

Fall 2014 FINRA Update: Automated Customer Account Data Collection, Arbitrator Diversity And Higher Arbitration Fees

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FINRA's Account Data Collection System Under Scrutiny

In recent years, everyone—from businesses, to government agencies and individuals—has turned to technology to simplify life and streamline the way things are done. Or at least that is the idea behind the Financial Industry Regulatory Authority's (FINRA) proposed Rule 4540 and "Comprehensive Automated Risk Data System" (CARDS), a massive technology-based initiative that would require brokerage firms to upload detailed account information and trade data to FINRA for computerized, rule-based analysis. FINRA believes the initiative will allow it to more closely supervise brokerage firms, monitor trading activity and detect wrongful or suspicious activity more quickly and less expensively than traditional review methods. Regulators also claim the routine collection of trade data will lessen the burden on firms during FINRA examinations and inquiries.

The data uploaded to FINRA would include securities purchases and sales; investment objectives; risk tolerances; account transactions, deposit and withdrawal histories; account holding details, including specific securities; and other highly detailed, sensitive information for all accounts as maintained pursuant to each firm's books and records policy. The proposed rule gives FINRA discretion to review these categories annually and, as is likely to occur, to broaden the categories of data collected. While customer names and other personally identifiable information would not be collected, investors and firms have expressed concern that their private account information could be disclosed in the event of a data breach, as has often been the case this year (Target, Home Depot and now the Post Office have reported large data breaches in the past several months alone).

Securities industry insiders also have criticized the proposal, citing the significant costs of complying with the new rule as firms will be required to roll out new staff, hardware, software and security measures. In response to those concerns, FINRA has proposed a phased rollout for CARDS, starting first with requiring carrying or clearing firms (e.g., firms that carry accounts and clear transactions) to produce a "limited" set of information. Phase two would require all member-firms, including smaller broker-dealers who do not custodialize funds or clear trades, to report the required information to FINRA or another authorized third party (e.g., the clearing firm with whom they transact securities business). The proposed rule is expected to be enacted in 2015, though FINRA is accepting comments through December 1, 2014.

FINRA Arbitrators Lack Diversity, According To Investor Group

A recent study from the Public Investors Arbitration Bar Association (PIABA), a group formed to assist investors in recovering investment losses, concludes that the arbitrator pool maintained by FINRA lacks diversity.

The PIABA study found that investors often are forced to choose an arbitration panel from a pool consisting of mostly elderly men. According to the investor group, males make up approximately 80% of the arbitrator pool while the average age of arbitrators is 69 years old. PIABA maintains that this lack of diversity is a factor in the declining number of awards favoring investors.

In July of this year, FINRA assembled a 13-person task force to review its arbitration procedures and identify areas that could be improved. According to FINRA, the task force was empanelled to improve the transparency, impartiality, and efficiency of the arbitration process.

SEC Backs FINRA In Arbitration Fee Rate Hike

The cost of bringing an arbitration claim before FINRA's arbitration division is on the rise.

The SEC, which oversees FINRA, recently pledged support for FINRA's proposal to increase arbitration claim filing and hearing session fees. The rate hike will apply to claims larger than \$250,000 and will result in filing fee increases of 10 – 25%, depending on the amount at stake in the arbitration, plus additional hearing session fees. By way of example, the filing fee for a claim involving more than \$1 million in damages will rise from \$1,575 to \$1,725 under the proposed rule change. The new rule also will increase the member surcharges and processing fees brokerage firms must pay to FINRA.

The fee increases follow FINRA's recent decision to increase arbitrator pay as part of a move to attract additional—and more qualified—arbitrators, likely in response to recent criticisms (see above) about FINRA's Arbitrator Pool. FINRA has not yet announced when the new fees will take effect, though it will likely be in the first half of 2015.

Shustak & Partners, P.C.'s FINRA Arbitration Practice Group

FINRA's arbitration division is the mandatory forum for most investors who bring claims against brokerage firms, stockbrokers and financial advisors. In addition, most financial advisors and employees of FINRA firms must pursue any employment disputes in the forum. From our offices in San Diego, Irvine, San Francisco, Chicago, and New York, our FINRA Arbitration Practice Group represents brokerage firms, RIA firms, registered representatives and individuals in FINRA customer and employment/promissory note disputes, as well as FINRA and SEC investigations and enforcement proceedings.