



COMPLIANCE CLARIFIED

Arbitration: Handling FINRA's New Discovery Guide

Most customer disputes in the securities industry are adjudicated by panels of arbitrators under the auspices of the **Financial Industry Regulatory Authority**. On May 16, 2011, FINRA implemented its revised Discovery Guide and document production lists supplement to its Code of Arbitration Procedure for Customer Disputes (CR, 4/11). The discovery guide provides a list of documents that parties and arbitrators are directed to consider “presumptively discoverable” in customer disputes. This revised guide applies to any claims filed on or after May 16, 2011, while the former version applies to any claims filed before that time. Registrants who participate in arbitration should be mindful of the following issues.

- **Simplified document production list.** The former NASD discovery guide is divided into 14 lists of documents—the first consisting of documents the firm and associated persons should presumptively produce in all customer cases—plus 12 additional lists of documents that should be produced based on the particular types of allegations made in the complaint; for example, unsuitability, churning or misrepresentation. A party seeking to ascertain its discovery obligations must navigate a hodgepodge of different categories. The revised guide no longer predicates discoverability upon the allegations of the complaint, and consolidates these lists into two overall lists encompassing those documents that firms and associated persons must produce in all customer cases, and those documents that customers must produce in all customer cases. This simplifies and streamlines the discovery process.

- **Electronic discovery.** The revised discovery guide expressly states that electronic files are considered documents for the purpose of securities arbitrations. This is important due to the increased use of electronic trading and online customer account access in the industry. In addition, the guide authorizes arbitrators to decide any dispute arising over the form in which documents are to be produced. As a result, broker/dealers and other registrants should take care to ensure that any electronic files that fall within the categories of discoverable documents are preserved. Registrants should also bear in mind that the

form in which documents are normally kept may not be the form by which they will ultimately be produced should a dispute arise. An examination of the manner in which files are stored and maintained may aid in reducing the costs of production in subsequent arbitrations.

- **Regulatory investigations.** The 2011 discovery guide requires the production in arbitrations of examination reports from any state or federal authority or self-regulatory organization regarding the customer's claims, accounts or transactions, the types of products at issue and conduct similar to that alleged in the complaint. FINRA members should be mindful that it is not only the disciplinary record of the associated person at issue that will be produced in customer cases, but also any reports of investigations that have a connection with the customer allegations. Member firms should ensure that the records of regulatory reviews and investigations are complete and accurate.

- **Investment and trading strategies.** FINRA registrants should presumptively produce documents showing any investment or trading strategy used or recommended in *any* of the complaining customer's accounts. This includes options programs and any supervisory review of those strategies. This requirement appears to anticipate the new suitability and know-your-customer rules that are scheduled to take effect in July 2012 (CR, 6/13). These new regulations place an emphasis on strategies employed by registered representatives and B/Ds.

- **Correspondence beyond that involving the customer.** Previously, registrants only had to produce correspondence with customers related to the transactions at issue. The revised discovery guide now requires the production of *all* correspondence sent to the customer or *received* by the firm or associated persons relating to the claims, accounts, transactions or products or types of products at issue. This widens the scope of discoverable documents, as any correspondence received by the firm pertaining to a product or account involved in a customer dispute will now have to be produced. FINRA member firms should take steps to preserve correspondence related to the account regardless of whether that correspondence was transmitted to the customer.



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