

## Inactive Members and Associated Persons in FINRA Arbitration

### FINRA Amends Arbitration Code to Expand Options Available to Customers if a Firm or Associated Person Is or Becomes Inactive

Effective Date: June 29, 2020

#### Summary

FINRA amended its Code of Arbitration Procedure for Customer Disputes (Customer Code) to expand a customer's options to withdraw an arbitration claim if a member firm or an associated person becomes inactive.<sup>1</sup> These amendments also allow customers to amend pleadings, postpone hearings, request default proceedings and receive a refund of filing fees in these situations.

The [amendments](#) are effective for cases filed on or after June 29, 2020.

Questions concerning this *Notice* should be directed to:

- ▶ Victoria Crane, Vice President and Associate General Counsel, Office of General Counsel (OGC), at (202) 728-8104 or [victoria.crane@finra.org](mailto:victoria.crane@finra.org); or
- ▶ Mignon McLemore, Assistant General Counsel, OGC, at (202) 728-8151 or [mignon.mclemore@finra.org](mailto:mignon.mclemore@finra.org).

#### Background & Discussion

Most customer arbitration awards that go unpaid are rendered against firms or individuals whose FINRA registration has been terminated, suspended, cancelled or revoked, or who have been expelled from FINRA. These firms and individuals, generally referred to as "inactive," are no longer FINRA members or associated with a FINRA member firm, although they may continue to operate in another area of the financial services industry where FINRA registration is not required. Firms and individuals can become inactive prior to an arbitration claim being filed, during an arbitration proceeding, or subsequent to an arbitration award, and this status can be caused by FINRA's action, such as when a firm or individual is suspended for failing to pay an award, or by the firm's or individual's own voluntary action.

April 9, 2020

#### Notice Type

- ▶ Rule Amendment

#### Suggested Routing

- ▶ Compliance
- ▶ Legal
- ▶ Registered Representatives

#### Key Topics

- ▶ Arbitration
- ▶ By-Laws
- ▶ Codes of Arbitration Procedure
- ▶ Definition of Inactive Member
- ▶ Definition of Inactive Associated Person
- ▶ Dispute Resolution

#### Referenced Rules & Notices

- ▶ FINRA Rule 12100
- ▶ FINRA Rule 12202
- ▶ FINRA Rule 12214
- ▶ FINRA Rule 12309
- ▶ FINRA Rule 12400
- ▶ FINRA Rule 12601
- ▶ FINRA Rule 12702
- ▶ FINRA Rule 12801
- ▶ FINRA Rule 12900
- ▶ FINRA Rule 13100

FINRA has expanded the options available to a customer claimant when dealing with those members or associated persons that are inactive either at the time the claim is filed or at the time of the award. For example, when a customer claimant first files an arbitration claim, FINRA alerts the customer claimant if the respondent is inactive. FINRA also informs the claimant that awards against such members or associated persons have a much higher incidence of non-payment and that FINRA has limited leverage over inactive members or associated persons that fail to pay arbitration awards. Thus, the customer knows before pursuing the claim in arbitration that collection of an award may be more difficult. Upon learning that the member or associated person is inactive, a customer may amend his or her claim to add other respondents from whom the customer may be able to collect should the claim go to award.

### Expansion of Customer Options in Arbitration

Under FINRA Rule 12202 (Claims Against Inactive Members), a customer's claim against an inactive firm is ineligible for arbitration unless the customer agrees in writing to arbitrate after the claim arises (*i.e.*, when the customer claimant first files the arbitration claim). In these situations, the customer is able to evaluate the likelihood of collecting on an award and make an informed decision whether to proceed in arbitration, to file the claim in court or to take no action, regardless of whether the customer signed a predispute arbitration agreement.<sup>2</sup> Accordingly, claims against inactive firms proceed in arbitration only at the customer's option. The Customer Code does not address situations, however, where a member firm becomes inactive *during* a pending arbitration. In addition, the Customer Code does not provide specific procedures for a customer to withdraw, and file in court, a claim against an associated person who becomes inactive before the customer files a claim or during a pending arbitration.

Accordingly, FINRA has amended the Customer Code to expand further the options available to customers in situations where a firm becomes inactive during a pending arbitration,<sup>3</sup> or where an associated person becomes inactive either before a claim is filed or during a pending arbitration.<sup>4</sup> Thus, under the amendments, if a member firm or an associated person is inactive at the time a claim is filed, the claim is ineligible for arbitration unless the customer claimant agrees in writing to arbitrate after the claim arises. If a member firm or an associated person becomes inactive during a pending arbitration, FINRA will notify the customer claimant of the status change. Within 60 days of receiving notice of a member firm's or an associated person's status change to inactive, a customer claimant may withdraw the claim or claims,<sup>5</sup> amend the pleading to add a claim or new party without prior approval by a panel, or postpone a scheduled hearing that is within 60 days of the date the customer claimant receives the notice from FINRA.<sup>6</sup> The amendments retain the customer's option to request a default proceeding against an inactive member or associated person.<sup>7</sup>

Similar to the current rules and procedures relating to claims filed against inactive member firms, the amendments will allow the customer to evaluate the likelihood of collecting on an award, adjust his or her litigation strategy, and make an informed decision whether to proceed in arbitration, to file the claim in court or to take no action, regardless of whether the customer signed a predispute arbitration agreement.

### Effective Date

The amendments are effective for cases filed on or after June 29, 2020.

## Endnotes

1. See Securities Exchange Act Release No. 88254 (February 20, 2020), 85 FR 11157 (February 26, 2020) (Order Approving File No. SR-FINRA-2019-027).
2. If the customer notifies FINRA in writing that he or she does not want to proceed against the inactive member in FINRA's forum, FINRA deems the customer's agreement to submit to arbitration rescinded and sends the customer a full refund of any filing fee remitted.
3. An "inactive member" is defined as a member whose membership is terminated, suspended, cancelled or revoked; that has been expelled or barred from FINRA; or that is otherwise defunct.
4. An "inactive associated person" is defined as a person associated with a member whose registration is revoked, cancelled, or suspended, who has been expelled or barred from FINRA; or whose registration has been terminated for a minimum of 365 days.
5. If the customer withdraws the claim or claims against all parties within 60 days of the notification, FINRA will refund a customer's full filing fee even if the customer withdraws the claim or claims within 10 days of the date that the hearing is scheduled to begin.
6. If the customer postpones the scheduled hearing, FINRA will not charge the customer a postponement fee or an additional fee of \$600 per arbitrator. See FINRA Rules 12601(b)(1) and (b)(2). In addition, the amendment makes clear that FINRA will continue to pay the \$600 honoraria to the arbitrators to compensate them for their time if a customer chooses to postpone a scheduled hearing within 10 days before it is scheduled. See FINRA Rule 12214.
7. See FINRA Rule 12801(a). In the case of an inactive associated person whose registration has been terminated, a customer may request default proceedings against the inactive associated person, regardless of the number of days since termination.