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Brokers fear Finra wants to dig fingers in outside pies

Revamped Finra rule could allow the regulator to probe deeper into outside business activities of registered representatives, as well as affiliates and parent companies of broker-dealers

By Dan Jamieson
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Legal observers are concerned that a revamped Finra rule could allow the regulator to probe deeper into outside business activities of registered representatives, as well as affiliates and parent companies of broker-dealers.

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The Financial Industry Regulatory Authority Inc.'s newly revised Rule 8210 goes into effect today. It governs Finra's ability to get records and testimony in connection with an exam, investigation, complaint or proceeding.

Brokerage firms and industry lawyers have long had concerns about what they view as overly broad "8210 requests," as Finra's information demands are known, and lawyers worry that the problem could get worse.

The new rule "creates a whole new world for Finra to pretty dramatically expand its reach," said securities attorney David Chase, founder of an eponymous law firm.

NEW LANGUAGE

Of particular concern is new language that requires anyone under Finra's jurisdiction to produce information that is under their "possession, custody or control."

Some observers argue that the legal meaning of "control" opens the door for Finra to get records of entities over which it has no jurisdiction by demanding information from registered individuals or firms that it does supervise.

This means that Finra could now have another tool to obtain financial documents and records of independent advisory firms, insurance agencies, tax practices or other entities with which securities-registered financial advisers often are associated.

"A hybrid adviser might have partners in a CPA firm, for example, and [the new rule] raises the

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question of whether the books of the CPA firm would all be open" to Finra, said Brian Neville, a founding partner of Lax & Neville LLP.

"My gut reaction is that [Finra has] already been digging and reaching as far as they could" into outside businesses such as RIAs, said Kirk Francis, president of Cross Financial Services. "It's interesting that they enact this after they've backed off on the fight to be our regulator" on the advisory side.

In a regulatory notice last month, Finra explained the new rule this way: A broker-dealer or registered person must make their books, records or accounts available even when those records are in the possession of another person or entity — if the person or entity subject to Finra's jurisdiction "controls or has a right to demand" the information.

SEPARATE BUSINESS

"If you own another business, maybe even something like a restaurant, under Finra's interpretation, the documents owned by that restaurant could be viewed by Finra because you control them," said Alan Wolper, a partner at Ulmer & Berne LLP.

"There are lots of third-party entities that might share ownership with a B-D," he said. "I'm not sure Finra has a right to see those documents."

When Finra first proposed the changes in 2009, it said it wanted to clarify the scope of the rule and the legal procedures used in making 8210 requests.

Another impetus for the change was a Finra case that the Securities and Exchange Commission rejected in 2006 in which Finra had sought bank records of a church group founded by a registered representative. The broker, Jay Ochanpaugh, refused to give Finra copies of checks drawn on the church's account.

Finra wanted to know whether Mr. Ochanpaugh made money from the church, which had been set up with the intent of paying members' bills using their tax-deductible contributions.

"Finra uses the investigative tool of a Rule 8210 request to conduct examinations and investigations for the purpose of protecting investors," Finra spokeswoman Michelle Ong wrote in an e-mail.

The "possession, custody or control" language was added "to respond to a concern raised by a Securities and Exchange Commission decision and clarify when [Finra] investigators may request information," Ms. Ong added, referring to the Ochanpaugh case.

In approving the revised rule in December, the SEC said the revision helped to clarify Finra's ability to obtain records and would "be helpful to Finra members in understanding the scope of notice requirements under Rule 8210."

The Financial Services Institute Inc. has supported the rule change and believes the revision will provide "clarity regarding both the scope of and service of requests for information and testimony," FSI general counsel David Bellaire wrote in an e-mail.

"Anything that helps the authorities uncover unscrupulous advisers is good for clients and the industry as a whole," said Bernard Smit, a principal at Walnut Creek Wealth Management.

NO DUE PROCESS

In addition to concerns that Finra is overstepping its authority, critics of the rule are upset that the regulator still has no procedure by which reps could resist an 8210 demand, other than by fighting it in a formal proceeding.

"Finra can charge you separately" for refusing to produce records under Rule 8210, Mr. Neville said. "If you withheld documents in good faith and the [hearing] panel disagrees, you can lose your license."

In responding to comment letters, Finra argued that its investigations can involve unregistered

customers, issuers or foreign businesses, and that third-party documents should be fair game if they are in the control of a regulated person or firm.

Concerns that Finra has no right to documents solely because they are held by third parties "should not prevent the commission from approving the proposed rule change," the SEC said in its approval order.

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