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May 1, 2026

Jennifer Piorko Mitchell
Office of the Corporate Secretary
FINRA
1700 K Street, NW
Washington, DC 20006

RE: Request for Comment - Regulatory Notice 26-06

Dear Ms. Mitchell,

Capulent LLC (“Capulent” or the “Firm”) appreciates the opportunity to comment on Regulatory Notice 26-06 (the “Notice”) issued by the Financial Industry Regulatory Authority regarding the modernization of FINRA’s arbitration rules, guidance, and processes.

Capulent is a FINRA member broker-dealer primarily engaged in the distribution of real estate oriented alternative investments, including Delaware Statutory Trusts, private placements, and other Regulation D offerings. In this capacity, the Firm performs due diligence, conducts suitability analysis, and facilitates transactions between investors and issuers. Capulent does not act as sponsor, manager, or issuer of the investments it distributes and does not control issuer operations, governance, or post-closing conduct.

We commend FINRA for undertaking this review. In our view, this Notice presents a meaningful opportunity to address structural inefficiencies that have developed over time within the arbitration framework. Based on our experience, many of these issues are particularly acute in the context of alternative investments, where the allocation of responsibility between broker-dealers and issuers is both critical and frequently misunderstood.

Capulent strongly supports investor protection and accountability at every stage in this process. We also believe each participant plays a distinct role, and the framework should reflect those distinctions. Firms that engage in misconduct should be held responsible. However, a regulatory system that does not appropriately distinguish between broker-dealer misconduct and sponsor and issuer misconduct harms both investors and market participants. It creates incentives that distort behavior, encourages defensive practices that reduce access to legitimate investment opportunities, and undermines confidence in the dispute resolution process itself.

This response articulates our position on the following topics:

I. The Structural Misalignment in FINRA Arbitration

At the core of Capulent's experience is a recurring structural misalignment. FINRA arbitration, particularly in the alternative investment space, increasingly functions as a mechanism through which broker-dealers are asked to absorb losses that arise from risks they neither created nor controlled.

The pattern is consistent. An investment is made following standard processes: due diligence is conducted, suitability is evaluated, disclosures are provided, and the investor elects to proceed. At the time of the transaction, no material red flags are present that would preclude the offering. Months or even years later, the investment experiences distress. That distress may stem from issuer misconduct, operational failures, macroeconomic changes, interest rate movements, insurance cost increases, or other external factors.

At that point, the issuer is frequently unavailable as a practical recovery source. Bankruptcy, insolvency, or jurisdictional barriers often make direct recovery infeasible. The broker-dealer, however, remains solvent, regulated, and accessible. As a result, claims are redirected toward the broker-dealer, often framed as due diligence failures but substantively seeking recovery for losses caused by third-party conduct or market conditions.

This dynamic effectively transforms broker-dealers into respondents of last resort.

That outcome is not contemplated by the regulatory framework governing broker-dealer obligations. Nor is it economically sustainable. If left unaddressed, it will continue to reshape the market in ways that reduce investor access to alternative investments, increase costs, and incentivize overly restrictive distribution practices.

II. The Time-of-Transaction Standard Must Be Reinforced

A foundational principle that must be reaffirmed is that broker-dealer conduct is evaluated based on the information available at the time of the transaction.

This principle is well understood in theory but inconsistently applied in practice. Arbitration claims frequently rely on hindsight, asserting that a firm "should have known" of risks that only became apparent after the investment was made. This retrospective reasoning is fundamentally flawed. It imposes a standard of omniscience that is neither realistic nor required under existing rules.

Due diligence is inherently a point-in-time exercise. It involves evaluating available information, assessing risk factors, and forming a reasonable basis for offering a security. It does not and cannot guarantee future performance or prevent subsequent misconduct by independent actors.

FINRA's modernization effort should explicitly reinforce this principle. Arbitrators should be instructed, through rulemaking or guidance, that due diligence and suitability must be evaluated in the context of contemporaneous information, not subsequent outcomes.

Without this clarification, other reforms will have limited effect, as hindsight bias will continue to drive inconsistent and inequitable outcomes.

III. Eligibility Rule as a True Statute of Repose

Capulent strongly supports establishing the six-year eligibility rule as a strict statute of repose.

The current flexibility in determining when the eligibility period begins has created significant uncertainty. Claimants frequently argue that the clock should begin at the point of "discovery" of harm, which may occur years after the transaction. This effectively eliminates any meaningful outer boundary on liability. In some cases, claimants' attorneys specifically point to discoveries and legal actions that occurred long after the point of sale and general basis suitability analysis. In these cases, we would like to see FINRA actively screen for these incongruencies and deny the claims on this basis alone.

A statute of repose serves a distinct and important purpose. It provides finality. It ensures that claims are brought within a timeframe where evidence is available, witnesses can be located, and events can be fairly evaluated.

Broker-dealers operate within defined record retention frameworks. Aligning the eligibility rule with those frameworks is both logical and necessary. Without such alignment, firms are exposed to claims at a time when they may no longer have access to the information needed to defend themselves effectively.

Capulent also urges FINRA to require early determination of eligibility. This threshold issue should be resolved before significant resources are expended. Allowing claims to proceed through discovery and hearing only to be dismissed on eligibility grounds undermines efficiency and increases costs unnecessarily.

IV. Realized Damages and the Problem of Premature Claims

One of the most significant procedural gaps in the current framework is the absence of a requirement that claimants demonstrate realized damages at the time of filing.

Claims are routinely filed based on interim developments. A reduction in distributions, for example, is often treated as evidence of loss. While distribution reductions can in some cases reflect material impairment, they are frequently discretionary, temporary, or reflective of prudent asset management decisions rather than permanent impairment.

In many cases, the underlying investment remains viable. Assets may still hold value, operations may stabilize, and ultimate recovery may occur over time. Filing claims at this stage converts temporary fluctuations into litigation triggers.

This has several consequences. It increases the volume of claims, many of which ultimately prove premature. It imposes defense costs regardless of merit. And it creates settlement pressure unrelated to actual damages.

Requiring realized, cognizable damages would address these issues directly. It would ensure that arbitration is reserved for disputes involving actual harm, not potential or speculative outcomes. It would also align FINRA arbitration with broader legal principles governing ripeness and standing.

Importantly, such a requirement can be implemented without prejudicing investors. Tolling mechanisms can preserve claims until damages materialize, ensuring that legitimate claims are not lost.

V. Portfolio Context and the Distortion of Selective Claims

Capulent has repeatedly observed the selective presentation of investment outcomes in arbitration claims.

Investors often allocate across multiple similar investments as part of a diversification strategy. This is encouraged by broker-dealers and widely understood as a prudent approach to managing risk. However, when one investment underperforms, claims are often brought focusing exclusively on that position, ignoring others that performed as expected.

This “cherry-picking” distorts the analysis. It isolates negative outcomes while disregarding the broader context in which the investment decisions were made. It also undermines the evaluation of suitability, which is inherently a portfolio-level consideration.

FINRA should address this by requiring that damages analysis consider the investor’s broader portfolio of comparable investments facilitated by the same firm. Arbitrators should be explicitly instructed that suitability and damages cannot be evaluated in isolation where a diversification strategy was employed.

Additionally, somewhat unique to real estate investments, tax deferral is also an important consideration in calculations of damages. Often with DSTs, an investor's primary goal is to defer capital gains on a relinquished property rather than immediate income or capital appreciation. In these cases, the realized gains are much more than the actual returns of the investment and only achievable by the specific investor or claimant. If arbitration awards are not granted in a rescissory manner, unwinding the transaction as if it never happened, these allow claimants to ‘have their cake and eat it too’ allowing claimants to retain tax benefits while also recovering losses.

This reform would not eliminate claims, but it would ensure that they are evaluated in a manner that reflects economic reality.

VI. Due Diligence Safe Harbor and the Need for Defined Standards

Capulent believes that one of the most impactful reforms FINRA could implement is the establishment of a defined due diligence safe harbor.

At present, Regulatory Notice 10-22 provides helpful guidance regarding the elements of a reasonable due diligence process; however, it does not provide firms with meaningful certainty as to when that standard has been satisfied. Firms are instructed on what constitutes reasonable diligence in principle, but adherence to those principles does not insulate a firm from liability in practice, particularly in the face of hindsight-driven claims.

This dynamic creates a fundamental and persistent asymmetry within the arbitration framework. Claimants are effectively permitted to evaluate a firm's due diligence process through the lens of subsequent events, asserting that additional steps "should have been taken" based on information that was not reasonably available, knowable, or material at the time of the offering. In doing so, the analysis is no longer tethered to the contemporaneous standard of reasonableness, but instead becomes outcome-oriented.

Such hindsight-based reasoning imposes a de facto standard of perfection or omniscience that is neither contemplated by FINRA rules nor consistent with established legal principles. Due diligence is inherently a forward-looking, risk-based exercise that relies on the evaluation of available information, representations, and third-party data. It cannot—and is not intended to—serve as a guarantee against future adverse developments, including sponsor misconduct, operational failures, or changing market conditions.

The absence of a defined endpoint for what constitutes "sufficient" diligence allows claims to proceed based on generalized assertions that more could have been done, without requiring claimants to identify specific deficiencies grounded in the facts and circumstances known at the time. This not only undermines predictability for member firms, but also introduces inconsistency in arbitral outcomes, as determinations of adequacy become inherently subjective and dependent on post hoc interpretations.

A clearly articulated safe harbor would directly address these concerns. Under such a framework, if a firm demonstrates compliance with defined due diligence elements, a rebuttable presumption of adequacy should apply. Claimants would then bear the burden of identifying specific, material deficiencies in the diligence process and demonstrating a causal connection between those deficiencies and the alleged harm. This would appropriately shift the inquiry from an outcome-based critique to a conduct-based analysis grounded in contemporaneous facts.

In this regard, FINRA could build upon and enhance the framework set forth in Regulatory Notice 10-22 by more clearly delineating baseline diligence standards that, if satisfied, would

qualify for safe harbor treatment. These standards could include, for example, documented review of offering materials, financial statements, sponsor background and track record, third-party reports where applicable, and reasonable verification of key representations. Providing greater specificity around these elements would not only promote consistency across firms, but also provide arbitrators with a more objective framework for evaluating compliance.

Importantly, the establishment of a safe harbor would not shield misconduct or insulate firms that fail to conduct meaningful diligence. Rather, it would ensure that liability is predicated on identifiable failures in process, as opposed to adverse investment outcomes that materialize after the fact. In doing so, it would restore balance to the current framework, promote regulatory clarity, and reinforce the principle that broker-dealer obligations must be assessed based on what was known, or reasonably knowable, at the time the recommendation was made.

VII. Expanded Grounds for Dismissal and Early Case Screening

The current limitations on prehearing motions to dismiss materially contribute to inefficiency within the arbitration framework and, more significantly, permit the continued advancement of claims that lack a legally cognizable basis at inception. Capulent supports expanding the grounds for dismissal to include the absence of realized damages and the failure to establish a cognizable causal nexus. However, the Firm believes that additional clarification and structural reinforcement are necessary to ensure that such reforms are effective in practice.

First, with respect to realized damages, the absence of a clear pleading-stage requirement permits claims to proceed notwithstanding the absence of any actual, crystallized loss. As discussed above, claims are frequently precipitated by interim developments, including distribution suspensions, covenant concerns, or fluctuations in asset-level performance. While such developments may be relevant to ongoing monitoring, they do not, standing alone, constitute realized economic harm. Permitting such claims to proceed beyond the initial stage creates a procedural imbalance, whereby respondents are compelled to incur substantial legal and administrative costs in defending claims that may never mature into actionable losses.

FINRA should therefore expressly authorize dismissal where a claimant cannot demonstrate, at the time of filing, a realized and quantifiable loss. This determination should be grounded in objective criteria, including whether the investment has been liquidated, whether there has been a measurable impairment of principal, and whether the asserted damages are speculative or contingent upon future events. Where claims are dismissed on this basis, FINRA should implement an appropriate tolling mechanism to preserve a claimant's ability to refile if and when actual damages materialize. This approach appropriately balances the protection of investor rights with the need to prevent premature and inefficient litigation.

Second, Capulent strongly supports dismissal where a claimant fails to plead a specific and demonstrable causal connection between the alleged conduct of the broker-dealer and the claimed loss. Consistent with the experience described by WealthForge Securities, Inc., many claims rely on generalized and conclusory assertions that a firm "should have known" of risks

that only became apparent after the transaction. Such assertions are frequently untethered from any identifiable contemporaneous red flags and instead rely impermissibly on hindsight and outcome-driven reasoning.

To address this deficiency, FINRA should require that statements of claim include particularized factual allegations identifying: (i) the specific information available at the time of the transaction, (ii) the manner in which such information was allegedly overlooked or misinterpreted, and (iii) how proper consideration of that information would have altered the investment decision. Absent such specificity, claims should be subject to dismissal at the prehearing stage.

In addition to expanding dismissal grounds, Capulent believes FINRA should implement a more formalized early case screening mechanism. Such a process, administered by the Director or a designated panelist, would function as a threshold review of the legal and factual sufficiency of the claim prior to full panel appointment and discovery. The purpose of this review would not be to adjudicate the merits, but rather to ensure that the claim satisfies minimum standards of plausibility.

This screening mechanism could evaluate, among other factors, whether the claim: (i) alleges realized damages, (ii) articulates a coherent theory of liability, (iii) identifies specific conduct attributable to the respondent, and (iv) establishes a plausible causal nexus between that conduct and the alleged harm. Claims that fail to meet these threshold criteria should be dismissed or, where appropriate, required to be amended prior to proceeding.

Such front-end filtering would yield several material benefits. It would reduce the volume of marginal claims entering the system, conserve FINRA's administrative resources, and materially lessen the burden imposed on member firms. It would also mitigate the current dynamic in which claims are filed with the expectation that defense costs alone will create settlement pressure, irrespective of the underlying merits.

Finally, Capulent believes that any expansion of dismissal authority should be accompanied by clear guidance to arbitrators emphasizing that the early resolution of legally deficient claims is not disfavored, but rather constitutes an essential component of an efficient and credible arbitration framework. Absent such guidance, there remains a meaningful risk that arbitrators will continue to defer threshold determinations in favor of full evidentiary hearings, thereby undermining the intended objectives of these reforms.

VIII. Explained Decisions and Appellate Oversight

Capulent strongly supports requiring explained decisions in arbitration awards.

The absence of explanation undermines transparency and limits accountability. It also makes it difficult to assess whether decisions are grounded in applicable standards or influenced by equitable considerations untethered to legal principles.

Requiring panels to articulate causation, allocation of responsibility, and damages methodology would significantly improve the quality and consistency of outcomes.

Capulent also believes that an appellate mechanism should be considered. Arbitration need not be devoid of review. A limited appellate process focused on clear errors would enhance confidence in the system without undermining efficiency.

IX. Arbitrator Training and Subject Matter Competence

Many of the issues described above are exacerbated by gaps in arbitrator familiarity with alternative investments.

These products involve structures, roles, and risks that differ materially from traditional securities. Without adequate training, arbitrators may misinterpret standard practices or apply inappropriate analytical frameworks.

Enhanced training should focus on causation, time-of-transaction analysis, and product structure. This is not advocacy. It is foundational competence necessary to adjudicate complex disputes fairly.

X. Cost Asymmetry and Settlement Dynamics

The economics of FINRA arbitration play a significant and often underappreciated role in shaping the behavior of both claimants and respondents. Capulent has observed, consistent with the experience described by WealthForge Securities, Inc., that the current framework creates a pronounced cost asymmetry that can incentivize the filing and prosecution of claims independent of their underlying merit.

Defending an arbitration claim through a full evidentiary hearing can be costly. Legal fees, expert witness costs, document production expenses, and forum fees can collectively reach substantial levels, even in cases involving relatively modest claimed damages. These costs are largely unavoidable once a claim proceeds beyond the initial stages, regardless of whether the claim ultimately proves to be meritorious.

Claimants' counsel are aware of this dynamic. In some instances, it creates an economic incentive to file claims that are sufficiently plausible to survive initial scrutiny but lack substantive merit. The expectation is not necessarily to prevail at a hearing, but rather to create settlement leverage by imposing defense costs on the respondent. From the respondent's perspective, the cost of defending the claim may exceed the cost of settling it, leading to economically rational but substantively unwarranted settlements.

This dynamic has broader implications for the integrity of the arbitration system. It shifts the focus from adjudicating legitimate disputes to managing litigation risk and cost exposure. It also

undermines confidence in the fairness of outcomes, as settlements may reflect economic pressures rather than the merits of the case.

Capulent believes FINRA should take a more active role in addressing this imbalance. As a starting point, the procedural reforms discussed in Section VII, including early case screening and expanded dismissal grounds, would reduce the number of claims that progress to costly stages of the process. However, additional measures are warranted.

One such measure is the introduction of a more robust cost-shifting or cost-recovery framework in appropriate circumstances. Where a claim is dismissed at an early stage due to lack of realized damages, failure to state a claim, or absence of a causal nexus, FINRA should consider permitting respondents to recover a portion of their reasonable defense costs. This would help realign incentives by ensuring that the cost of pursuing deficient claims is not borne entirely by the respondent.

Capulent recognizes that cost-shifting must be applied carefully to avoid discouraging legitimate claims. Accordingly, any such framework could be limited to cases where the claim fails to meet clearly defined threshold standards or where a pattern of filing deficient claims is identified. The goal is not to penalize claimants, but to deter the filing of claims that lack a reasonable factual or legal basis.

In addition, FINRA should consider whether greater transparency around claim outcomes, including dismissal rates and cost allocations, could further discourage the filing of marginal claims. Providing more visibility into how claims are resolved may influence claimant behavior and encourage more careful evaluation prior to filing.

Capulent also believes that arbitrators should be explicitly authorized, and encouraged, to consider the economic realities of the dispute when evaluating settlement dynamics and procedural decisions. While arbitrators are not responsible for the parties' strategic choices, awareness of cost asymmetry can inform decisions regarding scheduling, discovery scope, and the handling of threshold motions.

Finally, addressing cost asymmetry is not solely about reducing expenses for respondents. It is about preserving the arbitration forum as a venue for resolving legitimate disputes in a fair and efficient manner. A system that allows economic pressure to substitute for substantive merit risks eroding trust among all participants, including investors, member firms, and regulators.

By implementing targeted reforms that address both the procedural and economic drivers of this dynamic, FINRA can help ensure that its arbitration framework operates as intended: as a fair, balanced, and credible mechanism for dispute resolution.

XI. Punitive Damages and Procedural Safeguards

Capulent supports the imposition of reasonable limitations and safeguards on punitive damages.

At a minimum, such awards should require detailed explanation and be subject to clear standards. Consideration should also be given to allowing parties to limit punitive damages through agreement where permitted by law.

These measures would promote consistency and ensure that punitive awards are applied in a principled manner.

XII. Conclusion and Path Forward

The issues described in this letter are interconnected. They stem from a common underlying challenge: the need to align liability with conduct.

A broker-dealer that conducts reasonable due diligence, makes suitable recommendations, and provides appropriate disclosures should be evaluated based on those actions at the time they were taken. Liability should not be imposed for subsequent events outside the firm's control absent a clear and demonstrable connection to its conduct.

Addressing this issue requires a coordinated set of reforms. No single change will resolve it. However, taken together, the measures discussed in this letter would materially improve the arbitration framework.

They would reduce uncertainty, discourage premature and speculative claims, enhance decision-making, and restore balance to the system. Most importantly, they would reinforce the principle that accountability must be grounded in responsibility.

Capulent appreciates FINRA's willingness to engage with these issues and encourages thoughtful consideration of the reforms outlined above. We would welcome the opportunity to participate in further dialogue as FINRA continues this process.

Respectfully submitted,

A handwritten signature in black ink, appearing to read 'David Hsu', with a long horizontal stroke extending to the right.

David Hsu
Chief Compliance Officer
Capulent LLC