



Financial Industry Regulatory Authority

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December 22, 2009

Ms. Elizabeth M. Murphy  
Secretary  
Securities and Exchange Commission  
100 F Street, N.E.  
Washington, DC 20549-1090

**Re: SR-FINRA-2009-060 – Proposed Rule Change to Amend FINRA Rule 8210  
(Provision of Information and Testimony and Inspection and Copying of  
Books) – Response to Comments**

Dear Ms. Murphy:

The Financial Industry Regulatory Authority, Inc. (“FINRA<sup>®</sup>”) hereby responds to comment letters received by the Securities and Exchange Commission (“Commission” or “SEC”) in response to the publication in the Federal Register of Notice of Filing of SR-FINRA-2009-060. The purpose of the proposed rule change is to amend FINRA Rule 8210 (Provision of Information and Testimony and Inspection and Copying of Books) to clarify the scope of the Rule and to clarify certain issues with regard to service of requests made pursuant to the Rule.

### ***Proposed Rule Change***

FINRA Rule 8210 (Provision of Information and Testimony and Inspection and Copying of Books) confers on FINRA staff the authority to compel a member, person associated with a member, or other person over whom FINRA has jurisdiction, to produce documents, provide testimony, or supply written responses or electronic data in connection with an investigation, complaint, examination or adjudicatory proceeding. FINRA Rule 8210(a)(2) currently provides that FINRA staff shall have the right to inspect and copy the books, records and accounts of all applicable members and persons with respect to any matter involved in the investigation, complaint, examination or proceeding. The proposed rule change would clarify that the information must be in the member’s or person’s “possession, custody or control.”<sup>1</sup> The proposed rule change would

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<sup>1</sup> As stated in the rule filing, in using the word “control,” in addition to possession and custody, FINRA intends to require members or persons covered by the rule to

explicitly address the methods by which notice will be deemed received by persons currently or formerly associated with a member in an unregistered capacity. The proposed rule change also would amend FINRA Rule 8210 to explicitly address issues of service on members or persons that are known to be represented by counsel.

### ***Response to Comments***

The Commission received seven comment letters on SR-FINRA-2009-060.<sup>2</sup> Three of the commenters expressed full support for the amendments as proposed.<sup>3</sup> The remaining four commenters expressed concerns regarding some of the proposed amendments regarding the scope of the Rule. In particular, three comment letters expressed concerns with the proposed amendments to paragraph (a)(2) to clarify that information must be in a member's or person's "possession, custody or control."<sup>4</sup> The main issues they raised regarding these proposed amendments concern issues raised in previous litigation of Jay Alan Ochanpaugh, as well as the possibility that the amendments may permit FINRA to improperly obtain documents from third parties without certain procedural or confidentiality protections. As addressed in more detail below, we believe these concerns are unfounded.

### Issues raised in the Ochanpaugh Litigation

The Schwab and SIFMA letters contend that FINRA's rule proposal fails to engage in a full exploration of issues that were described in the Commission's decision in *Jay Alan Ochanpaugh*.<sup>5</sup> FINRA believes that both the premise of this comment and its conclusion are incorrect. Although the Commission's decision discussed both the legal argument that FINRA Rule 8210 (then NASD Rule 8210) did not include the concept of possession and control and the factual argument that FINRA (then NASD) failed to prove that the

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provide, for example, records that they have the legal right, authority, or ability to obtain upon demand. *See Camden Iron & Metal v. Marubeni Am. Corp.*, 138 F.R.D. 438, 441 (D.N.J. 1991) ("Federal courts construe 'control' very broadly under [Federal] Rule [of Civil Procedure] 34.").

<sup>2</sup> *See* comment letters from BTUD, FSI, NPB, Schwab, SIFMA, Wells Fargo and Woodforest. *See Exhibit A* for a list of comment letters received and abbreviations used herein.

<sup>3</sup> *See* comment letters from FSI, NPB and Woodforest.

<sup>4</sup> *See* comment letters from Schwab, SIFMA and Wells Fargo. A fourth commenter, BTUD, expressed concerns that could be construed as based on the scope of the Rule.

<sup>5</sup> *Jay Alan Ochanpaugh*, Securities Exchange Act Release No. 54363, 2006 SEC LEXIS 1926 (Aug. 25, 2006).

applicant had possession and control of the documents, the decision set aside FINRA's action purely on factual grounds.<sup>6</sup>

The Schwab and SIFMA letters are incorrect in implying that FINRA's rule proposal is a continuation of the *Ochanpaugh* litigation. It is not. FINRA seeks to amend Rule 8210 by adding the phrase "possession, custody or control" and, accordingly, is not addressing issues that the Commission raised when the Rule did not contain this language. Nevertheless, FINRA continues to believe that the proposed addition of "possession, custody or control" will resolve many of the questions that have arisen in litigation regarding the scope of the Rule.

The Schwab letter is also incorrect in suggesting that the legal standard for effectively changing FINRA Rule 8210 is mandated by the *Ochanpaugh* decision. To the contrary, the Securities Exchange Act of 1934 provides that the Commission shall approve a proposed rule change of a self-regulatory organization "if it finds that such proposed rule change is consistent with the requirements of this title and the rules and regulations thereunder applicable to such organization."<sup>7</sup> Likewise, SIFMA's request that FINRA undertake further analysis of the consequences of the proposed rule change and publicly report its findings has no basis in Section 19(b)(2). As stated in more detail in its initial filing, FINRA believes that the proposed rule change meets these requirements.

Moreover, attempting to quantify adverse consequences of the proposed rule change, as SIMFA requests, would be a futile task. Focusing, for the moment, on the fact that FINRA Rule 8210 facilitates investigations, the consequences or burdens of any particular request will be factually specific to that investigation. In some instances providing documents may trigger a breakthrough in the investigation. In other instances, the documents could verify a key point and support ending an investigation. The goal of FINRA's investigations is to uncover rule violations, a goal that substantially outweighs concerns that unknown consequences should first be quantified.

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<sup>6</sup> The Commission held that "[b]ecause NASD has not established that Ochanpaugh does possess and control the requested checks, we need not address whether possession and control suffice to make the requested checks 'books, records, and accounts of' Ochanpaugh for purposes of Rule 8210." *Ochanpaugh*, 2006 SEC LEXIS at \*23. While the Commission's decision was skeptical that Rule 8210 should be given the interpretation argued by FINRA, the observations in this portion of the Commission's discussion were not the basis of the decision. *Ochanpaugh*, 2006 SEC LEXIS at \*21-22.

<sup>7</sup> Securities Exchange Act of 1934, Section 19(b)(2).

### Issues Regarding Access to Third-Party Documents and Procedural Protections

FINRA maintains a robust examination program to monitor its members' and associated persons' compliance with, *inter alia*, the federal securities laws and FINRA rules. Some of these rules – for example NASD Rule 3030 (Outside Business Activities of An Associated Person) and NASD Rule 3040 (Private Securities Transactions of An Associated Person) – may apply to the activities of associated persons with non-FINRA members. When investigating potential violations of these rules, for example, FINRA examiners may seek information about whether an associated person conducted securities-related activities outside (or “away” from) the FINRA member with which he or she was associated. These types of investigations can uncover conduct that harms investors and can identify instances in which a FINRA member was unaware of securities-related activities of its associated person that it should have been supervising. Due to the important investor protection goal of these types of rules, FINRA does not limit its investigations simply because information about third parties may come to light. Further, FINRA does not limit its use of FINRA Rule 8210 or other investigative techniques in these types of investigations.

Schwab, SIFMA and Wells Fargo nevertheless express concerns that the rule, as amended, would appear to permit FINRA to compel members or associated persons to produce documents that may “belong” to a third party. This concern falsely assumes that FINRA’s investigations into the conduct of FINRA members and associated persons are strictly limited in scope to the FINRA members and associated persons under investigation. In fact, although FINRA has jurisdiction to file an action against its members and associated persons (and those otherwise subject to its jurisdiction), its investigations can involve non-FINRA members, including customers, issuers, or foreign businesses. As a result, FINRA believes that third party documents within the “possession, custody, and control” of the FINRA member or associated person that relate to the investigation should be produced pursuant to FINRA Rule 8210 and concerns solely limited to their status as third party documents should not prevent the Commission from approving the proposed rule change.

Four commenters raise concerns that the amended language may “undermine” the rights that parties have in ordinary civil or criminal proceedings.<sup>8</sup> BTUD suggests additional procedural rules akin to the Federal Rules of Civil Procedure are warranted. This comment appears to echo concerns raised by Schwab, SIFMA and Wells Fargo that parties should have rights in the investigatory process. FINRA believes this analysis relies on a misplaced analogy regarding FINRA’s relationship with its members and other persons over whom it has jurisdiction.

Schwab is partially accurate when it notes that FINRA’s authority to request documents rests on the contractual relationship between member firms (and associated persons) and

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<sup>8</sup> See comment letters from BTUD, Schwab, SIFMA and Wells Fargo.

FINRA. FINRA's authority also is based on its rules applying to all members and their associated persons. In light of these relationships, FINRA's investigations are based on a model of implied cooperation as opposed to the adversarial system that is governed by the Federal Rules of Civil Procedure. The Federal Rules – and the rules that define discovery – are interpreted and applied to the adverse parties by a judge. In marked contrast, FINRA's members and persons over whom it has jurisdiction have already agreed, explicitly or implicitly, to supply FINRA with information during its investigations. As the Commission has recognized, "it is critically important to the self-regulatory system that members and their associated persons cooperate with [FINRA] investigations".<sup>9</sup> Once an investigation has matured into the filing of a complaint, however, FINRA's Code of Procedure affords a respondent several procedural rights. FINRA's investigatory process should not be fundamentally altered as a result of the proposed rule change. Similarly, FINRA believes that this analysis also discredits Schwab's assertion that records "owned" by a third party should be subject to additional confidentiality requirements. As a result, FINRA believes that the proposed rule change should be approved under the current structure.

Contrary to these commenters' assertions, the wide scope of FINRA Rule 8210 comes not from the proposed rule change, but from the remainder of the Rule. Currently, the Rule provides that FINRA staff shall have the right to inspect and copy books, records and accounts of members, associated persons and others subject to FINRA's jurisdiction "with respect to any matter involved in the investigation, complaint, examination or proceeding." Because the current Rule is purposefully designed to cover a broad range of activities, concerns about limiting the scope of the Rule are misplaced.

Additionally, FINRA does not find merit in the suggestion by Schwab, SIFMA and Wells Fargo that adopting the "possession, custody or control" language would chill the likelihood of associated persons participating in non-profit entities due to fear by those entities that their documents would be disclosed during FINRA investigations. This concern is unsupported by any example or other data to validate its hypothesis. In as much as board members of nonprofit organizations often are employed in a for-profit industry, we see no greater likelihood that a nonprofit corporation's confidential information would be disclosed because they have associated persons as board members than if their board members are not associated with the securities industry.

#### ***Matters Significantly Beyond the Scope of the Proposed Rule Change***

One commenter expressed concerns regarding access by a witness to a written transcript of testimony, which addresses a practice that FINRA has not proposed to change.<sup>10</sup>

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<sup>9</sup> *Morton Bruce Erenstein*, Securities Exchange Act Release No. 56768, 2007 SEC LEXIS 2596, \*31 (Nov. 8, 2007).

<sup>10</sup> See comment letter from BTUD.

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Because this matter reaches beyond the scope of FINRA's proposed rule change, it is not addressed herein.

FINRA believes that the foregoing fully responds to the issues raised by the commenters to the rule filing. Please feel free to contact me at (202) 728-8056 if you have any questions.

Very truly yours,

A handwritten signature in black ink, appearing to read "Stan Macel". The signature is written in a cursive style with a large initial "S" and "M".

Stan Macel  
Assistant General Counsel

## **Comments on FINRA Rulemaking**

### **Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of Proposed Rule Change Relating to FINRA Rule 8210 (Provision of Information and Testimony and Inspection and Copying of Books)**

**(Release No. 34-60836; File No. SR-FINRA-2009-060)**

#### **Total Number of Comment Letters Received – 7**

1. Dale E. Brown, President & CEO, Financial Services Institute, Inc., dated November 4, 2009 (“FSI”)
2. BTUD, dated October 29, 2009 (“BTUD”)
3. Frederick T. Greene, CIMA, Senior V.P., Portfolio Manager, Woodforest Financial Services, Inc., dated October 29, 2009 (“Woodforest”)
4. Ira D. Hammerman, Senior Managing Director and General Counsel, Securities Industry and Financial Markets Association, dated December 16, 2009 (“SIFMA”)
5. Bari Havlik, Chief Compliance officer, Senior Vice President, Charles Schwab & Co., Inc., dated November 12, 2009 (“Schwab”)
6. Ronald C. Long, Director, Regulatory Affairs, Wells Fargo Advisors, dated November 12, 2009 (“Wells Fargo”)
7. Neal E. Nakagiri, President, CEO, CCO, NPB Financial Group, LLC, dated October 29, 2009 (“NPB”)