

FINRA 2009: What Employers Should Know

BY ALLAN S. BLOOM

Two years after its creation through the consolidation of the National Association of Securities Dealers and the member regulation, enforcement, and arbitration functions of the New York Stock Exchange, the Financial Industry Regulatory Authority (FINRA) is actively amending rules and issuing guidance that should be of great interest to in-house employment counsel and human resources professionals in the financial services industry. This alert will highlight some of the employment-related rule changes FINRA has implemented so far in 2009, as well as some approved rule changes that are awaiting implementation.¹

Dispute Resolution Rule Changes

Most disputes between FINRA member firms and their registered employees, with the notable exception of those involving statutory employment discrimination claims, remain subject to the mandatory arbitration provision in the Uniform Application for Securities Industry Registration or Transfer (Form U4) those employees are required to sign upon hire. The SEC approved a number of rule changes this year affecting the FINRA arbitration process.

Motions to Dismiss Limited

In new arbitration rules effective February 23, 2009, FINRA limited the filing of pre-hearing motions to dismiss to three situations:

- where the non-moving party signed an agreement releasing the claim in dispute
- where the moving party was not associated with the account, security, or conduct at issue
- where the six-year limitations period for submission of an arbitration claim has elapsed

The new rules are clearly intended to dissuade parties from filing motions to dismiss on all but the most meritorious grounds: A party whose motion to dismiss is denied will be required to pay the forum fees associated with hearings on the motion, and if the arbitrators determine that the motion is frivolous, they have the authority to award reasonable costs and attorneys' fees to the non-moving parties and to impose sanctions on the movant. The panel's decision to grant a motion to dismiss must be unanimous and accompanied by a written explanation.²

Increase in the Amount in Controversy Requirement for Three-Person Arbitration Panels

Effective March 30, 2009, FINRA raised the amount in controversy threshold for appointing a panel of three arbitrators. This change was intended to decrease costs for users of the FINRA arbitration forum and to reduce case processing times by accelerating arbitrator selection and case scheduling.

As amended, Rule 13401 provides that if the amount in controversy is \$25,000 or less, a single arbitrator will be appointed to resolve the matter. If the amount in controversy is between \$25,000 and \$100,000, a single arbitrator will be appointed unless the parties agree in writing to three arbitrators. If the relief requested is more than \$100,000 (exclusive of interest and expenses), unspecified, or not monetary in nature, the panel will consist of three arbitrators unless the parties agree in writing to proceed before a single arbitrator.³

Explanation of Decisions Upon the Parties' Joint Request

Effective April 13, 2009, FINRA amended Rule 13904 to enable parties to request jointly an explanation of the general reasons for the arbitration panel's decision. Explanations are to be written by the chairperson, and need not include legal citations or damage calculations. The parties must submit their joint request for an explanation at least 20 days before the first scheduled hearing date, pursuant to amended Rule 13514. Parties cannot request explained decisions in simplified arbitrations that are resolved without a hearing or in default proceedings, but arbitrators continue to be permitted to provide an explanation on their own initiative in any proceeding.⁴

Clarification Regarding Tolling of Statutes of Limitations

In May 2009, the SEC approved a change to Rule 13206 to clarify that the applicable state or federal statutes of limitations are temporarily suspended when a claimant files for arbitration with FINRA (in the event, for example, that FINRA subsequently declines to hear the dispute and it ends up in court). One interpretation of the rule, prior to the amendment, was that it required the state or federal law to expressly permit suspension of the applicable statute of limitations. The new rule, effective August 10, 2009, does not require such express authorization.⁵

Majority Public Panels for Most Employment Disputes

Amended Rule 13402, effective August 31, 2009, requires that the parties receive a majority public panel (two public arbitrators and one industry-affiliated arbitrator) for all disputes between a member firm and an associated person other than those involving statutory employment discrimination claims. Prior to the change, Rule 13402 required an all non-public (*i.e.*, industry-affiliated) panel for employment disputes between or among firms and associated persons that related exclusively to employment contracts, promissory notes, or receipt of commissions, and a majority public panel for all other arbitration-eligible employment disputes. Disputes involving statutory discrimination claims, which are only heard at FINRA if all parties agree to proceed there, are assigned a specialized, all-public panel.⁶

Arbitration Disclosures to Persons Signing Forms U4

On July 27, 2009, the SEC approved FINRA's proposal to adopt new Rule 2263, which tracks former NASD Rule 3080 and requires member firms to provide employees, at the time it asks them to sign a new or amended Form U4, with certain written disclosures regarding the nature and process of the mandatory arbitration system. Under the new rule, firms must make disclosures sufficient to enable an employee to understand, prior to signing the Form U4, (1) that the form contains a pre-dispute arbitration agreement; (2) that the employee is giving up the right to sue the firm, customer, or another employee in court, except as provided by the rules of the arbitration forum in which a claim is to be filed; (3) that claims of statutory employment discrimination are an exception to the arbitration requirement and may be arbitrated at FINRA only if the parties have agreed to arbitrate them; (4) that arbitration awards are generally final and binding; (5) that discovery is generally more limited in arbitration than in court; (6) that arbitrators do not have to explain the reasons for their awards; (7)

that the arbitration panel may include either public or industry arbitrators; and (8) that a claim that is ineligible for arbitration due to time limits may be brought in court. FINRA will announce the implementation date of the new rule in a *Regulatory Notice* to be published no later than October 26, 2009.⁷

Streamlined Arbitrations for Promissory Note Claims

On June 24, 2009, the SEC approved FINRA's proposal to adopt new Rule 13806, which establishes procedures to expedite the administration of arbitrations in which a member firm's only claim is that an associated person failed to pay money owed on a promissory note.⁸

Other Rule Changes

Prohibition on Interference with Customer Account Transfers

Effective June 15, 2009, new Rule 2140 prohibits member firms from interfering with a customer's request to transfer his or her account in connection with the change in employment of the customer's registered representative, provided the account is not subject to any lien for monies owed by the customer or another good faith claim. Prohibited interference includes actions taken to restrict the submission or acceptance of a customer's written request to transfer the account. The rule tracks, with some conforming revisions, former Section 2110-7 of the NASD Interpretive Material. It does not limit a firm's ability to rely on restrictive covenants in employment agreements to prevent former representatives from soliciting firm customers.⁹

Revisions to Forms U4 and U5

In May 2009, the SEC approved FINRA's proposal to modify the Form U4 and the Uniform Termination Notice for Securities Industry Registration (Form U5) in several ways:

- The revised forms contain additional disclosure questions regarding regulatory actions brought against industry employees. These questions are designed to enable FINRA and other regulators to more readily identify persons who are subject to disqualification from participation in the securities industry.
- On the revised Form U5, the date to be included in the "Date of Termination" field is the "date that the firm terminated the individual's association with the firm in a capacity for which registration is required." Additionally, firms will be permitted to amend the "Date of Termination" and "Reason for Termination" sections of the Form U5, without having to obtain a court order or arbitration award to do so.
- The revised forms require member firms to report allegations of sales practice violations made against a registered person in an arbitration or litigation even in cases where the registered person is not a named party. A firm is required to report a "yes" answer only after it has made a good-faith determination after a reasonable investigation that the alleged sales practice violations involved the registered person.

The effective date for the new regulatory action disclosure questions will be November 14, 2009; the other changes to the forms became effective May 18, 2009.¹⁰

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Paul Hastings regularly represents employers in the financial services industry in proceedings before FINRA, as well as in class-action, collective action, individual and multi-plaintiff litigation in federal and state trial courts and courts of appeal. If you would like more information about the issues in this Stay Current, please contact one of the attorneys listed below.

New York

Allan S. Bloom
212-318-6377
allanbloom@paulhastings.com

San Francisco

Katherine C. Huibonhoa
415-856-7035
katherinehuibonhoa@paulhastings.com

¹ In the typical rulemaking process, FINRA files a proposed rule or rule amendment with the Securities and Exchange Commission, and the SEC publishes notice of the proposal in the *Federal Register*, together with a request for public comment. If the SEC approves the proposed rule or rule change, it places an official announcement in the *Federal Register*, following which FINRA issues a *Regulatory Notice* announcing the new rule or rule amendment and its effective date. FINRA *Regulatory Notices* can be found online at <http://www.finra.org/Industry/Regulation/Notices/2009/index.htm>.

² See FINRA *Regulatory Notice* 09-07; FINRA Rules 13504(a), 13206(b).

³ See FINRA *Regulatory Notice* 09-13.

⁴ See FINRA *Regulatory Notice* 09-16.

⁵ See FINRA *Regulatory Notice* 09-36.

⁶ See FINRA *Regulatory Notice* 09-43.

⁷ See 74 Fed. Reg. 37077 (July 27, 2009).

⁸ See 74 Fed. Reg. 30191 (June 24, 2009).

⁹ See FINRA *Regulatory Notice* 09-20.

¹⁰ See FINRA *Regulatory Notice* 09-23.