BEFORE THE
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC

In the Matter of the Application of

Southeast Investments, N.C., Inc. and Frank Harmon Black

For Review of

FINRA Disciplinary Action

File No. 3-19185

FINRA'S OPPOSITION TO APPLICANTS' MOTION TO ADDUCE ADDITIONAL EVIDENCE

Southeast Investments, N.C., Inc. (the "Firm" or "SEI") and Frank Black (together "Applicants"), request that, in connection with this appeal, the Commission admit frequently asked questions ("FAQs") related to FINRA's supervision rules posted on FINRA's website. The several sentences in the FAQs that Applicants argue are relevant to their supervisory violations are not material to the outcome of this appeal. The Commission should therefore deny Applicants' motion to adduce additional evidence and decline to admit the FAQs.

Rule 452 of the Commission's Rules of Practice states, among other things, that the "Commission may accept or hear additional evidence . . . as appropriate." 17 C.F.R. § 201.452. A motion under Rule 452 must "show with particularity that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence previously." *Id.* The moving party carries the burden to meet each of the requirements under Rule 452. *See, e.g., Robert D. Tucker*, Exchange Act Release No. 68210, 2012 SEC LEXIS 3496, at *58 (Nov. 9, 2012) ("Tucker failed to satisfy either of these requirements and we therefore decline to admit them."); *John Edward Mullins*, Exchange Act Release No. 66373, 2012 SEC LEXIS 464, at *56 n.60 (Feb. 10, 2012).

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The Commission should not admit the undated FAQs, as Applicants have not demonstrated that they have met the requirements to adduce additional evidence under Commission Rule of Practice 452. In May 2019, FINRA's National Adjudicatory Council ("NAC") found that, among other things, Black (and through his actions, the Firm) testified falsely to FINRA and fabricated documents concerning office inspections. (RP 4294-99.) The NAC also found that Applicants failed to establish and maintain a reasonable supervisory system, and failed to enforce reasonably designed written supervisory procedures, to ensure the retention and review of business-related emails because they permitted the Firm's registered representatives to use personal email accounts to conduct Firm business and simply required them to copy or forward all business-related emails to the Firm's home office. (RP 4307-11.) The Firm thus depended on an "honor system" for retaining and reviewing business-related emails. The NAC found that this honor system was wholly inadequate for the Firm based upon its business and Applicants used this system despite separate warnings—contained in examination reports—from both Commission and FINRA staffs concerning the adequacy of their email supervisory system.

Applicants now seek to admit the FAQs to undermine the NAC's findings and sanctions concerning Applicants' serious supervisory violations and the two prior warnings that the Firm's honor system was inadequate. Specifically, they point to several sentences contained in the FAQs that discuss the obligation of financial and operation principals ("FINOPs") to conduct on-site visits. The FAQs state that previous guidance issued by FINRA in a 2006 notice to members (which provided that FINOPs working part-time or offsite should conduct a minimum number of onsite visits per year) should not be viewed as "requirements" if the FINOP can fulfill his or her obligations through other means. Applicants posit that this statement in the FAQs shows that "informal" FINRA guidance does not constitute a requirement that firms must follow. From this,

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they assert that they should not be punished for failing to heed the prior warnings from their regulators concerning the Firm's email retention system and the NAC put undo weight on these warnings because at least one of the warnings was allegedly based on a FINRA press release (which, according to Applicants, constitutes informal guidance).[1]

The Commission should reject Applicants' convoluted arguments and find that the FAQs are not material to the issues in this appeal. Rule 452 requires a distinctive demonstration that the additional evidence Applicants seek to admit will "materially affect the outcome of the proceedings." *See Richard A. Holman*, 40 S.E.C. 870, 874 (1961). The FAQs will not materially affect the outcome of Applicants' appeal.

First, the statement in the FAQs concerning a FINOP's responsibility to conduct onsite visits is irrelevant to the issue here—whether Applicants' honor system for email retention was adequate for the Firm and its business under FINRA's rules. FINRA's rules required the Firm to establish and maintain a system to supervise the activities of its registered personnel and associated persons that was reasonably designed to achieve compliance with applicable securities laws and regulations. *See* FINRA Rule 3110.

Nothing in the FAQs impacts the NAC's conclusion that the Firm's honor system for the retention of email was unreasonable and in violation of FINRA Rule 3110 (and its predecessor, NASD Rule 3010). Indeed, the NAC concluded that

> The unreasonableness of SEI's reliance solely on its "honor system" is obvious. For most of the relevant period, SEI permitted its numerous independent-contractor representatives, who were located throughout the United States, to use their own private email accounts to conduct business for SEI. Given that, and that most of SEI's independent contractor representatives typically worked alone in

[1] The FINRA press release cited by Commission staff in its examination report stated that although FINRA's rules afford firms flexibility to tailor supervisory procedures for their particular business, all firms must be able to flag emails that may evidence misconduct and that "[r]elying on brokers to provide copies of their own emails to supervisors for review is hardly an effective means to detect such misconduct." (RP 1858.)

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> their offices, SEI's system of supervising and retaining emails—which Black was primarily responsible for establishing and maintaining—was clearly vulnerable to SEI representatives simply not copying or forwarding their emails to the home office, whether due to oversight or bad faith. SEI's honor system also presented the risk that access to SEI representatives' emails might be lost before they forwarded or copied their emails to the home office, as a result of loss of access to email accounts with third parties. Making the system even worse, SEI lacked strong supervisory controls over its honor system for email retention.

(RP 4309.) Further, the NAC found that emails for at least one registered representative were not maintained because he did not copy the Firm or forward to it emails from his personal account. (RP 4312-16.) The FAQs are irrelevant to the NAC's conclusion, independent of any prior warnings from Commission or FINRA staff, that the Firm's email retention was unreasonable in light of its business.

Second, the FAQs do not stand for the proposition that Applicants cite them for. The FAQs simply provide that a statement concerning on-site FINOP visits contained in a notice to members from 2006 need not be followed if the FINOP can fulfill his or her duties through other means. That does not support Applicants' broad and unsupported argument that the FAQs show that they can ignore—without any repercussions—any and all pertinent guidance issued by regulators.[2]

Third, even assuming, arguendo, that the FAQs demonstrate that Applicants are free to ignore informal guidance without any consequences, the warnings issued by Commission and FINRA staffs in 2012 and 2014, respectively, are not akin to informal guidance contained in a broadly applicable press release. Indeed, although the warning issued by Commission staff in 2012 may have discussed a FINRA press release, the warning was contained in an examination report whereby Commission staff

[2] Unlike the FAQs with respect to the 2006 notice to members, Applicants do not point to any guidance subsequent to FINRA's press release that altered or changed the press release's statement that permitting brokers to provide copies of their own emails for review was not an effective way to detect broker misconduct.

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independently identified, as a deficiency and weakness for immediate corrective action, that the Firm's honor system was not a reasonable supervisory system to retain emails under FINRA's rules. (RP 1858.) FINRA issued Applicants a similar warning in 2014 in an examination report, without mentioning the press release. (RP 2469.) FINRA staff noted that the Firm failed to implement an adequate supervisory system for capturing and preserving emails, cited to NASD Rule 3010 and SEC Rule 17a-4, explained why the Firm's supervisory procedures did not comply with these provisions, and noted specific examples where the Firm's honor system failed to capture emails. (*Id.*)

Notwithstanding Applicants' attempt to downplay the significance of these examination reports, the warnings contained therein expressed Commission and FINRA staffs' beliefs that the Firm's email retention system did not comply with supervisory rules and regulations. These warnings thus put Applicants on notice that Commission and FINRA staff viewed the Firm's email retention system as problematic and not in compliance with their supervisory obligations. From this, the NAC reasonably concluded that Applicants were on notice that the Firm's honor system was inadequate after it reached the same conclusion and it was troublesome that Applicants did not rectify this identified deficiency until just prior to the filing of the complaint in this matter. The statements in the FAQs do not alter these facts or findings. Nor do the FAQs show that the NAC erred by using these warnings against Applicants when it imposed sanctions against them for their supervisory failures.[3]

[3] FINRA's Sanction Guidelines, which the NAC relied upon when it sanctioned Applicants, expressly provide that in assessing sanctions, an adjudicator may consider whether the respondent engaged in misconduct notwithstanding prior a warning from a regulator that the conduct violated applicable securities regulations and rules. *See* RP 4320 (citing Principal Considerations in Determining Sanctions, No. 14).

* * *

Applicants have failed to meet their burden under Rule 452. The Commission should therefore deny Applicants' motion to adduce additional evidence and decline to admit the FAQs into the record for this appeal.

Respectfully Submitted,

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CERTIFICATE OF COMPLIANCE

I, Andrew Love, certify that this brief complies with the Commission's Rules of Practice by filing a brief in opposition that omits or redacts any sensitive personal information described in Rule of Practice 151(e).

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CERTIFICATE OF SERVICE

I, Andrew Love, certify that on this 11th day of August 2021, I caused a copy of the foregoing Opposition to Applicants' Motion to Adduce Additional Evidence, Administrative Proceeding File No. 3-19185, to be filed through the SEC's eFAP system and to be served by electronic mail on:

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