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Confidential Financial Information of Non-Party Customers Placed at Risk When Litigants Subpoena FINRA Enforcement Files

An increasingly common tactic among claimants' lawyers in Financial Industry Regulatory Authority (FINRA) arbitrations is to issue subpoenas to securities regulators, including FINRA itself, calling for the production of investigative files. This is accomplished by asking the arbitration panel to issue a subpoena pursuant to FINRA Rule 12512 (or Rule 13512 in an employee versus firm case). The respondent firm typically opposes the issuance of such a subpoena on a number of grounds, including the fact that securities regulators have much broader investigative powers than do private litigants and often demand and collect large amounts of personal confidential information (**PCI**) about customers and employees who may not be parties to the arbitration in which the subpoena is sought.

Despite these objections, arbitration chairs have on occasion issued such subpoenas, sometimes with a proviso directing FINRA to redact any PCI pertaining to individuals who are not involved in the arbitration. However, FINRA has taken the position that while it will produce its files in response to an arbitration subpoena it will not redact PCI from those files due to the burden and expense such redaction entails. This has resulted in claimants and their counsel receiving significant amounts of PCI belonging to individuals who are not parties to the case. Such information may include full names, physical addresses, telephone numbers, email addresses, dates of birth, social security numbers, account numbers, account holdings, statements of net worth, beneficiary information, and other potentially valuable data. This article outlines the problem and offers some suggestions to remediate its effects.

The Problem

Broker-dealers possess vast amounts of PCI regarding customers (and employees) that may be invaluable to cyber criminals, identify thieves, economic spies, extortionists, and even foreign governments. Like other financial services firms, broker-dealers are required by federal and state law to have robust policies, practices, and procedures to protect PCI against unauthorized disclosure (e.g., Rule 30 of REG S-P (17 CFR § 248.30)). And woe betide the firm that through negligence or innocent mistake (say, a lost or stolen computer, a hacked password, or a failure to thwart a cyber-attack) suffers a data breach or other security lapse that exposes confidential customer information to

unauthorized persons; FINRA and the SEC have brought numerous enforcement actions against firms that have failed to adequately protect such data.

In the private litigation and arbitration context, it is standard practice for financial services firms to rebuff discovery requests and third-party subpoenas seeking PCI pertaining to customers or employees not involved in the case. And arbitrators rarely direct respondent firms to produce unredacted PCI pertaining to nonparty customers. A firm that failed to make reasonable efforts to protect such information likely would find itself in the legal crosshairs of regulators, not to mention attorneys for the affected persons.

FINRA's Dispute Resolution arm recognizes its obligation to guard the PCI of arbitration parties and imposes special requirements for the protection of PCI that is submitted to FINRA's arbitration staff in connection with a case. FINRA Regulatory Notice 14-27 provides in part:

> During an arbitration proceeding, parties submit pleadings and supporting documents to FINRA Dispute Resolution (DR) that may contain an individual's Social Security number, taxpayer identification number, or financial account number (personal confidential information or PCI). For example, customers often file account opening documents and account statements, which show their account numbers. Since FINRA employees regularly handle and transmit party documents containing PCI, FINRA has procedures in place to guide staff and arbitrators on how to keep confidential information safe. These procedures have enhanced the security of party documents and information. In an effort to further protect parties from identity theft and accidental loss of PCI, FINRA amended the Code of Arbitration Procedure for Customer Disputes and the Code of Arbitration Procedure for Industry Disputes to require parties to redact specified PCI from documents they file with FINRA.

Unfortunately, efforts by respondent firms and FINRA's Dispute Resolution staff to protect PCI in arbitrations may be circumvented and thwarted when claimant's counsel seeks the issuance of subpoenas calling for FINRA Enforcement and Examination files, which, as outlined below, often contain significant amounts of PCI.

FINRA's Enforcement and Examination arms have wide latitude to demand and collect all manner of documents and information from broker-dealers and their associated persons. Rule 8210 allows FINRA staff virtually unfettered access to any information, book, or record possessed by a regulated entity or person. Unlike in civil litigation, objections based on relevance, overbreadth, and burden are not recognized by the rule, and the only material that can be withheld as a matter of right is that which is protected by the attorney-client privilege and the bank examination privilege. Even sensitive information protected by the federal government's Bank Secrecy Act Suspicious Activity Report privilege must be produced, albeit under separate cover and clearly marked as such. And, while Rule 8210(g) requires that firms producing data to FINRA on portable media must encrypt that information, the rule imposes no data handling requirements on FINRA itself. Rule 8210 also empowers FINRA examiners and enforcement staff to take testimony under oath in wide ranging depositions during which FINRA staff can delve into the PCI of customers and employees while a court reporter creates a verbatim transcript that then becomes part of FINRA's investigative file.

What all this means is that FINRA investigative files are, not surprisingly, chock full of sensitive PCI, and, because such inquiries are rarely limited to a single customer, PCI pertaining to multiple individuals often will be mixed together in the same file. FINRA generally will resist producing its investigative file in response to an arbitration subpoena while an investigation is still open, but that reluctance abates once the file is closed (though FINRA will protect its own work product, notes, memoranda, *etc*.).

In the securities industry, it is not uncommon for arbitration claims to follow on the heels of regulatory investigations. In such cases, it is becoming more common for arbitration claimants to demand in discovery all information produced by the respondent firm to FINRA (and/or other regulators). Firms generally resist such requests, citing the PCI issue discussed above and the fact that private litigants do not have the sweeping powers that FINRA possesses under Rule 8210 and, therefore, should not be permitted to ride the coattails of FINRA's Examination and Enforcement arms and receive everything that the firm produced to the regulators, regardless of its relevance to the case at hand. Faced with the respondent's objection to this request, claimant's counsel then do one (or both) of two things: file a motion with the chairperson of the panel seeking an order compelling the firm to produce the documents; and/or seek the

issuance of a subpoena to FINRA itself for its complete file. As noted in the introduction, arbitration chairpersons have issued subpoenas calling for regulators' files.

Subpoenas for FINRA investigative files are handled by FINRA's office of General Counsel, which, in a series of recent cases, has employed the following approach. First, they assert the work product privilege as to their own notes, memoranda, etc. Second, they agree to produce the remainder of their file (assuming the investigation has been closed) without interposing any objection that FINRA need not comply with arbitration subpoenas that have not been compelled by a court of competent jurisdiction. And third, they expressly decline to assume the burden of redacting PCI that is contained in their investigative files. Set forth below is language that FINRA's office of General Counsel recently used in their response letter:

> Non-privileged documents that may be produced by FINRA in response to the subpoena potentially include personal identifying and confidential information. FINRA will not redact such information prior to production. FINRA expects the parties to safeguard any such information, keep it nonpublic, and use it only in this proceeding. Any redaction is the responsibility of the parties to the proceeding, and FINRA expects the parties to discharge that responsibility without FINRA's involvement.

Even when the subpoena issued by the arbitration chair expressly directs FINRA to redact PCI before producing an investigative file to claimant's counsel, FINRA's office of General Counsel demurs. Responding to such a directive in a recent case, FINRA counsel stated, in part:

> FINRA objects to the redaction requirement because it poses an undue and unnecessary burden on a non-party, a not-for-profit securities self-regulatory organization.

In that case, FINRA's counsel suggested instead that the subpoena be amended to require that the investigative file be sent to the respondent firm that produced the information to FINRA in the first instance so that the firm could make the redactions necessary to protect any PCI. Claimant's counsel objected to this procedure and convinced the non-lawyer chair that redaction wasn't necessary because of the confidentiality agreement that was in place between the parties. The chair – apparently not appreciating that the existence of a confidentiality agreement *between the parties* did nothing to ameliorate the fact that PCI belonging to *non-party customers* would be handed over to a lawyer they had not retained and likely had never heard of – ruled that FINRA should produce its file directly to claimant's counsel. That is then exactly what happened, and claimant's counsel received significant amounts of PCI pertaining to customers who were not parties to the case at hand.

Of course, besides the fact that claimant's counsel should not receive PCI belonging to individuals who are not their clients and have not consented to such disclosure, there is no guarantee that the sensitive information will remain secure in the files of claimant's counsel. While broker-dealers and their counsel are required to maintain strict controls on PCI, there is no such regime in place governing claimant's counsel outside of whatever their attorney ethics rules and other applicable state laws may require. And, of course, if the *claimant* gets access to the PCI of other customers, there are no ethical rules that would prevent the publication or misuse of that information.

Some Suggested Remedies

This is, then, a problem that cries out for a solution. Here are a few suggestions.

The soundest and safest course of action would be for FINRA simply to prohibit arbitration subpoenas for investigative files. After all, private litigants are not accorded the sweeping powers granted FINRA under Rule 8210 to collect any information and documents in the possession of broker-dealers, and there is no valid reason why arbitration claimants should be able to demand and receive everything that FINRA collected during an investigation. Adopting such a prohibition would neatly solve the PCI problem outlined above. If claimants think that information produced to a regulator is somehow relevant to their case, they should be required to issue a discovery demand to the firm that produced the information to the regulator in the first instance and then be prepared to explain to the chairperson why the firm's likely objection to that request should be rejected. The chair could then weigh the parties' conflicting positions and decided whether to deny, grant, or grant in part the claimant's discovery demand. In

particular, the chair could rule on specific categories of documents on an a` la carte basis rather than treating the entire FINRA file as a single repository of undifferentiated information, testimony, and documents. If the chair decided to require the respondent firm to produce to the claimant information and material that it had previously supplied to FINRA, the firm would be in a position to redact any PCI of non-party customers and employees. FINRA should welcome this approach since it removes them from the situation altogether, and they would not have to respond to arbitration subpoenas at all.

Of course, claimants' counsel may object to the approach outlined above, so a second course would be to preserve the option to subpoena FINRA investigative files but require FINRA to redact PCI pertaining to individuals who are not parties to the arbitration in which the subpoena has been issued. This would solve the PCI problem, but it may be difficult to overcome FINRA's reluctance to take on the burden and expense of redaction, which can be a time-consuming task depending on the scope and duration of the investigation and the size of the file. If FINRA's office of General Counsel were given additional money and resources to handle this task, that might assuage their concerns.

A third solution would be for FINRA to amend Rules 12512 and 13512 to require that, if an arbitration panel is going to issue a subpoena to a regulator for investigative files that may contain PCI, the subpoena must direct the regulator to produce the file in question *to the respondent*, which then would be responsible for redacting any PCI and producing the balance of the file to claimant's counsel. This would shift the cost and burden of redaction from FINRA to the respondent firms, and, based on the position that FINRA's office of General Counsel has taken in recent cases, this approach is palatable to FINRA.

Naturally, respondent firms may not appreciate having to bear the additional burden and expense of redaction that would be imposed on them by the first and third options outlined above, and smaller firms in particular might find such a requirement objectionable. One way to deal with cost objections by respondents would be to require the claimant who is seeking the investigative file to pay all or a portion of the respondent's expenses to redact PCI.

Because of the time it would take to implement any of these options, FINRA should, in the interim, issue guidance to arbitrators educating them about the need to protect PCI of non-parties and strongly encouraging them to order that any subpoenaed regulatory files be first produced to respondent's counsel for redaction. In particular, FINRA Dispute Resolution should make sure arbitrators understand that the existence of a confidentiality agreement between the parties to an arbitration does not abrogate the financial privacy rights of individuals who are not involved in the arbitration and may not appreciate having their confidential financial information shared with claimants and their counsel or aired at an arbitration hearing that they know nothing about.

Lastly, broker-dealers that are responding to FINRA 8210 requests that call for the production of PCI should consider cabining their responses so that each individual's PCI is produced in a separate production or on separate media. This would facilitate any subsequent redaction required by subpoenas issued in private client litigation or arbitration that follows a regulatory investigation or examination.

Conclusion

The explosion of identity theft has vaulted the protection of PCI to a front line concern for legislators, regulators, financial services firms, and consumer privacy advocates. Subpoenas for investigative files in private client litigation and arbitration expose the PCI of nonparties to unauthorized disclosure, and a remedy needs to be found and implemented to protect the financial privacy of those individuals. FINRA's new President and CEO, Robert Cook, has been on a widely touted ''listening tour,'' so perhaps member firms and Securities Industry and Financial Markets Association could make a concerted effort to put this issue on his agenda.

This *GT Advisory* was prepared by **Donald S. Davidson.** Questions about this information can be directed to:

- Donald S. Davidson | +1 415.655.1317 | davidsonds@gtlaw.com
- Or your Greenberg Traurig attorney

Amsterdam
+ 31 20 301 7300

Atlanta
+1 678.553.2100

Austin
+1 512.320.7200

Berlin¬
+49 (0) 30 700 171 100

Berlin-GT Restructuring¯
+49 (0) 30 700 171 100

Boca Raton
+1 561.955.7600

Boston
+1 617.310.6000

Chicago
+1 312.456.8400

Dallas
+1 214.665.3600

Denver
+1 303.572.6500

Fort Lauderdale
+1 954.765.0500

Houston
+1 713.374.3500

Las Vegas
+1 702.792.3773

London*
+44 (0)203 349 8700

Los Angeles
+1 310.586.7700

Mexico City+
+52 55 5029.0000

Miami
+1 305.579.0500

New Jersey
+1 973.360.7900

Northern Virginia
+1 703.749.1300

Orange County
+1 949.732.6500

Orlando
+1 407.420.1000

Philadelphia
+1 215.988.7800

Phoenix
+1 602.445.8000

Sacramento
+1 916.442.1111

San Francisco
+1 415.655.1300

Seoul∞
+82 (0) 2.369.1000

Shanghai
+86 (0) 21.6391.6633

Tallahassee
+1 850.222.6891

Tampa
+1 813.318.5700

Tel Aviv^
+03.636.6000

Tokyo¤
+81 (0)3 4510 2200

Warsaw~
+48 22 690 6100

Washington, D.C.
+1 202.331.3100

Westchester County
+1 914.286.2900

West Palm Beach
+1 561.650.7900