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Via Electronic Mail

September 24, 2018

Ms. Jennifer Piorko Mitchell
Office of the Corporate Secretary
FINRA 1735 K Street,
NW Washington, DC 20006-1506
pubcom@finra.org

Re: Comment regarding FINRA regulatory notice 18-22,
Production of Insurance Information in Arbitration

Dear Ms. Piorko Mitchell:

McCormick & O'Brien LLP submits this letter on behalf of our small and midsize broker dealer clients to the Financial Industry Regulatory Authority, Inc. ("FINRA") in response to FINRA's request for comment on proposed Amendments to its Discovery Guide to Require Production of Insurance Information in Arbitration. The Firm appreciates the opportunity to provide FINRA with insights whenever it undertakes a review of the arbitration process. As an overall observation, the Firm notes that the proposal appears inconsistent with FINRA's stated and historical role as an independent and impartial facilitator of industry disputes. The Firm further notes that the proposal will disproportionately impact small and mid-size firms, which were under represented on the Arbitration Committee that considered this proposal and which continue to be underrepresented through the NAMC.

For these and such other reasons discussed further herein, the Firm objects to the proposal on behalf of our small and mid-size broker dealer clients and hopes that this letter will initiate a review of the FINRA arbitration committee process as a whole. The Firm believes that a series of in-depth, follow-up discussions with FINRA are vital in order to provide FINRA with a more complete understanding of the burden that various arbitration rules have placed on firms and their representatives that utilize the FINRA Dispute Resolution Forum.

1. The Proposal Runs Counter To FINRA's role as a Neutral Forum Administrator

As stated in *Discussion Paper— FINRA Perspectives on Customer Recovery*, "FINRA's primary role in the arbitration process is to administer cases brought to the forum in a **neutral**, efficient, and fair manner."¹ [Emphasis Added]. A cursory review of FINRA's Request for Comment indicates that the primary purpose of the proposal is to materially benefit claimants and their counsel. In so doing, FINRA fails to act as a neutral forum administrator.

¹ See page 3.

Rather, FINRA acts in the capacity of an advocate for claimants by requiring documents and information on insurance policies which may have been obtained for a variety of business reasons but for which there is no regulatory requirement. We point to the following rationale provided by FINRA in its' Request for Comment 18-22 (July 26, 2018) which highlights the intended purpose of the rule proposal:

- FINRA'S Dispute Resolution Task Force (Task Force) reviewed the Guide and concluded that insurance information would be **beneficial to customers** in arbitration proceedings". (Emphasis Added)[See 18-22 page 2].
- These **customer representatives** believe that having knowledge of possible insurance, if any, would make them **better able to advise their clients and determine a litigation strategy**. (Emphasis Added)[See 18-22 page 2].
- Insurance information describing the policies of firms and associated persons can **benefit customers to determine a litigation strategy**". [Emphasis added].(See 18-22 page4].
- The **benefits** of the proposed amendments **accrue primarily to claimants** in arbitration cases. (See 18-22 page 5].
- Insurance information can **provide valuable information to a claimant** when determining a litigation strategy.
- The discovery of insurance information, therefore, could **increase the ability of customers to determine a litigation strategy to maximize the monetary compensation** they could expect to receive.

The role of a neutral administrator does not lend itself to advocating for policies or processes the primary purpose of which is to assist or benefit one party over another. At the present time, the process is neutral as regards insurance information – a party may request the information and the opposing party may object. A neutral arbitrator ultimately decides whether the information has probative value to the merits of the case – not its strategical value to a party. Mandating a practice or procedure which is known to and acknowledged from the outset to primarily benefit one party over another irreparably damages FINRA's position that it is a neutral administrator. As FINRA identifies in the Arbitrator Reference Guide (page 14):

In some ways, arbitrators have greater power than a judge (e.g., except for limited reasons, arbitration awards cannot be overturned). Therefore, **it is particularly important in arbitration that the forum be fair and be perceived to be fair.**

2. The Stated "Regulatory Need" does not identify a "Regulatory Need"

Error and Omission Insurance (E&O) may be a prudent business practice but it is not a regulatory requirement for member firms or associated members. The Wall Street Journal reported in October 2013 that FINRA was examining whether or not the regulator should require member broker dealers to secure E&O. FINRA's then executive vice president of regulatory operations - Susan Axelrod- indicated at that time that the focus would be to "reduce the level of unpaid awards". Seemingly after due consideration, a regulatory rule was not proposed. Further,

the level of unpaid awards has steadily declined since 2012². In fact, FINRA reports that “most unpaid customer arbitration awards are against firms or individuals whose FINRA registration has been terminated, suspended, canceled or revoked or who have been expelled by FINRA³” and “these firms and individuals are generally referred to as ‘inactive’ and are no longer FINRA members or associated with a FINRA member...”.

The “inactive members” that FINRA reports drive the majority (if not totality) of unpaid awards are not subject to FINRA and are not bound by FINRA’s regulations. FINRA’s previous scrutiny on this matter and decision not to act, coupled with the declining levels of unpaid awards and the fact that such awards relate to inactive members reflects that the regulatory need, if any, is deminimis. Consequently, any argument that disclosure of information regarding insurance – a non-required (and hence non-essential) third-party arrangement will fulfill a “regulatory need” is faulty. Moreover, as stated in the December 2015 FINRA Dispute Resolution Task Force Report:

In 2014, FINRA considered imposing an insurance requirement for payment of awards, but decided against it. A FINRA spokesperson stated that it had researched the issue and found that the cost would be “prohibitively high.” The task force discussed whether to recommend reconsideration of an insurance requirement for payment of awards, but reached no consensus.(page 51)

As there is no regulatory requirement for a member firm and/or representative to purchase and maintain such insurance coverage and there is no regulatory oversight of such coverage, there cannot exist a “regulatory need” which the current proposal satisfies.

3. The Proposal Seeks to Introduce Documents Which Have no Relevance to the Merits of the Case

The FINRA Discovery List has generally served its intended purpose of providing a framework for the exchange of documents which arguably hold probative value or relevancy to the merits of the case. In fact, the Discovery Guide speaks specifically to the “relevancy” of the documents sought to the claims asserted when providing guidance to arbitrators when disputes arise. Insurance arrangements or the lack thereof however have no direct relationship to the claims asserted. Rather, they relate to subsequent collectability, a secondary component of all litigation – regardless of whether the forum is FINRA arbitration or the underlying dispute is adjudicated in court. Collectability issues are handled by and through state and federal courts and that recourse is available for investors.

The sole function of a FINRA arbitration is to adjudicate on the merits of the case as pled – insurance information is extraneous and irrelevant to the merits of the case.

² See FINRA Perspectives On Customer recovery. February 2018.

³ See Statistics on Unpaid Customer Awards in FINRA Arbitration at www.finra.org/arbitration-and-mediation/statistics-unpaid-customer-awards-finra-arbitration. Last Updated May 2018.

4. The Proposal Conflicts with Existing Rules and Will Not Increase Efficiencies

FINRA's proposal anticipates that "by receiving details of the existence and scope of any third-party insurance coverage **a customer can decide whether to amend the statement of claim to fit within the coverage.**" FINRA discloses that the exchange of insurance information will allow customers the opportunity to amend their Statement of Claims after filing to tailor the claimed damages to the insurance coverage. Tailoring claims to existing insurance coverage rather than to the compensatory damages neither furthers "equity" or the efficiencies of the case.

As it relates to efficiency, under existing rules arbitrator selections begins upon the earliest of filing the Statement of Answer or the Answer due date. Arbitrator selection and appointment typically concludes within thirty days after the due date of the Statement of Answer. Discovery continues for, at a minimum, an additional thirty days thereafter. Under FINRA Rule 12309(b), after the appointment of an arbitration panel pleadings may only be amended upon Motion to the panel. Accordingly, under existing rules the claimant may only "tailor" their claim to the insurance after panel intervention. Panel intervention at this juncture will likely occur after the filing of a Motion in Support of an Amended Pleading, Motion in Opposition to the Amended Pleading, Filing of a Sur-reply and oral arguments at a telephonic hearing on the Motion. All of which do not relate to the merits of the case but are done for the sole purpose of aiding Claimant's counsel develop the most advantageous litigation strategy possible.

Protracting the process through this additional motion practice will not aid in managing expenses or increasing efficiencies but will serve to materially disadvantage broker dealers and/or industry representatives.

5. The Proposal Conflicts with Public Policy

Tailoring claims to existing insurance coverage rather than to the compensatory damages is an invitation to tailoring the facts of a claim and, as a result, to insurance fraud. Moreover, insurance carriers are not likely sit back and accept being treated like quarry and will more likely look at these amended pleadings with a healthy dose of skepticism when evaluating coverage claims. This will likely have the foreseeable effect of increasing denials of coverage and a corresponding increase in coverage litigation between the carrier and the insureds. Essentially, negating one of the purposes of having coverage to begin with, the efficient resolution of claims which fall within the contractual terms of the insurance coverage. In fact, The Proposal if enacted may actually result in the increase in the number of members who forego coverage, while increasing the cost of those that maintain it.

6. Proprietary and Confidential Business Practices

As with net-capital payment, business practices (including insurance levels) are confidential non-public information. When addressing confidentiality generally in the arbitrator reference guide, FINRA provides arbitrators with a framework to help guide the decision for disclosure. This framework includes the following:

When deciding contested requests for confidentiality orders, arbitrators should consider the competing interests of the parties. The party asserting confidentiality has the burden of establishing that the documents in question require confidential treatment. In deciding questions about confidentiality, arbitrators should, taking into account the facts of a particular case, consider factors such as the following:

1. Whether the disclosure would constitute an unwarranted invasion of personal privacy (e.g., an individual's Social Security number, or medical information).
2. Whether there is a threat of harm attendant to disclosure of the information.
3. Whether the information contains proprietary confidential business plans and procedures or trade secrets.
4. Whether the information has previously been published or produced without confidentiality or is already in the public domain.
5. Whether an excessively broad confidentiality order could be against the public interest or could otherwise impede the interests of justice.
6. Whether there are legal or ethical issues which might be raised by excessive restrictions on the parties.

Under the foregoing analysis, equity would weigh against disclosure of insurance information. As insurance is not a regulatory requirement and default rates are admittedly low for active members and registered representatives, and disclosure would be an “unwarranted invasion of personal privacy”. Insurance information – which is non-public- falls within the definition of a confidential business plan, procedure or trade secret. Disclosure of extraneous information is against the interest of justice and against the public interest as it is likely to impact both insurance rates and potentially reducing coverage availability.

7. The Proposal Disproportionately Impacts Small and Mid-sized Broker Dealers Which were Under-represented on the NAMC

FINRA’s recently released Industry Snapshot 2018 notes that the industry is comprised predominantly of small and mi-size broker dealers. In fact ninety five percent (95%) of FINRA member firms fall within this small and mid-size broker dealer model. Those firms, the firm most likely to employ independent error and omission insurance, had one (1) individual representing their interests on the 2015 Dispute Resolution Task Force which generated this proposal. That one individual was not an attorney and the sponsor member firm associated with this individual had participated in only one FINRA Dispute Resolution Arbitration. With limited dispute resolution experience and the sole advocate for small and mid-size broker dealers and registered representatives – the Task Force inadequately represented the industry as a whole. Further, at least one academic advisor to the task force advocated solely for customers through a law firm affiliation. When viewed from this optic, it is clear that the panel was not fair and balanced but was weighted towards customer representatives at the expense of the industry. Accordingly, the recommendations made by and through the Task Force cannot and are not representative of interests of the industry as a whole.

Accordingly, we believe that it is fair to reject this proposal in its entirety until such time that a Task Force is created which balances the interests of all participants in the dispute resolution process equally.

Very truly yours,



Liam O'Brien

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Harry Delagrammatikas