

This Order has been published by FINRA's Office of Hearing Officers and should be cited as OHO Order 14-03 (2010023218601).

**FINANCIAL INDUSTRY REGULATORY AUTHORITY  
OFFICE OF HEARING OFFICERS**

DEPARTMENT OF ENFORCEMENT,

Complainant,

v.

RESPONDENT

Respondent.

Disciplinary Proceeding  
No. 2010023218601

Hearing Officer—LOM

**ORDER DENYING RESPONDENT'S DISCOVERY MOTIONS**

FINRA's<sup>1</sup> Department of Enforcement ("Enforcement") brought this disciplinary action against Respondent on August 27, 2013. On October 11, 2013, Respondent filed an Answer. On December 3, 2013, the Hearing Officer issued a Case Management Order, which, among other things, set a hearing in this matter for May 19, 2014, through May 23, 2014. The Case Management Order also set dates for any motions and briefing relating to Enforcement's production of documents for inspection and copying pursuant to FINRA Rule 9251 and Enforcement's production of witness statements pursuant to FINRA Rule 9253.

Respondent filed a discovery motion pursuant to FINRA Rules 9251, 9252, and 9253, followed by a supplemental motion, both of which Enforcement opposes. The parties have filed and sought permission to file various papers. The Hearing Officer accepts for filing all the

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<sup>1</sup> The Financial Industry Regulatory Authority, Inc. ("FINRA") is responsible for regulatory oversight of securities firms and associated persons who do business with the public. FINRA was formed in July 2007 by the consolidation of NASD and the regulatory arm of the New York Stock Exchange ("NYSE"). FINRA is developing a new "Consolidated Rulebook" of FINRA Rules that includes NASD Rules. The first phase of the new consolidated rules became effective on December 15, 2008. *See* FINRA Regulatory Notice 08-57 (Oct. 2008). Because the Complaint in this case was filed after December 15, 2008, FINRA's procedural Rules apply to the proceeding. The applicable FINRA and/or NASD conduct Rules are those that existed when the conduct in issue occurred. FINRA's Rules (including NASD Rules) are available at [www.finra.org/Rules](http://www.finra.org/Rules). References here to FINRA include the NASD.

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papers regarding Respondent's discovery motions that have been submitted to date.<sup>2</sup> After considering the filings and being fully advised regarding the issues, the Hearing Officer **DENIES** all of Respondent's discovery requests for the reasons set forth below.

### **Nature Of The Case**

The Complaint alleges that the Firm failed to implement and enforce its anti-money laundering policies and procedures ("AML") adequately. The allegations in the Complaint may be summarized as follows. When the Firm's Chief Operating Officer ("CCO") joined the Firm in 2006, he brought approximately ten customers with him who traded using direct market access. Direct market access allows a customer to execute trades directly into the market without the need to place orders with a broker at the Firm. The Firm had not previously offered direct market access to its customers, but it permitted the CCO's customers to use direct market access. The CCO was the only representative at the Firm who dealt with those ten customers. As CCO, he also was a person designated to receive reports on issues relating to direct market access trading. Thus, he could fulfill his reporting responsibilities by reporting to himself. In effect, no

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<sup>2</sup> The following papers have been accepted and considered in connection with Respondent's discovery requests:

Respondent's Motion pursuant to FINRA Rules 9251, 9252, 9253 (dated December 26, 2013), seeking (i) exception reports from Respondent's two clearing firms, (ii) FINRA staff notes of interviews with customers and withheld document list, and (iii) documents, notes and testimony of FINRA and SEC personnel with respect to examinations of the Firm.

Respondent's Supplemental Motion (dated January 6, 2014), seeking (i) FINRA files relating to any inquiries and/or investigations of other broker-dealers and clearing firms with which certain direct market access customers of the Firm had other accounts to investigate what oversight the other firms conducted of these customers' activities.

Department of Enforcement's Opposition To Respondent's Discovery Motions (dated January 9, 2014).

Respondent's Reply (dated January 14, 2014), filed with Enforcement's consent.

Department of Enforcement's Sur-Reply (dated January 15, 2014), filed with Respondent's consent.

Respondent's Sur-Surreply (dated January 17, 2014), filed over Enforcement's opposition.

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one at the Firm reviewed the activities of the direct market access customers for AML purposes. At least three of those direct market access customers had questionable backgrounds that should have triggered red flags of suspicious activity, and certain trading raised additional red flags. The Firm failed to investigate. Even after the Securities and Exchange Commission ("SEC") raised issues regarding one of the direct market access customers, and after the Firm closed that customer's direct market access account, the Firm failed to investigate or close other related accounts over which that customer had trading authority.

### **Applicable Rules**

FINRA disciplinary proceedings have "unique characteristics" and are governed by FINRA's own procedural Rules, the Rule 9000 Series.<sup>3</sup> In particular, FINRA Rules 9251, 9252, and 9253 govern the limits of any discovery in a FINRA disciplinary proceeding.

#### **FINRA Rule 9251 – Discovery of investigative documents held by FINRA staff.**

Under FINRA Rule 9251(a)(1), Enforcement is obligated to make available to the respondent for inspection and copying the "[d]ocuments prepared or obtained by Interested FINRA Staff in connection with the investigation that led to the institution of proceedings." That provision identifies examples of such documents, including requests for information to FINRA member firms and associated persons pursuant to FINRA Rule 8210, requests for information to other persons not employed by FINRA, and documents that Interested FINRA staff may have obtained by such requests. Other examples include transcripts and transcript exhibits and all other documents obtained by Interested FINRA staff from persons not employed by FINRA.

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<sup>3</sup> E.g., OHO Order 12-02 (2011029760201); OHO Order 01-04 (CAF000045), 2001 NASD Discip. LEXIS 7, at \*25-26 (Feb. 14, 2001). Neither the Federal Rules of Civil Procedure nor the Federal Rules of Evidence apply in a FINRA disciplinary proceeding, although they may be consulted to the extent useful and not inconsistent with FINRA's own procedural rules.

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FINRA Rule 9251(a)(1) limits the documents Enforcement is required to produce to a respondent in two ways. *First*, only documents prepared or obtained by “Interested FINRA Staff” are required to be produced. FINRA Rule 9120(t) defines “Interested FINRA Staff” as certain FINRA employees with authority or involvement in an examination, investigation, prosecution or litigation relating to the specific disciplinary proceeding. *Second*, only documents prepared or obtained in connection with the investigation giving rise to the complaint must be produced. Under Rule 9251(a)(1), document production is narrowly focused on evidence that is directly relevant to the particular disciplinary proceeding against respondent.<sup>4</sup>

Separately, Rule 9251(b) also permits Enforcement to withhold (among other items): documents that are privileged, examination reports and other internal memoranda and notes prepared by FINRA employees, and documents that would disclose investigatory or enforcement techniques and guidelines. The focus of this provision is largely on protecting internal documents and communications. A respondent is not given access to Enforcement’s legal theories or FINRA’s internal workings during an investigation.

Under FINRA Rule 9251(c), a Hearing Officer may require Enforcement to submit a list of withheld documents or the withheld documents themselves. However the standard for such a direction is high. There must be “some reason to believe that a [d]ocument is being withheld in violation of the [FINRA] Code [of Procedure].”

*FINRA Rule 9252 – Seeking assistance  
to obtain documents and testimony for use at the hearing.*

FINRA Rule 9252 provides that a respondent may obtain the assistance of FINRA staff in seeking documents or testimony for use at the hearing in certain circumstances. Under FINRA

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<sup>4</sup> See *Dep’t of Enforcement v. Reichman*, No. 200801201960, 2011 FINRA Discip. LEXIS 18 (NAC July 21, 2011) (denial of discovery from Enforcement upheld as fair, where respondent sought information regarding larger investigation that was not relevant to narrow issues of case against respondent).

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Rule 9252(a), a respondent may ask that the staff invoke FINRA Rule 8210 to obtain document or testimony from persons subject to FINRA's jurisdiction. The request must "describe with specificity" the documents or testimony sought, state why they are material, describe the requesting party's previous efforts to obtain the documents or testimony by other means, and state whether the custodian or proposed witness is subject to FINRA's jurisdiction.

Under FINRA Rule 9252(b), the standard for granting such a request is that the information being sought is relevant, material, and non-cumulative. In addition, the Hearing Officer shall consider whether the request is unreasonable, excessive in scope, or unduly burdensome. The Hearing Officer may deny, limit, or modify such a request.

*FINRA Rule 9253 – Production of witness statements.*

FINRA Rule 9253(a)(1) authorizes a respondent to request to review and copy documentation of an oral statement by a witness to be called by Enforcement in certain circumstances. Enforcement may be asked to produce such documentation to the extent the witness's oral statement pertains to the witness's direct testimony and the statement is a stenographic or other type of recording or is a substantially verbatim recital recorded contemporaneously with the witness's oral statement.

FINRA Rule 9253(a)(2) additionally authorizes a respondent to request that Enforcement produce any contemporaneously written statement made by an Interested FINRA staff member during a routine examination or inspection about oral statements made by a non-FINRA person if two conditions are met. First, the Interested FINRA staff member or the non-FINRA person who made the statement is to be called as a witness by Enforcement. Second, the portion of the written statement that is sought directly relates to the anticipated testimony of the Interested FINRA staff member or non-FINRA person.

**Respondent's First Discovery Motion**

Respondent's initial Motion seeks three categories of documents: (i) exception reports from Respondent's two clearing firms, (ii) FINRA staff notes of interviews with customers and withheld document list, and (iii) documents, notes and testimony of FINRA and SEC personnel with respect to examinations of the Firm. None of these requests meets the applicable standards.

*Exception Reports.*

Respondent asserts that Enforcement "neglected" to request additional information that should have been requested. Citing FINRA Rule 9252, Respondent requests that Enforcement seek information pursuant to FINRA Rule 8210 concerning whether the clearing firms' monitoring programs triggered exception reports, and, "if so, who, if anyone, was advised."

Enforcement asserts that it did seek information from the two clearing firms Respondent used during the relevant period. That information had to do with the nature and extent of the clearing firms' AML monitoring programs and the programs they shared with Respondent during the relevant period. Enforcement represents that it produced to Respondent its correspondence with the two clearing firms.

Respondent's request fails to meet the standard set forth in FINRA Rule 9252. Information regarding exception reports not linked in any way to the allegations in the Complaint is not relevant or material to resolution of the charges against Respondent.

*Staff notes of customer interviews and withheld document list.*

Citing FINRA Rule 9251, Respondent suggests that Enforcement may have withheld from discovery FINRA staff notes of at least one customer interview, based on the recollection of Respondent's counsel of a conversation with counsel for Enforcement. Respondent has provided no detail regarding the substance or circumstances of the conversation.

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Respondent seeks the production of the staff's interview notes together with a withheld document list. Respondent contends that such information is material because customers' explanations of their activities "will bear directly" on the claims that those activities should have triggered further inquiry.

According to Enforcement, Respondent's counsel has misunderstood Enforcement's refusal to confirm or deny any of its investigative actions. Enforcement also represents that it has fully complied with its discovery obligations and produced for Respondent's inspection and copying all the evidence it is required to produce under FINRA Rule 9251.

Respondent has not met the standard for requiring production of staff notes of customer interviews. Staff notes of customer interviews may be withheld under FINRA Rule 9251(b) as attorney work product or to the extent they reflect an investigatory technique. If staff notes are not intended to be offered into evidence they also constitute internal memoranda not subject to discovery. Moreover, FINRA Rule 9253 makes plain that staff notes of a customer interview become discoverable only where those notes constitute a contemporaneously made and "substantially verbatim recital" of an oral statement made by a person to be called as a witness.<sup>5</sup>

Respondent's vague request for staff notes, if any, of an interview with an unknown customer does not even attempt to show that such notes are not typical staff notes – internal memoranda, reflecting investigative techniques, and constituting attorney work product. Typical staff interview notes are not discoverable.

Nor has Respondent met the standard for requiring a withheld document list. As noted above, the standard is high. There must be reason to believe that Enforcement has failed to

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<sup>5</sup> Under FINRA Rule 9251(b)(3), Enforcement must produce material exculpatory evidence. *See, e.g.*, OHO Order 12-04 (2010023367001) at 3-4. Respondent here, however, has not provided any basis for concluding that the requested notes contain material exculpatory evidence.

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comply with its obligations under the discovery rules. Here Enforcement has represented that it has timely produced all documents required by Rule 9251 to be produced, and Respondent has provided no reason to believe that is untrue.

*SEC and FINRA staff notes in connection with examinations.*

Respondent asserts that SEC and FINRA staff have conducted examinations of the Firm in which, according to Respondent, the staff concluded that the Firm's AML procedures were in order. Respondent seeks documents from those examinations. Enforcement maintains that such documents are not discoverable under FINRA Rule 9251, and, in any event, such documents are not relevant to this proceeding.

There is no basis for granting Respondent's request. A respondent's right to discovery in a FINRA disciplinary proceeding is limited to documents created or obtained by FINRA staff who directly participated in the investigation that led to the institution of the proceeding at issue. Other examinations and other investigations are simply not relevant, and documents relating to those other matters need not be produced in discovery.<sup>6</sup>

**Respondent's Second Discovery Motion**

Respondent's second Motion concerns the production of FINRA files relating to inquiries and investigations of other broker-dealers and clearing firms with which three of Respondent's customers did business. Respondent seeks production of "all Rule 8210 requests, OTRs and other information secured from these firms." Alternatively, Respondent requests that Enforcement be directed to obtain information pursuant to FINRA Rule 8210 regarding those other firms' oversight of the three customers' accounts.

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<sup>6</sup> See, e.g., OHO Order 13-03 (2009017529101) at 3-5.



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Enforcement maintains that Respondent is not entitled to probe whether or why FINRA investigated or chose not to investigate other FINRA members. In any event, the files sought are irrelevant because one FINRA member cannot excuse its misconduct by showing that others not charged engaged in similar misconduct.

Under FINRA Rule 9251, a respondent is entitled only to narrowly focused discovery of documents and information prepared or obtained by Interested FINRA staff in connection with the investigation that led to the filing of the complaint. A respondent is not entitled to information gathered in other investigations. Nor is a respondent entitled to information regarding FINRA's charging decisions relating to other FINRA members. In any event, such information is irrelevant to the case at hand. Accordingly, Respondent's request for such information, if it exists, and, alternatively, for Enforcement to be required to seek such information pursuant to FINRA Rule 8210 is without justification.

**SO ORDERED.**

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Lucinda O. McConathy  
Hearing Officer

Dated: January 24, 2014