

# FINRA Expert Witness: What FINRA is and how it helps to resolve investor/financial adviser disputes

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The Financial Industry Regulatory Authority—FINRA—was established in 2007 as a combination of the National Association of Securities Dealers—NASD and the member regulation, enforcement and arbitration functions of the New York Stock Exchange. Contrary to popular belief, FINRA is not an agency of the federal government. It is a private, non-profit corporation that acts as a self-regulating organization charged with overseeing all aspects of the securities industry. In this capacity, FINRA monitors all trading of public securities, maintains oversight of 4,250 member firms, conducts licensing and continuing education training for more-than 600,000 registered representatives and provides the largest forum for arbitration of disputes in the securities industry.

FINRA employs some 3,400 people and is funded through fees and assessments of member firms and individual representatives. FINRA is also funded from the fines it imposes on those firms and individuals who are found to have violated the rules of fair practice. On average in 2015, FINRA monitored 50 billion market events per day. This “big-data” evaluation of market activity provides a clear picture of anomalous market activity and resulted in 142 referrals to the SEC for further investigation of trading improprieties during 2015. In 2015 FINRA had revenues of \$992.5 million, including \$93.8 million in fines. The organization showed a small net loss due to adverse portfolio performance but it has about \$1.5 billion in net equity on its balance sheet. The organization is in excellent fiscal fitness.

For the average investor, the most interesting and visible manifestation of FINRA’s operations is in the area of dispute resolution. With very few exceptions, disputes between investors and member firms or between employees and their firms are adjudicated by arbitration. This is due to the universality of arbitration clauses built in to customer account agreements and employment contracts. These agreements have been called into question on numerous occasions but the courts have consistently upheld their validity except in cases of class action suits.

The FINRA arbitration process is considerably less formalized than a court proceeding but will often feature a FINRA expert witness employed by each litigant. Very few motions are entertained and the discovery process is more abbreviated.. This means that a FINRA expert witness might not be deposed prior to the hearing – which is different than federal court where depositions are common. The examination of witnesses tends to be less combative. In general, a FINRA arbitration is a more casual affair than a case in court. This is due in part to the fact that the arbitration is presided over by a three-person panel rather than a judge and jury. In disputes between a customer and a member firm, the panel consists of one non-industry arbitrator, one industry arbitrator (unless the customer opts for an all non-industry panel) and a non-industry chairperson. These are chosen from among a roster of ten available arbitrators in

each category by the disputants, each of whom is allowed four peremptory strikes and assigns a numerical rating to the remaining candidates. The panel is chosen from among the strongest combined rankings. In cases between employees and their member firm, the panel is composed of all industry arbitrators. This three-person panel has ultimate authority over the subsequent proceedings, including the weight to be assigned to the testimony of a FINRA expert witness, finding in favor of one of the parties and determining the extent of damages and/or penalties. The decision of the arbitration panel is final and binding. FINRA has no procedure to appeal a decision. Although a motion to vacate an arbitration award may be filed in state or federal court pursuant to the Federal Arbitration Act or state statute, such motions are rarely granted. In 2015 there were 3,435 arbitration filings with FINRA. Of these, only 828 (24%) were decided by the arbitrators. The remaining cases were decided by other means, usually by settlement agreement between the disputants prior to the arbitration proceedings. Of the 455 customer complaint cases decided by an arbitration panel, the customer was awarded damages 42% of the time. This percentage has remained fairly stable over many years—within two percentage points of the mean.

FINRA has come under a great deal of criticism as a self-regulatory organization, but it provides an amazingly effective platform to monitor and control an industry that is inherently rife with opportunities for conflict of interest and outright fraud. The Central Registration Depository—CRD is maintained by FINRA to keep a public record of all violations, disciplinary measures, settlements and adverse arbitration decisions for each registered representative in the country. These records are easily accessible through the Broker Check function at [www.finra.org](http://www.finra.org). There are many other consumer-related guides on the website designed to help investors make wiser choices of investments and advisors, including the Risk Meter, which tests investors' susceptibility to fraud and the Scam Meter, which helps investors analyze whether an investment opportunity may be too good to be true. All things considered, FINRA makes the investing landscape more hospitable for all of us.



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