

# **Bond Case Briefs**

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## **FINRA Moves to Allow Arbitrators to Call for Enforcement Midcase.**

A proposed rule could give arbitrators more authority in referring cases for disciplinary action

A hotly debated rule change that the Financial Industry Regulatory Authority Inc. has proposed to the Securities and Exchange Commission could allow arbitrators to direct cases to Finra's enforcement division before the case has closed.

Currently, arbitrators must wait until the case has concluded before they can report concerns to Finra's Department of Enforcement, which is responsible for suspending, sanctioning or taking other disciplinary action against firms and individuals.

But Finra said that making arbitrators wait could delay the ability to take action against a bad actor or hamper its ability to collect evidence.

"Finra is concerned that the current rule's requirement that arbitrators in all instances must wait until a case is concluded before making a referral could hamper Finra's efforts to uncover threats to investors as early as possible," according to the proposed rule change. "Finra is proposing, therefore, to broaden the arbitrators' authority under the Codes to make referrals during the hearing phase of an arbitration in those extremely rare circumstances in which investor protection requires that the referral not be delayed."

All initial pleadings for arbitration cases are also filed with and reviewed by Finra's enforcement department, but in a small number of cases, new evidence can come up during a hearing that may warrant immediate disciplinary action, according to Marc Dobin of the Dobin Law Group PA.

The self-regulator has spent the past four years in a back-and-forth with the industry over how to handle those instances where an arbitrator learns information that could present a clear and present danger.

Finra submitted two similar proposals in 2010 and 2011, but they were withdrawn or replaced after drawing significant opposition from commenters, who took issue with the implementation.

The concern is whether an arbitrator's disclosure of a possible investor protection issue could unnecessarily bias the rest of the panel against the respondent, Mr. Dobin said.

"It's similar to a jury where they tell you not to discuss anything about the case until it is over," he said. "It makes it harder to settle case if you're on the respondent's side if your arbitrators have said, 'Oh by the way, we think what we've heard so far is so bad that we're telling enforcement about it.'"

The original proposal, filed with the SEC in 2010, would have required the entire three-person arbitration panel to withdraw if one of the arbitrators made a mid-case referral. But commenters voiced concerns that this could unfairly affect the investor or claimant who would have to make their

case a second time and incur additional expenses.

The latest proposal seeks to limit the disruption of a midcase referral.

According to the most recent draft, arbitrators will refer their claims to the director or president of enforcement, and then the director is required to notify the parties involved in an arbitration proceeding that the referral had been made.

The parties would then have the opportunity to request the recusal of that individual arbitrator.

But in an effort to add another layer of protection for the claimant, Finra stated that an arbitrator's referring a claim for disciplinary action shouldn't be considered proof of bias, and it is still up to the arbitrator whether to resign from the panel even after a party has filed a motion for recusal.

"This means that the entire panel could remain after a party's recusal motion, and the case could proceed as normal," the proposal stated. "The investor would be less likely, therefore, to experience procedural disadvantages, significant delays, and increased costs, because Amendment No. 1 minimizes the possibility that the arbitration would start anew."

Final action could still be a way off. This proposal will go before the SEC where it will be on display for public comment, and then it will be subject to additional review by the commission before a final vote there on whether to approve the rule change.

By Mason Braswell

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