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Sent: Thursday, November 4, 2021 5:09 PM
To: NASAA Comments
Cc: kstandifer@dfi.wa.gov; Patrick Costello; Stephen Brey; Zev T Chabus
Subject: [EXTERNAL]RE: Proposed Model Rule for Unpaid Arbitration Awards Under the Uniform Securities Acts of 1956 and 2002

November 4, 2021

[Via Email \(NASAAComments@nasaa.org\)](mailto:NASAAComments@nasaa.org)

North American Securities Administrators Association, Inc.
750 First Street, N.E., Suite 1140
Washington, D.C. 20002

RE: Proposed Model Rule for Unpaid Arbitration Awards Under the Uniform Securities Acts of 1956 and 2002

The Cornell Securities Law Clinic (the “Clinic”) submits this comment supporting, and recommending additions to, the proposed model rules (the “Model Rules”) of the North American Securities Administrators Association, Inc. (“NASAA”) addressing unpaid Financial Industry Regulatory Authority (“FINRA”) arbitration awards by broker-dealers, agents, investment advisers, and investment adviser representatives. The Clinic is a Cornell Law School curricular offering in which students provide representation to public investors and public education as to investment fraud in the “Southern Tier” region of New York. For more information, please see <https://www.lawschool.cornell.edu/academics/experiential-learning/clinical-program/securities-law-clinic/>.

When investors seek to obtain compensation for misconduct by broker-dealers, such investors are often limited to arbitration due to provisions in their account opening agreements.^[1] Investors may seek compensation in a FINRA arbitration forum. However, even when investors win their cases, they do not always receive the amount that was awarded. Between 2015 and 2019, investors were owed several million dollars each year in unpaid arbitration awards.^[2] In 2020, nearly 30 percent of arbitration awards were not paid to investors.^[3] FINRA suspends broker-dealers and “associated person[s]” who do not pay arbitration awards,^[4] but suspended entities can still operate in NASAA member jurisdictions in other capacities,^[5] which lessens the severity of any FINRA suspension and limits the consequences of failing to pay arbitration awards. In light of this gap in regulation, NASAA drafted the Model Rules.

The Clinic accordingly submits this letter for your consideration.

1. Are there issues related to unpaid customer-initiated arbitration awards that the Model Rules do not address?

NASAA requests comment on whether there are issues that the Model Rules do not address. The Model Rules are comprehensive, but NASAA should work to create a uniform system to track unpaid awards.

The Model Rules make clear that unpaid arbitration awards will result in entities being unable to conduct business in NASAA member jurisdictions. However, the Model Rules do not provide a mechanism for ensuring that violators will be unable to do so. The Request for Public Comment references various FINRA rules for when firms and individuals must notify FINRA of unpaid arbitration awards,^[6] but FINRA does not directly notify NASAA member jurisdictions of unpaid awards. FINRA provides a list of firms and individuals with unpaid awards, but it currently only contains data from 2012 through 2019.^[7] Relying on this list, as well as information submitted to BrokerCheck, is inefficient and can result in increased time and effort to verify whether firms and individuals have unpaid awards from before 2012 or after 2019. As such, NASAA should work with FINRA and the Securities and Exchange Commission to ensure that unpaid arbitration awards are centrally reported and up to date and that the relevant information is easily accessible to NASAA member jurisdictions.

2. Is additional language in the second provision of the Model Rules necessary to clarify that a bankruptcy filing is not considered a failure to pay an arbitration award?

NASAA requests comment on whether the Model Rules should include language to clarify the effects of the automatic stay due to a bankruptcy filing. The second provision of the Model Rules should state that a bankruptcy filing is not per se an attempt to avoid payment of a judgment or arbitration award.

In their current form, the Model Rules do not acknowledge that firms and individuals may file for bankruptcy or that federal bankruptcy law supersedes the Model Rules.^[8] In such cases, the automatic stay would result in a violation of the Model Rules despite what may be legitimate reasons to file for bankruptcy. Such a result would appear unfair and weaken the legitimacy of the Model Rules and NASAA. However, it is possible that a firm or individual may file for bankruptcy precisely to avoid paying an arbitration award. NASAA can revise the second provision of the Model Rules to state that whether a firm's or individual's bankruptcy filing is an attempt to avoid paying an arbitration award should be determined on a case-by-case basis, but such an evaluation would involve increased time and effort for NASAA members. Instead, NASAA should work with lawmakers to have unpaid arbitration awards classified as non-dischargeable in bankruptcy proceedings.

3. Does paragraph three of the Model Rules undermine the focus on unpaid arbitration awards?

NASAA requests comment on whether the "broad reach" of the third paragraph of the Model Rules undermines the focus on unpaid customer-initiated arbitration awards. The Clinic believes that it does not.

Unpaid arbitration awards are an important issue and are addressed by the first two paragraphs of the Model Rules. However, the third paragraph of the Model Rules is just as important, as it addresses other monetary obligations. As the focus of the rest of the Model Rules makes clear, it is not acceptable for firms or individuals to avoid paying arbitration awards, and that evasion extends to any form of monetary obligation that results from a regulatory action. Thus, this third paragraph is appropriate and in line with the goal of these Model Rules.

4. Are there other ways to address unpaid customer-initiated arbitration awards?

NASAA requests comment on whether there are other ways to address unpaid arbitration awards. Along with these Model Rules, NASAA can increase its efforts to create a recovery fund for unpaid arbitration awards.

The focus of these Model Rules is, ultimately, on ensuring that investors receive the compensation that they are owed. NASAA has delineated the problems with creating a recovery fund to cover the cost of unpaid arbitration awards.^[9] However, these problems are solvable, in whole or in part, and a recovery fund would be another opportunity to make investors whole. To address conduct issues,^[10] the rules regarding the fund could be designed such that the Model Rules would apply if a firm or individual requires the use of the fund too many times or if an award exceeds a certain threshold, such as one that might significantly deplete the fund. Similarly, the Model Rules could apply if the fund is for any reason unable to make investors whole, such as if there is not enough money in the fund based on the funding criteria.

Conclusion

The Clinic supports the Model Rules and appreciates the opportunity to comment on them. We hope that NASAA considers our concerns and suggestions in making any changes to the Model Rules.

Respectfully submitted,

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^[1] Investor Bulletin: Broker-Dealer/Customer Arbitration (Dec. 20, 2016), https://www.sec.gov/oiea/investor-alerts-bulletins/ib_arbitration.html.

^[2] Statistics on Unpaid Customer Awards in FINRA Arbitration, <https://www.finra.org/arbitration-mediation/statistics-unpaid-customer-awards-finra-arbitration>.

^[3] PIABA's Third Report Concerning FINRA's Refusal to Tackle the Unpaid Arbitration Award Problem Head-On (Sept. 29, 2021), <https://piaba.org/piaba-newsroom/piaba-report-finra-arbitrations-persistent-unpaid-award-problem-september-29-2021>.

^[4] Statistics on Unpaid Customer Awards in FINRA Arbitration, *supra* note 2.

^[5] Request for Public Comment Regarding a Proposed Model Rule for Unpaid Arbitration Awards Under the Uniform Securities Acts of 1956 and 2002 (Oct. 5, 2021) (hereafter "Request for Public Comment").

^[6] Request for Public Comment at 4.

^[7] Member Firms and Associated Persons with Unpaid Customer Arbitration Awards, <https://www.finra.org/arbitration-mediation/member-firms-and-associated-persons-unpaid-customer-arbitration-awards>.

^[8] *See* U.S. Const., Art. I, sec. 8, cl. 4; Art. VI, cl. 2.

^[9] Request for Public Comment at 3.

^[10] *See id.*