

April 3, 2009

BY EMAIL TO: rule-comments@sec.gov

Ms. Nancy Morris
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549

**Re: File No. SR-FINRA-2008-024
Proposed amendments to the Discovery Guide
to update the Document Production Lists**

Dear Ms. Morris:

The Arbitration Committee of the Securities Industry and Financial Markets Association (“SIFMA”)¹ appreciates the opportunity to comment on the proposed amendments to the Discovery Guide.² The Discovery Guide’s purpose is to serve as a guide to ensure that all relevant material is exchanged, and also ensure that the parties and arbitrators retain the flexibility to alter the types of materials exchanged based upon the particular claims at issue.³ While SIFMA generally supports the goal of improving the discovery process, there are several proposed amendments that should be revised to ensure that the Discovery Guide better serves its stated purpose.

Our overarching general concern with the proposed amendments is that they go too far in certain areas – for example, in calling for the production to claimants of a broker’s own trading history and the trading history of wholly unrelated customers without any showing of relevance, need, or bearing on the case to justify production of these personal and sensitive records. This is particularly so for claims of excessive trading (List 3), unauthorized trading (List 9), and claims involving particular products or securities (List 12). To the extent the proposals require production of these records without such a showing, they are fundamentally unfair.

¹ SIFMA brings together the shared interests of more than 600 securities firms, banks and asset managers locally and globally through offices in New York, Washington, D.C., and London. Its associated firm, the Asia Securities Industry and Financial Markets Association, is based in Hong Kong. SIFMA’s mission is to champion policies and practices that benefit investors and issuers, expand and perfect global capital markets, and foster the development of new products and services. Fundamental to achieving this mission is earning, inspiring and upholding the public’s trust in the industry and the markets. More information about SIFMA is available at <http://www.sifma.org>.

² Notice of Filing of Proposed Rule Change and Amendment No. 1 Thereto Relating to Amendments to the Discovery Guide To Update the Document Production Lists, Release No. 34-59534; File No. SR-FINRA-2008-024, available at <http://edocket.access.gpo.gov/2009/pdf/E9-5389.pdf>.

³ The Discovery Guide at p.1, available at http://www.finra.org/web/groups/med_arb/documents/mediation_arbitration/p018922.pdf.

Our more specific comments and recommendations are as follows:

I. FIRM/ASSOCIATED PERSON(S) LISTS:

LIST 1

Documents to Be Produced in All Customer Cases by Firm/Associated Persons(s)

Request 1 (account record information). Revised Request 1 calls for, among other things, “[t]he account record information for the customer.” This phrase, however, is vague, and if construed broadly, would lead to the production of virtually every account-related report containing information regarding the customer’s financials, objectives, etc. Larger broker-dealers routinely maintain duplicative “account record information” in numerous reports, the collection and production of which would be overly burdensome, and would not lead to the discovery of relevant evidence or otherwise aid the claimant.

FINRA’s rule filing explains that the new “account record information” language was added in order to elicit: “the customer’s annual income, net worth, and account objectives, and [] indicate[] whether the record has been signed by the associated person responsible for the account and approved or accepted by a principal of the firm.”⁴ FINRA’s new Request 3, however, calls for essentially the same information. Accordingly, we recommend that the language “[t]he account record information for the customer” be stricken from Request 1 and that Request 3 be modified as discussed immediately below.

Request 3 (employment, financial status, and objectives). New Request 3 calls for “[a]ll documents concerning the customer’s employment status, financial status, annual income, net worth, investment objectives, and risk tolerance.” Use of the words “[a]ll documents,” however, renders this request overbroad and unduly burdensome. Applied literally, this request would lead to the production of duplicative information in numerous reports. To avoid this burden and to address the “account record information” concern in revised Request 1, we recommend: (i) replacing “[a]ll documents concerning” with “documents sufficient to show” and (ii) adding at the end “and all customer account record information signed by the associated person and/or his supervisors.”

Request 4 (investment or trading strategies). New Request 4 calls for “[a]ll documents evidencing any investment or trading strategies utilized or recommended in customer’s account, including, but not limited to, options programs, and any supervisory review of said strategies.” This phrase is vague. Given the volume of products and services offered by full-service broker-dealers – all of which arguably reflect “investment or trading strategies” (e.g., separately managed account programs) – the breadth and meaning of this Request is unclear. In the case of separately managed accounts, for example, the Request could be read as calling for virtually every internal document prepared or received relating to an investment manager’s strategy/discipline utilized in the claimant’s account. In another example, if the claimant used a covered call writing strategy, or a strategy of investing in one or more variable annuities, what would the firm/associated person be required to produce? In addition, the Request mentions

⁴ See Proposed Rule Change at pp.7-8, available at <http://www.finra.org/web/groups/industry/@ip/@reg/@rulfil/documents/rulefilings/p117762.pdf>.

“options programs” but fails to define or provide guidance on that term. FINRA’s rule filing explains that Request 4 is intended to cover a firm’s internal documents “that may not have been publicly disseminated.”⁵ Accordingly, we recommend that Request 4 be revised to read: “Documents sufficient to show whether any investment or trading strategies was utilized or recommended in the customer’s account, and any supervisory review of said strategies in the customer’s account(s) .”

Request 9 (exception reports). Request 9 calls for “[a]ll exception reports, supervisory activity reviews, activity concentration reports, active account runs and similar documents produced to review for activity in customer accounts in which customer’s account is referenced or listed.” This Request is overbroad and unduly burdensome because it would require firms to search through numerous exception reports and produce all of them that mention the claimant even if they concern matters completely unrelated to the conduct alleged. In a suitability case, for example, a firm would be required to search P.O. Box Surveillance Reports for references to the claimant. Accordingly, we recommend that Request 9 be revised to read: “All exception reports, supervisory activity reviews, activity concentration reports, active account runs and similar documents that relate to the conduct alleged in the claimant’s Statement of Claim and that reference or list the customer’s account at issue.”

LIST 3

Claims of Excessive Trading

Request 1 (commission runs of other customers). New Request 1 calls for, among other things, “monthly commission runs for the associated person, listing the securities traded, dates traded, solicited or unsolicited in nature, and the gross and net commission from each trade, for all years in which the conduct alleged in the Statement of Claim occurred.”

New Request 1 not only combines former Requests 1 and 2, but also provides for overreaching discovery that would require the production of irrelevant information and impose substantial and unnecessary burdens on brokerage firms with regard to document collection, redaction and production. New Request 1 would also unfairly shift onto brokerage firms burdens that properly belong to the claimant.

Unlike former Requests 1 and 2, new Request 1 would require brokerage firms to produce information on whether trades were solicited or unsolicited for every customer trade in every customer account, merely because the claim was styled as one for “excessive trading.” FINRA’s rule filing does not provide any substantive explanation why this requirement should be added and SIFMA objects to this significant departure from prior practice. Other customers’ transactions are only arguably relevant if the brokerage firm claims that the client initiated the trading activity in the account, not the broker. If the brokerage firm asserts this defense, then production of commission runs which show if the same securities purchased in claimant’s account were also purchased at or about the same time in other customer accounts (but which do not disclose whether the trades were solicited or unsolicited), would be sufficient to enable claimant’s counsel to attempt to prove that the financial advisor, not the claimant, initiated the securities trading in claimant’s account. The production of additional, separate records that show whether other customer trades were entered as solicited or unsolicited is not necessary for this purpose. Forcing

⁵ See Proposed Rule Change at p.9.

brokerage firms to produce thousands of pages of additional, separate records beyond commission runs which they must redact to remove customer names would impose an undue hardship on brokerage firms. This hardship is unjustified when one considers both the minimal probative value of information showing whether other customer trades were entered as solicited or unsolicited, and the fact that production of this collateral information would lead inevitably to time-consuming mini-trials regarding trading in third-party customer accounts.

In addition, we also object to that part of new Request 1 that would require brokerage firms to produce information identifying trading in the associated person's and related persons' accounts in every case where the firm asserts that the client controlled the account(s) in question. Rather, to obtain such private information, the claimant should be required to do more than simply allege "excessive" trading. At a minimum, the claimant should be required to identify the specific transactions that the claimant claims were excessive and improper. To the extent that the firm asserts that those specific transactions were initiated by the customer, the firm must then produce information sufficient to show whether the associated person traded those specific securities within six months of the customer's transactions. In other words, before shifting the burden and imposing new and invasive production obligations on brokerage firms that assert the claimant controlled the account(s), the burden should remain on claimant to make a prima facie showing by identifying those specific allegedly excessive and improper transactions in the account(s) in question. Without this requirement, the privacy rights of associated persons and third parties would be improperly infringed in most cases. Accordingly, we recommend that new Request 1 should read "If the firm asserts that the account activity was initiated by the customer, produce monthly commission runs for the associated person, listing the securities traded, dates traded, and the gross and net commission from each trade, for all years in which the conduct alleged in the Statement of Claim occurred. If the Claimant identifies the specific excessive transactions and if the firm asserts that those transactions were initiated by the customer, the firm must produce information sufficient to identify any transactions in the associated person's individual account(s) in the identified securities for a period of six months before or six months after the customer's transactions."

Request 2 (order tickets). New Request 2 would require "[f]or all transactions at issue in the Statement of Claim, the memorandum of each order or instruction given, as well as documentation showing the compensation, gross or net, to the associated person for each transaction." Thus, firms would be required to produce order tickets in all churning cases. FINRA's rule filing explains that "[o]rder memoranda may contain valuable notations made at the time an order was received."⁶ Producing order tickets, however, is a significant burden on firms and the overwhelming majority of such tickets will likely not contain such "valuable notations." Accordingly, we recommend that the production of order tickets be ordered only on a case by case basis and limited to order tickets that contain notations relevant to the allegations made in the Statement of Claim and that were made at the time the order was received.

LIST 4

Failure to Supervise

Request 2 (exception reports). Request 2 calls for "[a]ll exception reports, supervisory activity reviews, activity concentration reports, active account runs and similar documents produced to review for

⁶ See Proposed Rule Change at p.20.

activity in customer accounts related to the associated person(s) and/or the customer's account(s) at issue that were generated not earlier than one year before or not later than one year after the transactions(s) at issue.” The issue here is the same as List 1, Request 9 above. To the extent this Request can be read as requiring the production of all exception reports, etc., for every account handled by the associated person, whether or not they have any connection to the claimant, it is overbroad and unduly burdensome. Accordingly, we recommend that Request 2 be revised to read: “All exception reports, supervisory activity reviews, activity concentration reports, active account runs and similar documents that relate to the conduct alleged in the claimant’s Statement of Claim and that reference or list the customer’s account at issue.”

Request 4 (conversations with compliance). Request 4 calls for “[a] ny writing reflecting conversations between the associated person assigned to the customer's account at issue during the time period at issue and members of the firm's compliance department.” This Request is overbroad in that it would require production of every communication between the claimant’s broker and compliance personnel regardless of the subject matter of the communication. Communications with compliance personnel regarding the customer’s account at issue may have some probative value and we do not object to producing these documents. However, conversations between an associated person and compliance about unrelated customers’ accounts have no probative value, unnecessarily invade the privacy rights of other clients and would potentially result in mini-trials about third-party customers’ account activity. Moreover, as written, this request covers communications with compliance personnel regarding the associated person’s request to serve as a member of the board of a local charity or a request by an associated person to invest in his parents' outside business. Accordingly, we recommend that this Request be limited to communications regarding the customer or his/her accounts and revised as follows: “any writings reflecting conversations between the associated person assigned to the customer’s account at issue during the time period at issue and members of the firm’s compliance department relating to the customer or his/her accounts.”

Request 5 (regulatory inquiries). Request 5 calls for “[c] opies of any inquiries, charges or findings by any regulator (state, federal or self-regulatory organization) and the responses thereto by the [firm/associated Person] for alleged improper behavior by the associated person similar to that alleged in the Statement of Claim.” We recommend that the word “inquiries” be stricken as overbroad and irrelevant. FINRA and other regulators routinely make inquiries, which must be distinguished from investigations. These are preliminary fact gathering efforts and nothing more. Just as brokerage firms are not permitted to rely on the closure of routine preliminary inquiries as exculpatory evidence, so, too, customers should not be permitted to confuse panels by introducing evidence regarding these inquiries to try to prove misconduct. Accordingly, the fact/existence of a routine inquiry is immaterial and should not be the subject of discovery.

Request 6 (examination reports). Request 6 calls for examination reports that, among other things, discuss alleged improper behavior similar to that alleged in the Statement of Claim. Because there is no time limitation, however, it would be difficult and burdensome to comply with this Request. Accordingly, we recommend that this Request be limited to the time period at issue in the Statement of Claim.

LIST 9

Unauthorized Trading

Request 4 (commission runs of other customers). Request 4 calls for “[c]ommission runs or other documents sufficient to show all trading by the associated person(s) in the security at issue for a period extending from ten trading days before and after each transaction the customer alleges was unauthorized. This Request is premised on the false assumption that trading in the accounts of the broker’s other customers will assist arbitrators in determining whether there was unauthorized trading in the claimant’s account. The fact that other customers of the broker traded the same stocks as the claimant at or about the same time, however, has no bearing whatsoever on whether the broker contacted the claimant in advance of the trades in question to obtain his authorization for the trades. Production of this collateral information will result in mini-trials regarding third-party customers which will serve only to delay the arbitration proceeding. We recommend this Request be stricken.

LIST 12

Claims Involving Particular Products or Securities.

Requests 1-2 (information about other customers’ accounts). These Requests are premised on the false assumption that trading in the accounts of the broker’s other customers will assist arbitrators in determining whether there was misconduct in the claimant’s account. The fact that other customers of the broker invested in the same securities or products as the claimant has no bearing whatsoever on whether the securities recommended to the claimant were suitable for the claimant. There are numerous reasons why the same securities might be recommended or sold to numerous different customers. To properly evaluate this would require a complete understanding of each third party customer’s financial needs, investment objectives and other securities holdings, which would violate the privacy rights of these third parties and would serve no purpose other than to delay the arbitration proceeding. We recommend this Request be stricken.

II. CUSTOMER LISTS:

LIST 2

Documents and Information to be Produced in All Customer Cases by Customer

Request 1 (tax records). This Request call for the customers (claimants) to produce tax returns. As with Request 4, however, claimants should also be required to identify their accounting firms and/or tax preparers and to provide a written authorization for the release of the following records: (a) federal tax returns for the five year-period before the arbitration commenced prepared on behalf of claimant or any claimant-owned business; (b) financial statements or similar statements of claimant’s assets, liabilities, and/or net worth; and (c) any tax plan, estate plan or trust plan prepared by or on behalf of claimant.

Request 4 (accounts at other firms). This Request calls for the claimants to identify “each securities firm where the customer has maintained an account.” The claimant is also required to produce account statements for a five-year period and to “provide a written authorization allowing the respondent firm/associated person to obtain the account statements directly from each securities firm.” In addition to

requiring the claimant to authorize the release of account statements from the claimant's other securities firms, claimants should also be required to authorize the release of the following additional account records maintained by these firms: (a) financial statements or similar statements of the claimant's assets, liabilities, and/or net worth;⁷ (b) trade confirmations;⁷ (c) all agreements with claimant including, without limitation, account opening documents, cash, margin, and option agreements, trading authorizations, powers of attorney or discretionary authorization agreements; (d) opening account (new account) documents that contain any of the following information regarding claimant or his/her account(s): investment objectives; investment experience; risk tolerance; investment product preferences; investment time horizon; and/or financial situation; (e) notes including, without limitation, diary or calendar entries, ACT or daytimer notes, prepared by claimant's broker(s), account executive(s) or financial advisor(s) relating to claimant's investments or his/her account(s); (f) correspondence between the claimant and the firm; and (g) any complaints made by the claimant and the firm's response(s). If sufficient documents are produced in response to the authorization to release records, that may obviate the need to file a motion for the issuance of subpoenas to the customer's other firms, thereby relieving the parties and the panel chair of the burden and expense of motion practice.

Request 14 (documents customer relied upon). This Request calls for the claimant to produce "documents relied upon by the customer in making the investment decision(s) at issue." In addition to "documents," the Request should be modified to include "information" and, more particularly, "any documents or information reflecting investment research conducted or received by the customer relating to the customer's account(s), transaction(s) or investment(s) at issue." This modification of List 2, Request 14, should be duplicated for List 14, Request 2.

Omission of former Request 11 (complaints). Without sufficient explanation, FINRA proposes to remove the prior requirement that claimants produce prior complaints and the firm's response(s). Because of the passage of time (claimants sometimes file cases 5-10 years after the events in question), such complaints may be lost or destroyed by firms. As such, claimants should continue to be required to produce these documents.

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⁷ FINRA's omission of trade confirmation issued by claimant's other securities firms is based on a false premise, namely, that confirmations contain duplicative information. In fact, trade confirmations are often the only source of information demonstrating whether a claimant's trading at another securities firm was done on a solicited or unsolicited basis. This information can be highly probative of claimant's investment knowledge and experience, and does not appear in account statements.

Thank you for giving SIFMA's Arbitration Committee the opportunity to comment on the proposed amendments to the Discovery Guide. If you have any questions regarding this comment letter, please contact the Committee's staff advisor, Kevin Carroll, at 202.962.7382 (kcarroll@sifma.org).

Sincerely,

A handwritten signature in cursive script, reading "Patricia Cowart", written over a horizontal line.

Patricia Cowart
Chair, SIFMA Arbitration Committee

cc: Linda D. Fienberg, President, FINRA Dispute Resolution
George H. Friedman, Executive Vice President, FINRA Dispute Resolution
Erik R. Sirri, Director, Division of Trading and Markets, SEC
James L. Eastman, Chief Counsel, Division of Trading and Markets, SEC