KD Alert: FINRA Fines Merrill Lynch $1 Million

By Rina Spiewak
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On January 25, 2012, the Financial Industry Regulatory Authority (“FINRA”) announced that it had imposed a $1 million fine against member firm, Merrill Lynch, Pierce, Fenner & Smith, (“Merrill”), because Merrill had instituted expedited court actions, rather than arbitration proceedings, to collect money that former registered representatives owed pursuant to promissory notes. FINRA found that Merrill violated FINRA Rules 2010 and 13200 by structuring its promissory note program to avoid arbitrating disputes concerning promissory notes.

Background

In January 2009, after being acquired by Bank of America Corporation, Merrill created an Advisor Transition Program (“ATP”) to retain its registered representatives. Pursuant to the ATP, Merrill paid lump sum retention bonuses to its registered representatives, which were structured as loans evidenced by promissory notes. Among other things, the promissory notes indicated that the loan was being made by Merrill Lynch International Finance, Inc. (MLIFI), a non-FINRA registered affiliate of Merrill, and that any action regarding the note must “be brought solely in the Supreme Court of the State of New York in New York County.” However, Merrill, not MLIFI, actually supplied the money for the loans. According to the Acceptance, Waiver and Consent (“AWC”) executed by Merrill and FINRA, Merrill identified MLIFI as the party to the note and included the forum clause to allow Merrill to initiate expedited collection actions pursuant to CPLR Rule 3213, which according to the AWC, “greatly limits defendants’ ability to assert counterclaims.”

In between January 2009 and November 2009, Merrill filed over 90 collection actions in New York state court.

FINRA’s Findings

FINRA concluded that Merrill’s actions violated Rules 2010 and 13200. FINRA noted that Rule 13200(a) of FINRA’s Code of Arbitration Procedure requires that all disputes between members and its associated persons be arbitrated at FINRA Dispute Resolution and that IM 13000 states that the failure to submit a dispute to arbitration in accordance with the Code “may be deemed conduct inconsistent with just and equitable principles of trade and a violation of Rule 2010.”

In reaching this conclusion, FINRA specifically noted that Merrill structured the ATP to avoid arbitration by (1) making it appear that a non-registered entity, MLIFI, was providing the funds, and (2) including a forum selection clause identifying the proper forum as the Supreme Court of New York State for New York County.

Implications for Broker-Dealers

FINRA’s action against Merrill is significant for several reasons. First, the enforcement action and the $1 million fine signals FINRA’s commitment to ensuring that FINRA Dispute Resolution remains the exclusive forum for resolving all disputes involving FINRA members. Indeed, this case indicates that FINRA will oppose any legislative efforts to curtail mandatory arbitration. Second, the language of the AWC, which criticized the limited procedural rights available to defendants in expedited court proceedings, suggests that FINRA will take a negative view of any practices that seek to force litigants into forums less friendly than FINRA Dispute Resolution, where parties are generally prohibited from filing motions to dismiss in advance of hearings and arbitrators are free to issue decisions based upon “equitable principles” rather than upon strict application of the law. This decision, however, will buttress efforts by firms to ensure that statutory discrimination and other employment claims are resolved at FINRA Dispute Resolution rather than in more time consuming court proceedings.

Should you have any questions regarding this alert, please contact Janene M. Marasciullo, Esq. Rina Spiewak, Esq, or Gregg Breitbart.