

Regulatory Notice

10-31

Expedited Proceedings

Change to Expedited Proceedings for Failure to Comply with an Arbitration Award or Related Settlement

Effective Date: July 2, 2010

Executive Summary

Firms and associated persons will be unable to rely on an inability-to-pay defense in expedited actions¹ for failure to comply with arbitration awards involving customers if the FINRA Rule 9554 notice initiating the action is sent on or after July 2, 2010.²

The text of amended FINRA Rule 9554 is set forth in Attachment A.

Questions regarding this *Notice* should be directed to James S. Wrona, Associate Vice President and Associate General Counsel, Office of General Counsel, at (202) 728-8270.

Background & Discussion

FINRA Rule 9554 allows FINRA to bring expedited actions to address failures to comply with FINRA arbitration awards and related settlements. Once a monetary award has been issued in a FINRA arbitration proceeding, the party has 30 days to pay the award.³ FINRA coordinates with its dispute resolution and enforcement programs by verifying whether a firm or associated person (the respondent) has paid a monetary award on time. If the respondent has not paid, FINRA ordinarily initiates an expedited proceeding by sending a notice explaining that the respondent will be suspended unless the respondent pays the award or requests a hearing.

June 2010

Notice Type

- Guidance

Suggested Routing

- Compliance
- Legal
- Senior Management

Key Topics

- Arbitration Awards
- Expedited Proceedings
- Inability to Pay

Referenced Rules & Notices

- FINRA Rule 9554
- FINRA Rule 10330(h)

A respondent that requests a hearing may raise a number of defenses to the suspension. One of those defenses previously had been establishing a bona fide inability to pay.⁴ When a respondent successfully demonstrated an inability to pay, that was a complete defense to the suspension.

FINRA's expedited proceedings under Rule 9554 use the leverage of a potential suspension to help ensure that a firm or an associated person promptly pays a valid arbitration award. However, if a respondent demonstrated a financial inability to pay the award—regardless of the reason—the leverage was removed. When FINRA's efforts to suspend a respondent who had not paid an award were defeated, a claimant was much less likely to be paid.

Consequently, FINRA proposed, and the SEC recently approved, an amendment to FINRA Rule 9554 that explicitly eliminates the inability-to-pay defense in the expedited-proceedings context when a respondent fails to comply with an arbitration award or related settlement involving a customer. The amendment becomes effective on July 2, 2010. A bona fide inability to pay will not be a valid defense in an expedited action for failure to pay an arbitration award or related settlement involving a customer if the notice issued pursuant to FINRA Rule 9554 is sent on or after July 2, 2010.

However, a respondent still will have the following four defenses available:

- The firm or person paid the award in full or fully complied with the settlement agreement;
- The arbitration claimant has agreed to installment payments or has otherwise settled the matter;
- The firm or person has filed a timely motion to vacate or modify the arbitration award and such motion has not been denied; and
- The firm or person has filed a petition in bankruptcy and the bankruptcy proceeding is pending, or the bankruptcy court has discharged the award or payment owed under the settlement agreement.⁵

Endnotes

- 1 Expedited actions allow FINRA to address certain types of misconduct more quickly than would be possible using the ordinary disciplinary process. In general, these actions focus on encouraging respondents to comply with the law or take corrective action rather than on sanctioning them for past misconduct.
- 2 See Exchange Act Release No. 62211 (June 2, 2010), 75 FR 32525 (June 8, 2010) (SR-FINRA-2010-014) (Order Approving Proposed Rule Change Relating to FINRA Rule 9554 to Eliminate Explicitly the Inability-to-Pay Defense in the Expedited Proceedings Context). The approved amendment does not affect the defenses available in actions that do not involve customers.
- 3 FINRA Rule 10330(h).
- 4 The inability-to-pay defense emerged from a series of Securities and Exchange Commission decisions that require FINRA to consider the defense in *disciplinary* cases (as opposed to expedited actions), including disciplinary cases involving failures to pay arbitration awards and restitution. See Exchange Act Release No. 62211 (June 2, 2010), 75 FR 32525, 32526 (June 8, 2010) (citing *Toney L. Reed*, 52 S.E.C. 944 (1996), *recons. denied*, Exchange Act Release No. 39354 (Nov. 25, 1997); *Bruce M. Zipper*, 51 S.E.C. 928 (1993)).
- 5 Bankruptcy judges are experts in evaluating whether a debtor's obligations should be legally discharged. The bankruptcy process and associated filings are designed to consider fully and evaluate the financial condition of bankruptcy debtors. See 4 COLLIER ON BANKRUPTCY, 521.01, 521.09 (15th ed. 2009). In addition, bankruptcy filings, which are subject to federal perjury charges, provide greater penalties for hiding assets. See 18 U.S.C. §§ 151-58 (2010) (stating that bankruptcy fraud is punishable by a fine, or by up to five years in prison, or both).

ATTACHMENT A

(New language is underlined.)

* * * * *

9554. Failure to Comply with an Arbitration Award or Related Settlement or an Order of Restitution or Settlement Providing for Restitution**(a) Notice of Suspension or Cancellation**

If a member, person associated with a member or person subject to FINRA's jurisdiction fails to comply with an arbitration award or a settlement agreement related to an arbitration or mediation under Article VI, Section 3 of the FINRA By-Laws or a FINRA order of restitution or FINRA settlement agreement providing for restitution, FINRA staff may provide written notice to such member or person stating that the failure to comply within 21 days of service of the notice will result in a suspension or cancellation of membership or a suspension from associating with any member. When a member or associated person fails to comply with an arbitration award or a settlement agreement related to an arbitration or mediation under Article VI, Section 3 of the FINRA By-Laws involving a customer, a claim of inability to pay is no defense.

(b) through (h) No Change.

* * * * *