Mark Quinn
Director of Regulatory Affairs

Via Electronic Mail – pubcom@finra.org

September 24, 2018

Ms. Jennifer Piorko Mitchell
Office of the Corporate Secretary
The Financial Industry Regulatory Authority, Inc.
1735 K Street, NW
Washington, DC 20006-1506

Re: Regulatory Notice 18-22 – Request for Comment on Proposed Amendments to the FINRA Dispute Resolution Discovery Guide

Dear Ms. Mitchell:

Please allow this to serve as the comments of Cetera Financial Group ("CFG") with respect to Regulatory Notice 18-22 ("Notice 18-22"), which was published on July 26, 2018. CFG is the corporate parent of six FINRA member firms: Cetera Advisor Networks, LLC, Cetera Advisors, LLC, Cetera Investment Services, LLC, Cetera Financial Specialists, LLC, First Allied Securities, Inc., and Summit Brokerage Services, Inc. Collectively, the CFG broker-dealers have more than 8,000 registered representatives and serve more than 1 million clients. They are often parties to FINRA arbitration claims filed by customers, and the changes proposed in Notice 18-22 would have a substantial effect on them. We write today to offer our views regarding what can be expected if the changes described in Notice 18-22 are adopted, as well as negative effects that they may produce on both respondents in FINRA arbitrations and upon the arbitration process itself.

Background

Notice 18-22 describes proposed amendments to the rules of FINRA Dispute Resolution, Inc. regarding information to be produced in arbitration cases filed by customers against FINRA member firms and associated persons. In particular, the amendments would provide that information regarding certain types of insurance coverage maintained by the member firm or associated person should be produced to the claimant as a standard practice and without a specific request. Under the current guidelines, information regarding insurance coverage is presumptively not available to claimants. If it is requested by a customer claimant and the member or associated person elects not to produce this information, the claimant may make a motion to the arbitrators to require production. At present, there is relatively little guidance for arbitrators regarding whether and under what circumstances information about insurance coverage should be produced, and the changes described in Notice 18-22 would call on FINRA to supplement such guidance for arbitrators ruling on such requests.

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Summary of Our Comments

Our views on the matters described in Notice 18-22 are as follows:

- The Discovery Guide should not be amended to make information regarding insurance presumptively available to claimants in FINRA arbitration proceedings. Any benefits that this would produce for claimants are more than outweighed by detriments to respondents and to the dispute resolution process in general. The proposed amendments would create a number of negative and unintended consequences, as set forth in more detail below.

- There are limited circumstances in which disclosure of insurance coverage would be appropriate in FINRA arbitration proceedings. The Discovery Guide does not currently include sufficient guidance for arbitrators with respect to requests from parties for information regarding insurance coverage. As such, we endorse the proposal to provide additional training or guidance to arbitrators in connection with this issue.

- Any party to a FINRA arbitration proceeding that makes a request for information regarding insurance coverage should be required to establish that there is a good faith basis to believe that the party from whom it is requested, (the firm or associated person) does not have sufficient assets to satisfy an award in the event that one is rendered.

Comments on Proposed Revisions to the Discovery Guide

Notice 18-22 sets forth two primary reasons why information regarding insurance coverage should be made available to claimants as part of the standard pre-hearing process: That such information is generally discoverable in state and federal court proceedings, and that having access to it may assist claimants in negotiating settlements of pending claims. Both of these may be true, but they do not justify the proposed changes, for reasons including the following:

1. While FINRA arbitration proceedings are in some ways similar to litigation conducted in courts, there are a number of substantive differences in the two systems, such as:

    a. The Code of Arbitration Procedure specifically provides that the rules of evidence do not apply;

    b. There are no specific standards regarding what facts or legal basis must be pled in order to seek relief; and

    c. Because the arbitrators decide questions of both fact and law, there is no effective opportunity to prevent panel members from becoming aware of facts that would not ordinarily be revealed to jurors in a court proceeding.

    The fact that information regarding insurance coverage is obtainable under the law of most states is not a sufficient basis to make it presumptively available in FINRA arbitration proceedings.

2. Having access to information regarding insurance coverage that may be available to satisfy an award may be valuable to a claimant and assist them in negotiating a settlement of a contested matter. The ability of a respondent to pay an award or judgment is certainly a fact that would be relevant in determining whether or not to settle a case and for how much. However, the primary reason why the existence of insurance is not disclosed to jurors in court proceedings is that it tends to make them more likely to find in favor of the claimant or make a larger award in their favor, because the jurors do not believe that the respondent will be forced to pay the award themselves. A corollary of this is that if insurance coverage exists and that fact is known to the claimant, they will become more aggressive in negotiating settlements. This will tend to make respondents less likely to obtain insurance coverage, because they know that it could increase their cost of resolving claims, both individually and in the aggregate. A higher aggregate cost of resolving cases will also tend to increase the cost of such insurance coverage and make firms less likely to obtain it.

   Claimants have an interest in making sure that arbitration awards in their favor will be paid. It is therefore in their interest that respondents have as many resources as possible available to them to satisfy those awards, including liability insurance. However, if FINRA members believe that obtaining such insurance will increase the ultimate cost of resolution of claims against them, they will be less likely to obtain it. This would have the unintended effect of decreasing the resources available to claimants to satisfy awards, which is not in the interest of anyone.

3. Professional liability insurance of the type that would cover claims against FINRA member firms and associated persons often contains a number of exclusions and limitations. Common provisions exclude coverage for fraudulent acts and punitive damages. Giving claimants access to information regarding liability insurance that may be available to cover claims will lead to a number of negative consequences, including the following:

   - Claimants are likely to formulate and plead their claims in ways that make them more likely to be covered by the applicable insurance. This "gaming" of the system will lead claimants and their representatives to focus on selected facts or actions rather than presenting the entire scenario for consideration by the arbitrators. This may be in the interest of claimants, but it does not serve the interest of the arbitration process in seeking a full and fair hearing on the merits of the case.

   - FINRA member firms have obligations to supervise the activities of their associated persons under both FINRA rules and state and federal securities laws. FINRA members often become aware of alleged improper actions by associated persons through arbitration claims that are filed against them. In order to effectively supervise the activities of associated persons, member firms need as much information regarding alleged improper actions by representatives as they can get. If claimants believe that they are more likely to reach a favorable settlement of a claim where insurance coverage is available, they may elect to

state claims that would be covered by liability insurance and omit those that are not. In this circumstance, they would be more likely to state claims based on negligence or inadvertent breaches than claims based on fraud or other deliberate conduct. This eliminates an important source of information for both member firms and regulatory agencies in monitoring the conduct of investment professionals. Rather than promoting transparency, it would inhibit it.

4. Settlement of contested matters is an important goal of any dispute resolution system, and FINRA arbitration is an important mechanism in resolution of disputes between member firms and customers. However, given that arbitrators decide questions of both fact and law, the procedural safeguards that exist in state or federal court proceedings do not exist in FINRA arbitration. State and Federal Rules of Evidence generally have strict limitations on the circumstances under which jurors may be told about the existence of liability insurance. As discussed above, this arises out of the recognition that jurors having knowledge of liability insurance are more likely to find in favor of claimants. The proposed amendments to the Discovery Guide include a mechanism to control introduction of evidence regarding the existence of insurance coverage, but they do not go far enough to prevent the underlying problem. If the claimant is aware of the existence of insurance, they have a direct incentive to find ways to work that information into the proceeding. It is not possible to "unring" the bell. This proposed change is well-intentioned, but will lead inevitably to unintended consequences.

5. Most claimants in FINRA arbitration proceedings are represented by counsel. Many of these attorneys concentrate their practice on representation of claimants in arbitration maters against FINRA members and associated persons. Over the course of time, it is a virtual certainty that these claimant's counsel will represent multiple parties in claims against the same member firms. If information regarding insurance coverage maintained by member firms becomes automatically available to claimants, and by extension, to their counsel, information about which member firms have insurance coverage and its terms will quickly become widely dispersed. This will have corrosive effects on the integrity of the FINRA dispute resolution system for all of the reasons discussed herein and will tend to diminish confidence in it over time.

6. As we have noted above, there are circumstances under which disclosure of information regarding insurance coverage would be appropriate. These include cases in which the claimant can make a good faith showing that the existence of insurance bears a factual nexus to the claims that they have submitted. For example, if a claimant can truthfully allege that they were aware of the existence of insurance coverage at the time they established an account with the member firm and that it was a substantial factor in their decision to establish an account, this would establish an independent basis for production of the information to the claimant and its admissibility in the proceeding. Lacking that factual nexus, the relevance of such information to claimants is far outweighed by the prejudicial effect on respondents.

7. At present, the Discovery Guide provides relatively little direction to arbitrators regarding whether and when evidence about liability insurance should be produced and/or admitted into evidence in the proceeding. We applaud the efforts of FINRA Dispute Resolution to create additional clarity, and suggest the follow framework for consideration of this issue by arbitrators:

    a. If a party in a FINRA arbitration seeks production of information relating to liability insurance coverage maintained by a respondent, the requesting party should be required to either plead a factual nexus to the underlying dispute, such as the example noted above, or to state a good faith belief that the respondent does not have sufficient assets to satisfy an award if it is rendered in their case. The facts regarding the financial capability of the respondent should be specific enough to allow the arbitrators to determine if legitimate concern exists regarding the financial status of the respondent to render that information directly relevant. For example, if a claimant states a claim for $100,000 of damages, they should be required to make a showing that the member firm does not have assets sufficient to satisfy an award in that amount. Requests for production of information regarding insurance should not be allowed to simply state a claim for a large amount coupled with a conclusion that the firm could not satisfy it. Absent this threshold requirement, requests for disclosure of insurance information will become routine, and calculated primarily to place undue burdens on respondents and create an artificial advantage for claimants in negotiating settlements.

    b. If the arbitrators decide to require production of information regarding insurance coverage, the panel should also require all parties and their counsel to execute an appropriate confidentiality or non-disclosure agreement which prevents them from disclosing the existence or terms of the insurance arrangement to anyone who is not a party to the pending case.

The FINRA arbitration process was established to facilitate the prompt and fair resolution of disputes among member firms, associated persons, and customers. In order to be effective, it must take into account the reasonable needs and expectations of all parties and effect a workable balance of their respective interests. The proposed amendments to the Discovery Guide are well-intentioned, and may promote resolution of contested matters, but while reaching negotiated resolution of claims is a laudable and important goal, tilting the floor in the direction of either claimants or respondents is not the way to accomplish it. FINRA should develop additional guidance for arbitrators in deciding whether or not to require production of information about liability insurance, but should not make the proposed changes to the Discovery Guide that would effectively make it mandatory.

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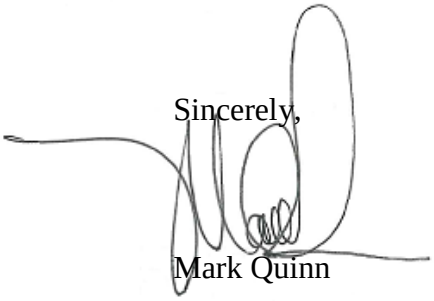
Thank you for this opportunity to comment on the proposed rule changes. If you have questions or if we may provide further information, please feel free to contact me 619/702-9735, or via e-mail at mark.quinn@cetera.com.

Sincerely,



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