

**FINANCIAL SERVICES
ALERT**

November 15, 2017

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FINRA Proposes Expanded Customer Options in Disputes Against Inactive Members and Persons

On October 18, 2017, FINRA released Notice to Members (“NTM”) 17-33 regarding proposed amendments to the Code of Arbitration Procedure for customer disputes that involve inactive members or persons. FINRA is addressing the issue based on the large number of arbitration awards which go unpaid when a respondent member or associated person is no longer registered with FINRA. FINRA enforcement has jurisdiction over a member or associated person for only two years after their registration is terminated, and accordingly, has limited authority to enforce an award. FINRA also became concerned that members and associated persons may terminate their registration in anticipation of an imminent award to possibly avoid payment.

To confront this issue of unpaid awards and jurisdictional limitations, FINRA has proposed augmenting the rules already in existence to broaden the avenues for customers to obtain a justiciable result. Currently, customers have the option to file their claims against inactive member firms in arbitration or in court, effectively trumping any pre-dispute arbitration agreements entered into by the customer and the member firm. FINRA has now proposed that this option be expanded to inactive associated persons. It further proposes allowing customers to withdraw their disputes against member firms and/or associated persons who become inactive during the arbitration, refunding their entire filing fee, and permitting them to re-file their claims in court. FINRA alleges this option gives customers more flexibility in choosing a path to collect on a potential award against former members and associated persons.

FINRA is also considering allowing a customer to amend their pleading within 60 days after receiving notice from FINRA that a respondent firm or associated person has become inactive, without seeking leave from the panel. That way, a customer may add a new party and theoretically increase his or her chances of obtaining relief. FINRA is also considering allowing a customer to postpone the evidentiary hearing, without incurring a postponement fee, if the customer receives notice within 60 days of the hearing that the member firm or associated person has become inactive.

Finally, FINRA has proposed to define an “inactive associated person” as “a person associated with a member whose registration is revoked or suspended, or whose registration has been terminated for a minimum of 365 days.” Notably,

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FINRA has not specified how this definition will apply to the proposed rules regarding an associated person who terminates their registration during a pending arbitration. However, the proposed definition does provide insight on FINRA's jurisdiction over customer complaints involving inactive associated persons. The Notice explains that its definition of "inactive associated person" will specifically not apply to default proceedings, the procedure by which a customer may obtain a default judgement against an associated person or member who does not submit a timely answer to a statement of claim. FINRA explicitly states that a customer may initiate default proceedings against an inactive associated person regardless of the amount of time they have been inactive.

This proposal is significant because now, FINRA is clarifying its jurisdiction over formerly associated persons involved in customer disputes. The existing Rules give FINRA jurisdiction over formerly associated persons in disciplinary and enforcement proceedings for two years. They also establish that former member firms are subject to customer disputes if the customer agrees to arbitration after the dispute arises. However, whether formerly associated persons were required to answer customer complaints was debatable. Now, FINRA acknowledges that default awards may be granted against any formerly associated persons who do not timely answer customer complaints. Theoretically, the proposed rule would support a customer seeking confirmation of the award in court, which could become an enforceable judgement.

The other proposed rules may also impact active firms, if adopted. Simplifying the process to amend a pleading when a respondent becomes inactive could lead to the naming of active firms and/or associated persons less connected to the facts and claims, but who, nonetheless, have deep pockets. Although the customer's case is likely weaker against such "secondary" respondents, the litigation will still burden the new respondent(s) forced to defend against arguably meritless claims.

Written by [Kelsey Hotchkiss](#), Associate.

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