



Updates in the Handling of Securities Claims

Common Issues In Current FINRA Cases

- FINRA is concerned about the suitability of recommendations to retail investors for all products.
 - Of late, there is heightened concern about the suitability of complex products whose risk-return profiles, including their sensitivity to interest rate changes, underlying product or index volatility, fee structures or complexity may be challenging for investors to understand.
- The SEC and FINRA are getting tough on broker-dealers, putting intense focus on those recommending and selling alternative investments
 - Examples: Nontraded real estate investment trusts (REITs), complex structured products, emerging-markets investment funds, mortgage-backed securities, long-duration bond funds and municipal securities.
 - Why?
 - Firms and reps lacking an understanding of the products' nature
 - Illiquidity issues
 - Over concentration issues—unable to replenish retirement assets
 - Other risk factors associated with investing in non-publicly traded products that suggest less clarity on security.
- Due Diligence

Suitability Standard

- The New Suitability Rule?
 - FINRA Rule 2111 requires that a broker-dealer or associated person “have a reasonable basis to believe that a recommended transaction or investment strategy involving a security or securities is suitable for the customer, based on the information obtained through the reasonable diligence of the [firm] or associated person to ascertain the customer’s investment profile.”
 - Suitability of transactions is the key issue that tends to underpin claims.
- Factors considered?
 - In general, a customer’s investment profile would include the customer’s age, other investments, financial situation and needs, tax status, investment objectives, investment experience, investment time horizon, liquidity needs and risk tolerance. The rule also explicitly covers recommended investment strategies involving securities, including recommendations to “hold” securities.
- What are the key suitability obligations?
 - (1) Reasonable-basis,
 - (2) Customer-specific, and
 - (3) Quantitative suitability.

Broadening the Fiduciary Duty?

- The Securities and Exchange Commission (SEC) is split on whether to proceed with a rule that would raise investment advice standards for brokers by imposing a universal fiduciary duty for anyone providing retail investment advice.
 - Draft five-year strategic plan was out for public comment until March 10.
 - Michael Piwowar and SEC member Dan Gallagher probably would oppose a fiduciary rule proposal, and members Luis Aguilar and Kara Stein would probably support it. SEC Chairman Mary Jo White would be the swing vote.
- When? Proposed regulation is slated for "long-term action" without a specific timetable.
 - The SEC and Labor Department agendas demonstrate that each regulator continues to move at its own pace regarding their fiduciary duty rules.
- In the foreseeable future, the duty will likely remain governed by the suitability standard.
- How does this effect exposure of insureds?



Developments in FINRA Arbitration Process

- Mixed panel vs. All public panel
 - FINRA data shows that there is no significant difference in outcomes of cases decided by solely public arbitrators instead of those with public and non-public arbitrators.
 - Until 2011, FINRA required arbitration panels to include one non-public arbitrator, but has since changed its rules to let investors choose a panel of all public arbitrators.
- All public
 - Excludes people who had past industry ties
 - Former bankers and brokers and lawyers who worked on behalf of brokerages
 - Exception: FINRA allows people who have been out of the industry for at least five years - but who may have worked in it as many as 20 years - to hear cases as public arbitrators.
- Motions to Dismiss – Rule 12504
 - Discouraged Practice/ Attorneys Fees for “Frivolous Motions to Dismiss”
 - Limited Bases
 - Non-moving party released by signed settlement agreement
 - Moving party not associated with the accounts, securities or conduct at issue
 - “Six Year Rule” – Rule 12206
 - Pros/Cons
 - Time Limitation: Must serve motion at least 90 days before a scheduled hearing



Expungement

- Rule 12805 - Arbitrators considering a request for expungement relief under Rule 2130 are required to:
 - Hold a recorded hearing session by phone or in person;
 - Review any settlement documents to examine the amount paid to any party and other terms and conditions of the settlement;
 - Provide a written explanation for ordering expungement; and
- Assess forum fees for hearing sessions held to consider expungement.
- Coverage Issues
- Repeat Offenders

Q & A

