



April 9, 2018

Via E-Mail to [pubcom@finra.org](mailto:pubcom@finra.org)

Jennifer Piorko Mitchell  
Office of the Corporate Secretary  
FINRA  
1735 K Street, NW  
Washington, DC 20006-1506

Re: Regulatory Notice 18-06 (proposed amendments to Membership Application Program to incentivize payment of arbitration awards)

Dear Ms. Mitchell:

The Securities Industry and Financial Markets Association (“SIFMA”)<sup>1</sup> appreciates the opportunity to comment on Notice 18-06 (the “Notice” or the “Proposal”).<sup>2</sup> We applaud FINRA’s efforts to amend its Membership Application Program rules to help ensure that arbitration claims, awards, and settlements are paid in full.

We have long held that the issue of unpaid awards originates with the integrity and quality control standards that FINRA establishes for membership. That is the most appropriate juncture and means to address the issue, rather than viewing the issue as requiring some form of post-award collection pool, insurance, or guaranty. We offer the following comments and recommendations for your consideration.

**1. Membership applications are presumptively denied if there are pending arbitration claims.**

NMA. SIFMA supports the presumption of denial for a new membership application (“NMA”) if the applicant or its associated persons are subject to pending arbitration claims. We likewise support

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<sup>1</sup> SIFMA is the voice of the U.S. securities industry. We represent the broker-dealers, banks and asset managers whose nearly 1 million employees provide access to the capital markets, raising over \$2.5 trillion for businesses and municipalities in the U.S., serving clients with over \$18.5 trillion in assets and managing more than \$67 trillion in assets for individual and institutional clients including mutual funds and retirement plans. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit <http://www.sifma.org>.

<sup>2</sup> Notice 18-06, available at <http://www.finra.org/industry/notices/18-06>.

the applicant's ability to overcome the presumption of denial upon showing its ability to satisfy the pending arbitration claims through an escrow agreement, a clearing deposit, a guarantee, a reserve fund, or the retention of proceeds from an asset transfer.

If the applicant designates a clearing deposit or the proceeds from an asset transfer for purposes of demonstrating its ability to satisfy a pending arbitration claim, unpaid award, or unpaid settlement, then it would be appropriate for FINRA to require the applicant to provide some sort of written guaranty that the funds would be applied for that purpose.

We do not support overcoming the presumption of denial upon a showing of insurance coverage. It is erroneous to conflate insurance coverage with a respondent's ability to pay an award. Most insurance policies do not in fact provide coverage for FINRA arbitration claims.

Most relevant insurance coverages generally exclude, for example, fraud claims and conduct outside the scope of employment (e.g., selling away). In addition, determining whether an insurance policy "may" apply to a claim (in terms of subject matter, policy limits, and coverage determinations) is often difficult based on the Statement of Claim and other information available during the pendency of a case. Thus, in many cases, it would be unclear whether the policy may cover the claim.

Moreover, even if the claim may be covered, it is uncertain whether the insurance company would make an affirmative coverage determination, much less one that would cover the full prospective arbitration award. In many cases, even at the time an award is made, many insurers have not yet provided an opinion on whether their policy would apply. For all the foregoing reasons, insurance policies should not be allowed to demonstrate an applicant's ability to satisfy pending arbitration claims.

CMA. SIFMA agrees that the presumption of denial for pending arbitration claims should not apply to a continuing membership application ("CMA"). Instead, consistent with current practice, FINRA should consider pending arbitrations in determining if the applicant meets the standards for admission.

## **2. Business expansions require a materiality consultation for unpaid arbitration claims.**

SIFMA supports the Proposal to not permit a member to effect a business expansion that involves adding one or more associated persons with a "covered pending arbitration claim,"<sup>3</sup> unpaid arbitration award, or unpaid settlement related to an arbitration, and the member is not otherwise required to file a CMA, unless the member first seeks a materiality consultation with FINRA and FINRA determines that the member may effect the contemplated business expansion without a CMA.

The definition of "covered pending arbitration claim" should include only those pending arbitration claims filed prior to public announcement of the contemplated transaction.

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<sup>3</sup> "Covered pending arbitration claims" means: (1) an investment-related, consumer-initiated claim filed against the associated person that is unresolved; and (2) whose claim amount (either individually or in the aggregate) exceed the member's excess net capital. The claim would include only claimed compensatory loss, not requests for pain and suffering, punitive damages, or attorneys' fees.

**3. Direct or indirect acquisitions or transfers of assets require a materiality consultation for unpaid arbitration claims.**

SIFMA supports the Proposal to not permit any direct or indirect acquisitions or transfers of a member's assets or any asset, business or line of operation where the transferring member or one or more of its associated persons has a covered pending arbitration claim, unpaid arbitration award or unpaid settlement related to an arbitration, and the member is not otherwise required to file a CMA, unless the member first seeks a materiality consultation and FINRA determines that the member is not required to file a CMA for approval of the acquisition or transfer.

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If you have any questions or would like to further discuss these issues, please contact the undersigned.

Sincerely,



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Kevin M. Carroll  
Managing Director and  
Associate General Counsel

cc: *via e-mail to:*  
Robert L.D. Colby, Chief Legal Officer, FINRA  
Richard W. Berry, Executive Vice President and Director, FINRA-DR