.<sup>76</sup> We cannot, however, estimate the extent of this effect.

Compensated NARs would lose the business of representing parties in the DRS forum which may be their sole business. Although compensated NARs may replace the lost business with other opportunities or employment, they would incur search costs in the form of time, effort and expense. These other opportunities or employment may also not be as profitable as representing parties in the DRS forum. The costs to compensated NARs from the loss of business would depend on their earnings from representing parties in the DRS forum, the costs of searching for other business opportunities or employment, and the profitability of these other ventures.<sup>77</sup>

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<sup>76</sup> FINRA notes that it advises arbitrators on the treatment of pro se parties, including advising arbitrators to be sensitive to the fact that the pro se party is most likely inexperienced in either litigation or the arbitration process, and that pro se parties may need some guidance from the panel. See FINRA Dispute Resolution Services Arbitrator's Guide, <https://www.finra.org/sites/default/files/arbitrators-ref-guide.pdf>.

<sup>77</sup> The loss of business by compensated NARs attributable to the proposed rule change includes only that which does not constitute the unauthorized practice of law. The extent to which the

Uncompensated NARs, or the party they are representing, would incur the cost to prepare and submit a written statement to the Director attesting that the NAR has not received, and will not receive, compensation in connection with the representation. FINRA anticipates, however, that these costs should not be material and would not restrict uncompensated NARs from representing parties in the DRS forum.<sup>78</sup>

D. Anticipated Competitive Effects

The proposed rule change may result in other economic effects. These other economic effects relate to the choice of representation in the DRS forum and the efficiency of the DRS forum.

Attorneys would have less competition to provide legal services to parties who may have otherwise considered compensated NARs for representation, and some attorneys may experience an increase in business from representing these parties. The shift of business from the compensated NARs, who would have otherwise been retained by parties in the DRS forum, is likely not a new economic cost or benefit of the proposed rule change but is instead an economic transfer from compensated NARs to attorneys.

The proposed rule change may also impact the efficiency of the DRS forum to process and resolve disputes in a timely manner. The efficiency of the DRS forum may increase if the conduct of compensated NARs would have hindered or delayed the

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representation of parties by compensated NARs in arbitration or mediation in a particular jurisdiction is legally permissible is often not known. See supra note 24 and accompanying text.

<sup>78</sup> See supra Item II.A.1.B. and accompanying text. The proposed rule change would not permit uncompensated NARs, or the party they are representing, to refile a previously obtained statement of no compensation from another case, as these statements will necessarily be specific to the individual representation.

proceedings.<sup>79</sup> The efficiency of the DRS forum may also increase as a result of arbitrators no longer being required to resolve issues regarding the ability of NARs to represent parties in arbitration.<sup>80</sup> The efficiency of the DRS forum to process and resolve disputes may decrease, however, if parties who have determined the need for representation, and would otherwise retain compensated NARs if not for the proposed rule change, forgo representation. These parties may be less familiar with DRS forum procedures, and this unfamiliarity may result in delays.

#### 4. Alternatives Considered

FINRA considered establishing additional requirements on compensated NARs before they could represent a party in an arbitration or mediation in the DRS forum, such as requiring compensated NARs to demonstrate that the applicable state or other U.S. jurisdiction considers the representation by the compensated NAR in the DRS forum to be appropriate and legally permissible. FINRA rejected this alternative as unworkable due to the uncertainty as to whether NARs could legally represent parties in the DRS forum in different U.S. jurisdictions and feedback from state institutions indicating that they would not opine on the ability of a NAR to represent parties in securities arbitration in the DRS forum.

The proposed rule change would not prohibit uncompensated NARs from representing parties in the DRS forum. Like compensated NARs, uncompensated NARs are not subject to the client protections and disciplinary processes the states and jurisdictions have determined should apply to attorneys. Unlike compensated NARs,

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<sup>79</sup> Commenters stated that participation by compensated NARs resulted in longer or additional hearings. See Commonwealth and Harris, infra note 90.

<sup>80</sup> See supra note 21.

however, uncompensated NARs do not have the direct pecuniary incentive to engage in misconduct when seeking new client relationships or bringing claims in the DRS forum, and FINRA is not aware of any assertions of misconduct by uncompensated NARs. Further, prohibiting uncompensated NARs in addition to prohibiting compensated NARs would remove the possibility of substituting compensated with uncompensated NARs, although the extent to which individuals would do so is not known. These parties, and parties who would have otherwise retained uncompensated NARs, would instead have been required to retain an attorney or appear pro se.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

In October 2017, FINRA published the Notice requesting comment on forum users' experiences with compensated NARs and whether FINRA should further restrict their representation of parties.<sup>81</sup> FINRA received 59 comment letters in response to the Notice. A copy of the Notice is available on FINRA's website at <http://www.finra.org>. A list of the comment letters received in response to the Notice is available on FINRA's website.<sup>82</sup> Copies of the comment letters received in response to the Notice are available on FINRA's website.

Most of the commenters supported restricting compensated NARs' ability to represent parties in the DRS forum. Twenty-eight commenters supported prohibiting the

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<sup>81</sup> Although the Notice was focused on compensated NAR firms, the commenters who addressed uncompensated NARs and SACs generally supported continuing to allow them to represent parties in the DRS forum. See Aidikoff, Bakhtiari, Cornell, Cottone, FSI, Georgia, Harris, J. Kaplan, M. Kaplan, Pace, PIABA, Port, SIFMA, St. John's and Wexler. But see CSAG and Sacks (questioning the efficacy of SACs).

<sup>82</sup> See SR-FINRA-2023-013 (Form 19b-4, Exhibit 2b) for a list of abbreviations assigned to commenters (available on FINRA's website at <http://www.finra.org>).

representation of parties by compensated NARs entirely.<sup>83</sup> Four commenters supported limiting the dollar value or complexity of the cases that compensated NARs could handle,<sup>84</sup> and six other commenters supported imposing other restrictions on representation by compensated NARs.<sup>85</sup> Twenty-one commenters, 15 of whom were clients of a single NAR firm, supported continuing to allow compensated NARs to represent parties in the DRS forum.<sup>86</sup> A summary of the comments and FINRA's responses are discussed below.

(A) Comments That Supported Prohibiting Compensated NARs from Representing Parties in the DRS Forum

Criticisms of Compensated NARs

In the Notice, FINRA requested comment on experiences with NAR firms in the DRS forum and whether FINRA should amend the Codes to prohibit entirely compensated NARs from representing parties in the DRS forum. In response, a number of commenters criticized compensated NARs' conduct in the DRS forum. Some commenters stated that some compensated NARs are, or work in coordination with, persons who are: (1) suspended or barred from the securities industry; (2) the subject of customer complaints; (3) associated with broker-dealers that were expelled from FINRA membership; or (4) guilty of criminal charges.<sup>87</sup> Some commenters stated that

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<sup>83</sup> See Aidikoff, Bakhtiari, Bandes, Caruso, Commonwealth, Cottone, Dobin, Edwards, Feldman, Glick, Harris, Ilgenfritz, ISBA Business, ISBA Unauthorized, ISBA Task, J. Kaplan, Kohler, M. Kaplan, Lincoln Financial, Meyer, Nelson, PIABA, Port, Sabino, SIFMA, St. John's, Sutherland and Wexler.

<sup>84</sup> See BFS, Cornell, Sec. Arb. Commentator and Wall.

<sup>85</sup> See Benade, FSI, Georgia, Pace, Starr and Wood.

<sup>86</sup> See Abrahamsen, A. Lincoln, Bartness, Byrd, CSAG, Flack, Hambright, Inglis, Kabat, Kashouty, Kuefler, Mitchell, Mulligan, Neuman, Pate, Sacks, Scronce, Stein, Steinmetz, Stott and Wilson.

<sup>87</sup> See Bakhtiari, Caruso, Dobin, Ilgenfritz, J. Kaplan, Meyer, M. Kaplan, PIABA and Shepherd.

compensated NARs may engage in improper business practices, such as cold calling investors with aggressive sales tactics, that would be prohibited if they were attorneys.<sup>88</sup> Other commenters asserted that compensated NARs bring frivolous cases.<sup>89</sup> A number of commenters also stated that compensated NARs mishandle or achieve worse outcomes or awards for their clients than attorneys, or that they were not competent, were inexperienced, or were a danger to investors or to the quality or integrity of the DRS forum.<sup>90</sup> Several commenters expressed concerns that compensated NARs charge clients non-refundable processing or investigation fees.<sup>91</sup>

Several commenters also described how clients, and others who deal with NARs, do not receive the benefit of the numerous protections that are available to persons who interact with attorneys, including disciplinary oversight, malpractice insurance, client trust accounts, rules of professional conduct, legal skills, legal education, or legal training.<sup>92</sup> PIABA stated that, unlike attorneys, information about NARs' disciplinary history was not readily available. Some commenters described specific ethical duties that lawyers have that do not apply to NARs, including the duties of loyalty and honesty, to safeguard client funds and confidentiality.<sup>93</sup> Some commenters stated that clients'

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<sup>88</sup> See Caruso, Meyer, M. Kaplan, PIABA and Wexler; see also Kohler.

<sup>89</sup> See Bades, Commonwealth, Edwards, Lincoln Financial, M. Kaplan and SIFMA; see also Kohler.

<sup>90</sup> See Aidikoff, Caruso, Commonwealth, Cottone, Edwards, Feldman, Glick, Harris, J. Kaplan, Kohler, Nelson, PIABA, Port, Sutherland and Wexler.

<sup>91</sup> See, e.g., PIABA and Wexler. Other commenters stated that attorneys also charge upfront fees, in the form of a retainer. See, e.g., Neuman.

<sup>92</sup> See Aidikoff, Bakhtiari, Caruso, Commonwealth, Dobin, Edwards, Feldman, Ilgenfritz, J. Kaplan, Lincoln Financial, M. Kaplan, Meyer, PIABA, Port, Sabino, SIFMA, St John's, Sutherland and Wexler; see also FSI. Other commenters stated that not all attorneys have malpractice insurance. See, e.g., Neuman.

<sup>93</sup> See Dobin, Feldman, Ilgenfritz, J. Kaplan, Nelson and PIABA; see also Caruso.

communications with NARs were not protected by the attorney-client privilege, a legal principle that prevents the disclosure of confidential communications with attorneys.<sup>94</sup>

FINRA's review of compensated NARs validated some of the commenters' serious concerns and, as previously noted, identified allegations about NAR misconduct.<sup>95</sup> Accordingly, FINRA believes it is appropriate to disallow compensated NARs from representing parties in arbitrations and mediations in the DRS forum.

#### Compensated NARs Engage in the Unauthorized Practice of Law

Many of the commenters who supported prohibiting compensated NARs argued that their representation of parties in the DRS forum constituted the unauthorized practice of law.<sup>96</sup> These and other commenters stated that DRS arbitrations were complex or legal in nature, or had evolved to become more so over time, and that representing parties in DRS arbitration necessarily required legal skills, knowledge and training.<sup>97</sup> For example, PIABA stated that "NARs interview clients, draft pleadings, develop litigation strategy, engage in discovery, negotiate settlements, engage experts, and conduct examination of witnesses at the arbitration hearing, all of which involves legal skill and knowledge."

One commenter, Nelson, stated that the current prohibition on NARs representing parties when state law prohibits such representation was insufficient because the

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<sup>94</sup> See Dobin, Edwards and PIABA.

<sup>95</sup> See supra Item II.A.1. (discussing Background).

<sup>96</sup> See Caruso, Dobin, Feldman, Glick, Harris, Ilgenfritz, ISBA Business, ISBA Task, ISBA Unauthorized, Kohler, Nelson, PIABA, Port, Sabino, Sutherland and Wexler. Compare Steinmetz (stating that if any restrictions were imposed, they should be "ones which prevent the unauthorized practice of law and to prevent fraud.")

<sup>97</sup> See Aidikoff, Feldman, Glick, Ilgenfritz, ISBA Business, ISBA Task, ISBA Unauthorized, Kaplan, Kohler, Meyer, PIABA, Port, Sabino, SIFMA and Wexler.



requirements of state law may be unclear.<sup>98</sup> PIABA stated that some claimants have had their claims dismissed because their NARs were found to have engaged in the unauthorized practice of law, and suggested that NARs may be operating in states even where they are prohibited from doing so. Commonwealth and Wexler suggested that NAR firms were assisting customers with small claims decided “on the papers” without disclosing their representation of the party to the DRS forum.<sup>99</sup> Harris and Nelson expressed concern that as arbitrators, they could be placed in the position of aiding the unauthorized practice of law when NARs represent parties in the DRS forum.

FINRA shares commenters’ concerns about compensated NARs engaging in the unauthorized practice of law. When represented by compensated NARs, forum participants do not receive the benefit of the type of specific professional qualification requirements, ethical rules, disciplinary processes and other protections that the relevant jurisdiction has determined should apply to attorney representation. In addition, as previously noted, customers have had their claims dismissed or delayed when compensated NARs engaged in the unauthorized practice of law.<sup>100</sup>

(B) Comments Addressing Potential Benefits of NARs

Compensated NARs Fill a Void for Customers Who Cannot Find Representation

In the Notice, FINRA requested comment on the factors that limit customers’ access to attorney representation in arbitration. Several commenters stated that

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<sup>98</sup> See also PIABA (stating that most states have been silent on the issue of whether the appearance of NARs in an arbitration forum constitutes the unauthorized practice of law).

<sup>99</sup> Wexler stated that NAR firms had done so in order to avoid appearing in a state that would consider the appearance to be the unauthorized practice of law.

<sup>100</sup> See supra notes 20 and 21 and accompanying text.

compensated NARs fill a void for customers who cannot find or afford counsel.<sup>101</sup> Some commenters stated that attorneys are sometimes unwilling to take smaller cases because the prospects of recovery are low, or because potential claimants may not be able to afford the retainer fee.<sup>102</sup> Other commenters stated that compensated NARs were willing to represent them at a lower cost than attorneys.<sup>103</sup> CSAG and Neuman stated that customers who retain compensated NARs are often from small towns where there is limited access to counsel who are knowledgeable about securities arbitration.

One commenter, Georgia, stated that until SACs can receive sustained funding, “entirely eliminating” compensated NARs may cause more valid claims to go unfiled. Georgia recommended that FINRA work with SACs to identify funding sources to sustain and grow SACs. Pace stated that when SAC representation is “not available due to lack of funding, jurisdictional issues, client preference, or other reasons, investors who cannot afford a private attorney may turn to NAR firms to assist them with their claims rather than bringing them pro se or not at all.”

Twenty-two commenters, 15 of whom were clients of a single NAR firm, stated that compensated NARs provided effective representation in the DRS forum or described how they had done so in specific arbitrations.<sup>104</sup> Some commenters who had retained the services of a compensated NAR suggested that they would not have obtained the same

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<sup>101</sup> See CSAG, FSI, Georgia, Hambright, Neuman, Pace, Scronce, Steinmetz and Wall.

<sup>102</sup> See Hambright, Neuman, Scronce, Steinmetz and Wall.

<sup>103</sup> See, e.g., Abrahamsen, A. Lincoln, Inglis, Kabat and Scronce.

<sup>104</sup> See Abrahamsen, A. Lincoln, Bartness, Benade, Byrd, CSAG, Flack, Hambright, Inglis, Kabat, Kashouty, Kuefler, Mitchell, Mulligan, Neuman, Pate, Sacks, Scronce, Stein, Steinmetz, Stott and Wilson.

recovery if not for the compensated NAR's involvement.<sup>105</sup> Kashouty stated that claimants and respondents should be allowed to make their own decision as to who will represent them, based on pecuniary or other considerations. Steinmetz and Neuman stated that it should be a customer's decision whether to retain a compensated NAR.

As noted above, FINRA has taken a number of steps to make arbitration and mediation accessible and affordable to parties, particularly those with small claims, and continues to look for ways to improve the DRS forum in this regard.<sup>106</sup> As also previously noted, despite the low numbers of compensated NARs, FINRA's review identified multiple allegations of improper conduct by compensated NARs, who are not subject to the specific and extensive professional qualification requirements, ethical rules, disciplinary processes and client protections that apply to attorneys.<sup>107</sup> On balance, FINRA believes it is appropriate to disallow compensated NARs from representing parties in arbitrations and mediations in the DRS forum.

#### Compensated NARs Educate Uninformed Customers

In the Notice, FINRA requested comment on the factors that limit customers' access to attorney representation in arbitration. In response, several commenters stated that compensated NARs educate customers about their ability to arbitrate a claim in the

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<sup>105</sup> See Flack, Hambright, Inglis and Mulligan.

<sup>106</sup> See supra note 36. In recognition of the important role of SACs, FINRA supports SACs in a number of ways, including by leveraging its staff and arbitrator and mediator rosters to participate in law school events, such as judging in competitions, speaking in seminars, and conducting mock arbitrations and mediations.

<sup>107</sup> See supra Item II.A.1. (discussing Background). Notably, a FINRA arbitrator and securities dispute resolution expert has stated that FINRA has "explored amending their rules to ban" compensated NARs "from representing parties as a means to prevent exploitation of investors, not as a means to decrease access to justice." See Jill Gross, Arbitration Archetypes for Enhancing Access to Justice, 88 FORDHAM L. REV., 2319, 2333, n.78 (2020).

DRS forum.<sup>108</sup> Several investors who commented stated that they were unaware of having a valid claim until a NAR firm offered services through a cold call or unsolicited letter and reviewed their account statements.<sup>109</sup> Steinmetz and CSAG stated that some customers with small claims against brokerage firms and associated persons might only be made aware of the availability of the DRS forum through the compensated NARs' marketing efforts.

FINRA notes that it educates customers regarding dispute resolution and representation in the DRS forum through initiatives led by FINRA's Office of Investor Education ("OIE") and the FINRA Investor Education Foundation ("Foundation").<sup>110</sup> For example, both OIE and the Foundation participate at in-person investor education events. Separately, the Foundation has published a guide for customers on how to prevent and resolve securities industry disputes,<sup>111</sup> and OIE has provided guidance on what customers should consider when trying to decide whether to hire an attorney in arbitration or mediation.<sup>112</sup> In addition, staff from FINRA's Securities Helpline for

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<sup>108</sup> See A. Lincoln, Byrd, CSAG, Flack, Pate and Steinmetz.

<sup>109</sup> See A. Lincoln, Byrd, Flack, Hambright, Pate and Wilson; see also Stott.

<sup>110</sup> OIE engages investors through in-person outreach and the development and dissemination of articles, alerts and tools. The Foundation, a subsidiary of FINRA with a separate governance structure, aims to build financial capability through education and research. More information can be found at <https://www.finrafoundation.org>.

<sup>111</sup> See Investor's Guide to Securities Industry Disputes: How to Prevent and Resolve Disputes with Your Broker (2009, rev. 2013; rev. 2017), [https://www.finra.org/sites/default/files/Investors\\_Guide\\_to\\_Securities\\_Industry\\_Disputes.pdf](https://www.finra.org/sites/default/files/Investors_Guide_to_Securities_Industry_Disputes.pdf). The Guide was authored by a SAC, Pace Investor Rights Clinic, through a grant from the Foundation.

<sup>112</sup> See Securities Arbitration—Should You Hire an Attorney? (Jan. 3, 2019), <https://www.finra.org/investors/highlights/securities-arbitration-should-you-hire-attorney>. The article was co-authored by FINRA staff and The PIABA Foundation and provides guidance on how to find an attorney, including questions to ask when screening attorneys. The article also provides cautionary language about compensated NARs and notes the important role of SACs in representing customers with small claims.

Seniors<sup>®113</sup> have been trained to guide senior customers, and individuals caring for seniors, about the availability of mediation and the ability to file an arbitration claim in the DRS forum.

FINRA is concerned that compensated NARs' interactions with customers are not subject to regulation like the state disciplinary rules on lawyer advertising and solicitation,<sup>114</sup> and that this also is not an area that FINRA regulates. FINRA is concerned with allegations that some compensated NARs have misrepresented or willfully failed to disclose important facts to their clients. For example, FINRA is aware of compensated NARs who have omitted their disciplinary history in order to represent clients or assured customers that they would recover their investments despite almost never doing so.<sup>115</sup> Compensated NARs' largely unregulated access to potential claimants is another reason that FINRA believes that it would be appropriate to disallow compensated NARs from representing parties in arbitrations and mediations in the DRS forum.

(C) Comments Supporting Restrictions or Conditions on Representation by Compensated NARs

In the Notice, FINRA requested comment on alternatives to the rule proposal that FINRA should consider to reduce the incidence of harmful activities by compensated NARs while ensuring customers are able to retain representation. In response, several

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<sup>113</sup> FINRA's Securities Helpline for Seniors<sup>®</sup> provides a toll-free number that senior investors can call to get assistance from FINRA or raise concerns about issues with brokerage accounts and investments. More information can be found at <http://www.finra.org/investors/highlights/finra-securities-helpline-seniors>.

<sup>114</sup> See supra note 17.

<sup>115</sup> See, e.g., PIABA; Chambliss, supra note 9 and accompanying text.

commenters suggested restrictions or conditions on the ability of compensated NARs to represent parties in the DRS forum. Four commenters recommended that FINRA allow compensated NARs to continue to represent parties in the DRS forum in smaller or less complicated cases.<sup>116</sup> Nine commenters recommended that FINRA exercise some additional form of oversight over compensated NARs.<sup>117</sup> These commenters suggested that FINRA could: (1) train or certify compensated NARs to meet standards, skills or experience criteria; (2) require compensated NARs to make disclosures to their clients that are approved by FINRA; (3) require compensated NARs to adhere to a fiduciary standard; (4) require compensated NARs to carry insurance; or (5) limit the fees compensated NARs charge clients. FSI recommended that if FINRA chose this approach, it should provide a list of qualified compensated NARs on its website or to claimants. SIFMA, however, stated that FINRA has no current means to measure or ensure the competency of compensated NARs and it should not put itself in the business of doing so.<sup>118</sup> Pace stated that NAR firms should provide documentation that they are not in violation of state law.

FINRA believes that it would be impractical to create its own system of training, certifying or otherwise overseeing compensated NARs.<sup>119</sup> FINRA further notes that it does not have direct authority to investigate or discipline compensated NAR conduct.<sup>120</sup>

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<sup>116</sup> See BFS, Cornell, Sec. Arb. Commentator and Wall.

<sup>117</sup> See Benade, CSAG, FSI, Georgia, Pace, Sacks, Starr, Wall and Wood.

<sup>118</sup> M. Kaplan stated that FINRA has no jurisdiction over NAR firm conduct.

<sup>119</sup> See supra Item II.B (discussing Alternatives Considered).

<sup>120</sup> See supra note 19.

(D) Commenters Suggesting that FINRA Should Broaden its Review

In the Notice, FINRA requested comment on the other types of representation or assistance investors retain in arbitration. In response, several commenters recommended that FINRA conduct additional study on compensated NARs. Cornell commented that FINRA should differentiate the impact of compensated NARs on arbitration versus mediation and provide comparable data on the conduct of attorneys, compensated NARs and SACs in the DRS forum. Sacks similarly suggested that FINRA provide comparable data on the performance of attorneys and compensated NARs in representing their clients in the DRS forum. CSAG stated that FINRA should send questionnaires to customers that have used the services of compensated NARs to seek their input and the results of any settlements. Pace recommended that FINRA's Foundation fund further research into whether customers fare better when represented by a compensated NAR than when representing themselves.

As previously noted, FINRA has identified several allegations of misconduct by compensated NARs and harm to parties from compensated NARs' unauthorized practice of law. FINRA does not believe that it would be practical to draw conclusions from the relative performance of compensated NARs and attorneys at this time. Potential differences in the characteristics of customer claims and the confidentiality of settlements makes direct comparisons difficult, as does the low number of compensated NARs currently practicing in the DRS forum.

(E) Other Comments

In response to the Notice, some commenters recommended that instead of focusing on compensated NARs, FINRA should focus on preventing or remediating

abuses by brokerage firms and associated persons.<sup>121</sup> Five commenters recommended that FINRA focus on the issue of unpaid customer arbitration awards by requiring brokers to carry insurance or by creating a restitution fund.<sup>122</sup> Neuman and Stein criticized the DRS forum for becoming too expensive and complicated for customers.

Although these comments are beyond the scope of the proposed rulemaking, FINRA notes that it has amended its Membership Application Program rules to help further address the issue of unpaid arbitration awards.<sup>123</sup> FINRA has also expanded 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.<sup>124</sup> In addition, FINRA has adopted rules to address brokers with a significant history of misconduct and the broker-dealers that employ them.<sup>125</sup> FINRA has also adopted new rules to address

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<sup>121</sup> See CSAG, Stein and Stout.

<sup>122</sup> See Byrd, Kabat, Neuman, Pate and Wilson.

<sup>123</sup> The amendments help prevent a member firm with substantial arbitration claims from avoiding payment of potential awards or settlements by shifting its assets to another firm and closing down. See Securities Exchange Act Release No. 88482 (March 26, 2020), 85 FR 18299 (April 1, 2020) (Order Approving File No. SR-FINRA-2019-030); Regulatory Notice 20-15 (May 2020) (announcing the effective date of September 14, 2020 for the amendments discussed in File No. SR-FINRA-2019-030).

<sup>124</sup> In addition, the amendments allow customers to amend pleadings, postpone hearings, request default proceedings and receive a refund of filing fees in these situations. See Securities Exchange Act Release No. 88254 (February 20, 2020), 85 FR 11157 (February 26, 2020) (Order Approving File No. SR-FINRA-2019-027); Regulatory Notice 20-11 (April 2020) (announcing the effective date of June 29, 2020 for the amendments discussed in File No. SR-FINRA-2019-027).

<sup>125</sup> See Securities Exchange Act Release No. 90635 (December 10, 2020), 85 FR 81540 (December 16, 2020) (Order Approving File No. SR-FINRA-2020-011, as Modified by Amendment No. 1); Regulatory Notice 21-09 (March 2021) (announcing the effective dates of April 15, 2021, May 1, 2021, June 1, 2021 and September 1, 2021 for the respective amendments approved in File No. SR-FINRA-2020-011); see also Securities Exchange Act Release No. 92710 (August 19, 2021), 86 FR 47527 (August 25, 2021) (Order Approving File No. SR-FINRA-2021-011); Securities Exchange Act Release No. 92793 (August 27, 2021), 86 FR 49394 (September 2, 2021) (Notice of Filing and Immediate Effectiveness of File No. SR-FINRA-2021-020).



firms with a significant history of misconduct.<sup>126</sup> In addition, to provide further transparency regarding unpaid awards:

- FINRA issued a Discussion Paper that identifies possible measures that could be taken to either enhance the resources to pay such awards or provide greater incentives to pay such awards.<sup>127</sup>
- FINRA makes data on unpaid customer arbitration awards for the past five years available on its website.<sup>128</sup>
- FINRA also makes available in one place on its website a list of firms and individuals responsible for unpaid customer arbitration awards.<sup>129</sup>

Thus, FINRA continues to focus on this important issue.

### III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

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<sup>126</sup> See Securities Exchange Act Release No. 92525 (July 30, 2021), 86 FR 42925 (August 5, 2021) (Order Approving File No. SR-FINRA-2020-041, as Modified by Amendment Nos. 1 and 2); see also Securities Exchange Act Release No. 92525 (July 30, 2021), 86 FR 49589 (September 3, 2021) (Order Approving File No. SR-FINRA-2020-041, as Modified by Amendment Nos. 1 and 2) (Correction); Regulatory Notice 21-34 (September 2021) (announcing the effective date of January 1, 2022 for the amendments approved in File No. SR-FINRA-2020-041); Securities Exchange Act Release No. 95048 (June 6, 2022), 87 FR 35582 (June 10, 2022) (Notice of Filing and Immediate Effectiveness of File No. SR-FINRA-2022-014); Securities Exchange Act Release No. 96798 (February 3, 2023), 88 FR 8494 (February 9, 2023) (Order Approving File No. SR-FINRA-2022-015); Regulatory Notice 23-07 (May 2023) (announcing the effective date of June 1, 2023 for the amendments approved in SR-FINRA-2022-015).

<sup>127</sup> See Discussion Paper, FINRA Perspectives on Customer Recovery, [https://www.finra.org/sites/default/files/finra\\_perspectives\\_on\\_customer\\_recovery.pdf](https://www.finra.org/sites/default/files/finra_perspectives_on_customer_recovery.pdf).

<sup>128</sup> See Statistics on Unpaid Customer Awards in FINRA Arbitration, <https://www.finra.org/arbitration-and-mediation/statistics-unpaid-customer-awards-finra-arbitration>.

<sup>129</sup> See Member Firms and Associated Persons with Unpaid Customer Arbitration Awards, <https://www.finra.org/arbitration-and-mediation/members-firms-and-associated-persons-unpaid-customer-arbitration-awards>. The list includes the names of firms and individuals whose FINRA registration has been terminated, suspended, canceled or revoked, or who have been expelled from FINRA. These firms and individuals are no longer FINRA members or associated with a FINRA member, but they may be operating in another area of the financial services industry where FINRA registration is not required. The list also shows those firms and individuals with unpaid arbitration awards, but where bankruptcy is a defense to non-payment. These firms and individuals may still be active in the brokerage industry due to the bankruptcy defense to non-payment.

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) by order approve or disapprove such proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

#### IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

##### Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an email to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-FINRA-2023-013 on the subject line.

##### Paper Comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street NE Washington, DC 20549-1090.

All submissions should refer to File Number SR-FINRA-2023-013. This file number should be included on the subject line if email is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website

(<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street NE Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 p.m. Copies of such filing also will be available for inspection and copying at the principal office of FINRA. Do not include personal identifiable information in submissions; you should submit only information that you wish to make available publicly. We may redact in part or withhold entirely from publication submitted material that is obscene or subject to copyright protection. All submissions should refer to File Number SR-FINRA-2023-013 and should be submitted on or before [INSERT DATE 21 DAYS FROM PUBLICATION IN THE FEDERAL REGISTER].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>130</sup>

**J. Lynn Taylor,**

*Assistant Secretary.*

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<sup>130</sup> 17 CFR 200.30-3(a)(12).