Regulatory Notice 14-40

Confidentiality Provisions

Confidentiality Provisions in Settlement Agreements and the Arbitration Discovery Process

October 2014

Notice Type
- Guidance

Suggested Routing
- Compliance
- Legal
- Registered Representatives
- Senior Management

Key Topics
- Arbitration
- Confidentiality Provisions
- Discovery
- Dispute Resolution
- FINRA Rule 2010
- Settlement Agreements

Referenced Rules & Notices
- NTM 86-36
- NTM 95-87
- NTM 04-44
- FINRA Rule 2010
- SEA Rule 21F-17

Executive Summary

FINRA reminds firms that it is a violation of FINRA Rule 2010 (Standards of Commercial Honor and Principles of Trade) to include confidentiality provisions in settlement agreements or any other documents, including confidentiality stipulations made during a FINRA arbitration proceeding, that prohibit or restrict a customer or any other person from communicating with the Securities and Exchange Commission (SEC), FINRA, or any federal or state regulatory authority regarding a possible securities law violation.

Questions concerning this *Notice* should be directed to:

- Victoria L. Crane, Associate General Counsel, Office of General Counsel, at (202) 728-8104 or *victoria.crane@finra.org*; or
- Margo A. Hassan, Assistant Chief Counsel, Dispute Resolution, at (212) 858-4481 or *margo.hassan@finra.org*.

Background & Discussion

A. Settlement Agreements

FINRA has previously cautioned firms about the use of provisions in settlement agreements with customers or other persons that impede, or have the potential to impede, FINRA investigations and the prosecution of FINRA enforcement actions. For example, in *Notice to Members 04-44*, FINRA cautioned firms regarding the use of confidentiality provisions in settlement agreements that prohibit or restrict the customer or other person from disclosing to FINRA or other securities regulators the settlement terms and the underlying facts of the dispute upon inquiry.[1] FINRA noted that such provisions violate FINRA Rule 2010, which requires firms to observe high standards of commercial honor and just and equitable principles of trade in the conduct of their business.

This *Notice* supplements FINRA's prior guidance by reminding firms that confidentiality provisions also cannot be used to prohibit or restrict an individual from initiating communications directly with FINRA or other securities regulators regarding the settlement terms or underlying facts of a dispute, regardless of whether the individual has received an inquiry from such regulatory authority regarding the dispute. For example, notwithstanding a confidentiality provision in a settlement agreement, the customer or any other person may, at any time, alert FINRA to potentially fraudulent or suspicious activities by a firm or its associated persons through FINRA's Investor Complaint Center,[2] or communicate directly with SEC staff regarding a possible securities law violation.[3]

Confidentiality provisions in settlement agreements should be written to expressly authorize, without restriction or condition, a customer or other person to initiate direct communications with, or respond to any inquiry from, FINRA or other regulatory authorities. As FINRA has stated in prior guidance regarding confidentiality provisions in settlement agreements, it is not FINRA's intent to preclude firms from entering into settlement agreements that include acceptable confidentiality provisions. The following is an example of an acceptable confidentiality provision in a settlement agreement:

> Any non-disclosure provision in this agreement does not prohibit or restrict you (or your attorney) from initiating communications directly with, or responding to any inquiry from, or providing testimony before, the SEC, FINRA, any other self-regulatory organization or any other state or federal regulatory authority, regarding this settlement or its underlying facts or circumstances.

FINRA reminds firms that the use of confidentiality provisions in settlement agreements that prohibit or restrict a customer's or other person's ability to communicate directly with or in response to an inquiry from a regulatory authority, constitutes conduct that is inconsistent with just and equitable principles of trade that may result in FINRA disciplinary proceedings for violation of FINRA Rule 2010.

B. Arbitration Discovery Process

The discovery process allows the parties to an arbitration to obtain facts and information from other parties to the arbitration to support their case and prepare for the hearing. FINRA's Code of Arbitration Procedure for Customer Disputes (Customer Code) requires parties to cooperate with each other to the fullest extent practicable in the voluntary exchange of documents and information to expedite the arbitration process. The code contains rules that govern the discovery process, including making discovery requests, responding to such requests, objecting to discovery requests, and arbitrator authority to issue sanctions against parties for discovery abuses.

FINRA's Discovery Guide supplements the Customer Code. The introductory language describes the discovery process generally and explains how arbitrators should apply the discovery guidelines in arbitration proceedings. The introduction is followed by document production lists that specify the documents that parties should exchange with each other in customer cases. In discussing confidentiality in the discovery process, the guide provides: "If a party objects to document production on grounds of privacy or confidentiality, the arbitrators or one of the parties may suggest a stipulation between the parties that the documents in question will not be disclosed or used in any manner outside of the arbitration of the particular case, or the arbitrators may issue a confidentiality order."

FINRA notes that any stipulations between the parties or confidentiality orders issued by an arbitrator as part of the discovery process regarding the non-disclosure of the documents in question outside the arbitration of the particular case, do not restrict or prohibit the disclosure of the documents to the SEC, FINRA, any other self-regulatory organization, or any other state or federal regulatory authority. Thus, confidentiality provisions relating to document production in the discovery process do not apply to the sharing of the documents with regulatory authorities.

FINRA cautions firms that the use of confidentiality provisions in discovery stipulations that prohibit or restrict a customer's or other person's ability to communicate directly with or in response to an inquiry from a regulatory authority, constitutes conduct that is inconsistent with just and equitable principles of trade that may result in FINRA disciplinary proceedings for violation of FINRA Rule 2010.

Endnotes

1. *See NTM 04-44* (June 2004). *See also NTM 95-87* (October 1995), *NTM 86-36* (May 1986), and NASD Regulatory and Compliance Alerts (June 1994 and July 1995).
2. FINRA maintains an Investor Complaint Center on its website. Individuals with evidence of, or material information about, potentially illegal or unethical activity may also contact FINRA's Office of the Whistleblower.
3. *See* Rule 21F-17 of the Securities Exchange Act of 1934 that provides, in part: "No person may take any action to impede an individual from communicating directly with the Commission staff about a possible securities law violation, including enforcing, or threatening to enforce, a confidentiality agreement... with respect to such communications."