

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-65281; File No. SR-FINRA-2011-031)

September 7, 2011

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Order Granting Approval of Proposed Rule Change to Amend FINRA Rule 9251 to Explicitly Protect from Discovery those Documents that Federal Law Prohibits FINRA from Disclosing

I. Introduction

On July 8, 2011, the Financial Industry Regulatory Authority, Inc. (“FINRA”) filed with the Securities and Exchange Commission (“SEC” or “Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² a proposed rule change to amend FINRA Rule 9251 to explicitly protect from discovery those documents that federal law prohibits FINRA from disclosing. The proposed rule change was published for comment in the Federal Register on July 26, 2011.³ The Commission received two comment letters on the proposed rule change.⁴ This order approves the proposed rule change.

II. Description of the Proposal

FINRA Rule 9251 delineates the types of documents that FINRA’s Department of Enforcement (“Enforcement”) and Department of Market Regulation (“Market Regulation”) must produce to respondents during the discovery phase of a disciplinary proceeding. The rule also explicitly shields certain types of documents from production. For example, the rule

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 64934 (July 20, 2011), 76 FR 44645 (July 26, 2011) (“Notice”).

⁴ See letter from Neal E. Nakagiri, President, Chief Executive Officer and Chief Compliance Officer, NPB Financial Group, LLC, dated July 27, 2011 (“NPB Letter”); letter from Joyce Dillard, dated August 16, 2011.

provides that Enforcement and Market Regulation may withhold documents that are protected by attorney-client privilege or constitute attorney work product.⁵ The rule also allows documents to be withheld where a hearing officer determines that they are irrelevant to the proceeding or for other good cause.⁶ The rule does not, however, explicitly shield from discovery documents that federal law prohibits FINRA from disclosing.

The rule contains procedural safeguards to protect against inappropriate withholding of documents by Enforcement and Market Regulation. Specifically, the rule provides that the hearing officer may require Enforcement or Market Regulation to submit to the hearing officer either a list of withheld documents or any document withheld so that the hearing officer may privately review it to determine the appropriate status of a withheld document.⁷ Upon review, the hearing officer may order Enforcement or Market Regulation to make the list or document withheld available to other parties.⁸ Moreover, the rule prohibits Enforcement or Market Regulation from withholding a document, or part thereof, that contains material exculpatory evidence.⁹

FINRA's proposal would amend FINRA Rule 9251 to explicitly protect from discovery documents that are prohibited from disclosure pursuant to federal law. Currently, when Enforcement and Market Regulation possess a document that federal law prohibits them from disclosing, they must affirmatively seek a hearing officer determination that they can withhold it

⁵ FINRA Rule 9251(b)(1)(A).

⁶ FINRA Rule 9251(b)(1)(D).

⁷ See FINRA Rule 9251(c).

⁸ Id.

⁹ FINRA Rule 9251(b)(2).

on the grounds of lack of relevancy or for other good cause.¹⁰ The proposed rule change will eliminate the need for such a hearing officer determination by adding a new provision that expressly provides that Market Regulation or Enforcement shall withhold a document from production if disclosure is prohibited by federal law.

Certain of the rule's procedural safeguards discussed above would apply to documents withheld pursuant to this new provision. As discussed above, a hearing officer may review any documents withheld pursuant to this new provision, and may order Enforcement or Market Regulation to make the list of withheld documents or the documents withheld available to other parties. However, the proposed rule change precludes a hearing officer from requiring Enforcement or Market Regulation to make the list of documents withheld or any document withheld available to other parties if federal law prohibits disclosure of the document or the document's existence. Moreover, the rule's prohibition on withholding documents, or parts thereof, that contain exculpatory evidence does not apply to documents prohibited from disclosure by federal law.

FINRA stated that the proposed rule change will be effective 30 days following publication of the Regulatory Notice announcing Commission approval.

III. Summary of Comment Letters

Both commenters questioned the fairness of the proposed rule change, and noted concerns about the opportunities afforded to those charged in a FINRA disciplinary proceeding.¹¹ In particular, one commenter stated that if the present system results in "testing" the federal laws that may prevent disclosure of certain documents, then the current system should

¹⁰ See FINRA Rule 9251(b)(1)(D).

¹¹ See supra, note 4.

continue as is.¹² The commenter was particularly concerned about the ability of Market Regulation or Enforcement to withhold documents that contain exculpatory evidence.¹³ While the commenter appreciated FINRA’s desire to streamline the disciplinary process, the commenter believed that given the stakes involved, “every opportunity and effort” should be afforded to those charged in a disciplinary proceeding.¹⁴

IV. Discussion and Commission’s Findings

The Commission has carefully reviewed the proposed rule change and the comments received, and finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities association.¹⁵ In particular, the Commission finds that the proposed rule change is consistent with Section 15A(b)(6) of the Act,¹⁶ which requires, among other things, that FINRA rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. The Commission also believes that the proposal is consistent with Section 15A(b)(8) of the Act,¹⁷ which requires that the rules of the association provide a fair procedure for the disciplining of members and associated persons.

¹² NPB Letter.

¹³ Id.

¹⁴ Id.

¹⁵ In approving this proposed rule change, the Commission has considered the rule’s impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

¹⁶ 15 U.S.C. 78o–3(b)(6).

¹⁷ 15 U.S.C. 78o–3(b)(8).

More specifically, the Commission believes that clarifying that Market Regulation and Enforcement shall withhold documents prohibited from disclosure by federal law both promotes a fair and efficient disciplinary process and helps ensure compliance with federal law by avoiding the need for unnecessary “good cause” motions regarding documents that federal law prohibits FINRA from producing during a disciplinary proceeding.

The Commission also believes that the proposed rule change is subject to adequate procedural safeguards to protect against inappropriate use by FINRA and that address the commenters’ concerns. Specifically, a hearing officer may review and determine whether a document was appropriately withheld by Market Regulation or Enforcement as prohibited from disclosure by federal law. If the hearing officer determines that the document is not prohibited from disclosure by federal law, the hearing officer may order the document be made available to the other parties.

While the Commission appreciates the commenter’s concern about FINRA withholding exculpatory evidence, the proposed rule would not change current practice, as FINRA currently cannot legally disclose a document—even if the document contains exculpatory evidence—if federal law prohibits disclosure of the document in that instance. Moreover, the Commission believes that as part of determining whether FINRA appropriately withheld a document, the hearing officer would need to review the applicable federal law to assess whether the document at issue is, in fact, prohibited from disclosure.

For the reasons stated above, the Commission finds that the rule change is consistent with the Act and the rules and regulations thereunder.

V. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,¹⁸ that the proposed rule change (SR-FINRA-2011-031) be, and it hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.¹⁹

Elizabeth M. Murphy
Secretary

¹⁸ 15 U.S.C. 78s(b)(2).

¹⁹ 17 CFR 200.30-3(a)(12).