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FINRA Issues Notice Stating That Confidentiality Provisions Governing FINRA Arbitrations Must Advise Parties They Can Still *Initiate* Communication With Regulators

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On October 9th, 2014, the Financial Industry Regulatory Authority ("FINRA") issued Regulatory Notice 14-40 ("Notice 14-40") related to non-disclosure provisions in FINRA arbitration confidentiality agreements and settlement agreements. While the Notice states that it is issued as a "reminder" to firms as to the acceptable parameters of non-disclosure provisions used in FINRA arbitrations, Notice 14-40 goes a step further than previous FINRA guidance. Firms are now required to *explicitly* notify signatories that confidentiality provisions do not limit their ability to *initiate* contact with regulators. FINRA's prior guidance on this topic was far more limited, only requiring that confidentiality provisions state that they do not prevent a party from responding to a regulator *upon inquiry*. Firms must review their current confidentiality provisions and add language where needed to explicitly advise customers that signing the document does not prohibit them from *initiating* contact with a regulator regarding a settlement, the case or the underlying facts.

Notice 14-40 reminds firms that they cannot use confidentiality provisions with customers or individuals in FINRA arbitrations that impede or have the potential to limit regulatory investigations and enforcement actions. Notice 14-40 further states that FINRA is "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."[1]

Notice 14-40 advises that an individual customer's right to initiate communications with FINRA or other regulatory authorities must be clearly stated in confidentiality provisions and settlement agreements. FINRA advises that any limit on a person's ability to communicate with FINRA, the SEC, any self-regulatory organization or any state or federal regulatory authority regarding settlements or underlying facts in disputes is inconsistent with just and equitable principles of trade and constitutes a violation of FINRA Rule 2010.[2] While open communication with regulators has always been the standard, none of FINRA's prior guidance on this topic required *explicit* notice to the parties that executing a document with a confidentiality provision would not prohibit that party from *initiating* contact with a regulator. In fact, a review of prior notices and guidance on the topic reveals that until now acceptable confidentiality provisions simply could not hinder a party's ability to respond to a regulator *upon inquiry*.

Background

FINRA, and its predecessor the National Association of Securities Dealers ("NASD"), has long been concerned with a member's

1 See Notice to Members 14-40 (emphasis added).

2 See FINRA Rule 2010 that provides, "A member in the conduct of its business, shall observe high standards of commercial honor and just and equitable principles of trade."

Notice 14-40 was Issued to Again Remind Members of What Constitutes Permissible Non - Disclosure Provisions in Confientiality Agreements and Settlement Agreements

use of confidentiality clauses in confidentiality agreements and settlement agreements having a negative affect on regulatory investigations and enforcement actions. Nearly thirty years ago, the NASD issued Notice 86-36 after finding that customers who had signed releases to settle arbitration complaints were reluctant to cooperate with NASD investigations fearing it was a violation of the confidentiality provision of the arbitration settlement agreement. At that time, the NASD made clear that it was a violation of the NASD Rules of Fair Practice for a member to use a confidentiality provision to limit or impede an NASD investigation.[3]

A decade later, the NASD issued Notice 95-87 which advised members to review and correct FINRA arbitration agreements that contained confidentiality clauses which prohibited or discouraged parties from disclosing the settlement terms and/or underlying facts of the dispute to the NASD or any securities regulator *upon inquiry*.[4] This notice was issued as a result of a series of NASD examinations and a special survey which was conducted to determine if confidentiality clauses were too broad and thus limiting investigations. For the first time, the NASD advised that a non-disclosure provision must specifically state that a customer or other person was permitted to disclose "the settlement terms (and underlying facts of the dispute) *upon inquiry*, to a securities regulator, such as NASD, or imposes a condition on such a disclosure."[5] Failure to include such a provision constituted a violation of NASD Rules of Fair Practice.[6]

3 See Notice to Members 86-36. See also NASD Regulatory and Compliance Alert, page 14 (June 1994) .
4 See Notice to Members 95-87.
5 Id (emphasis added). This message was further disseminated in the NASD Regulatory & Compliance Alert released in July 1995.
6 See NASD Regulatory and Compliance Alert (July 1995).

In June 2004, the NASD issued their penultimate notice on the issue. Notice 04-44 was issued to again remind members of what constitutes permissible non-disclosure provisions in confidentiality agreements and settlement agreements.[7] The NASD advised that upon review it had found several impermissible inclusions to confidentiality provisions, such as language that required customers to withdraw complaints from regulators and/or provide affidavits to regulators that contradicted prior statements, prohibited the customer from testifying before a regulator or required that prior notice be given to the member firm before the customer provided testimony to a regulator. Notice 04-44 reiterated the requirement that confidentiality provisions "expressly authorize the customer or other person to respond, without restriction or condition, to any inquiry regarding the settlement or its underlying facts by any a regulator, including NASD."[8]

Notice 14-40 Requires Firms To Revise Non-Compliant Confidentiality Provisions

Notice 14-40 states that it is a "reminder" to members regarding acceptable confidentiality provisions, yet this Notice goes decisively further than FINRA's prior guidance. Notice 14-40 expands upon the required language in an effort to ensure all parties are explicitly advised of their right to *initiate* contact with a regulator regarding the facts and circumstances of the case, regardless of a governing non-disclosure agreement. The expansion can easily be seen by comparing the suggested language provided in the notices. In 1995, the NASD suggested the following language for settlement agreements:

7 See Notice to Members 04-44.
8 Id (emphasis added).

> "Any non-disclosure provision in this agreement does not prohibit or restrict you (or your attorney) *from responding* to any inquiry about this settlement or its underlying facts and circumstances by the Securities and Exchange Commission (SEC), the National Association of Securities Dealers, Inc. (NASD) or any other self-regulatory organization."[9]

The Notice released in 2004 was verbatim except for the inclusion of the words "or providing testimony" to reiterate that any type of cooperation with a regulatory body was permissible. In the latest Notice, FINRA suggests the following language:

> "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."[10]

The only change to the language suggestions that were released in notices nearly two decades apart was the requirement that members include clear language advising that all parties may initiate contact with regulators. A provision that states that only cooperating when asked by a regulator is no longer sufficient.

Regulators have long been concerned that confidentiality provisions were being used to hinder investigations into the conduct of registered firms and individuals. FINRA has now determined that members must explicitly advise customers or other persons that they are permitted to initiate contact with regulators at any time regarding the conduct about which is the basis of the arbitration.[11] In order to comply with Notice 14-40, member firms must review and revise, where needed, non-disclosure provisions in confidentiality and settlement agreements to ensure that they explicitly advise signatories that signing the document does not prohibit them from *initiating* contact with a regulator regarding a settlement, the FINRA arbitration or the underlying facts. ■

9 See Notice to Members 95-87 (emphasis added).
10 See Notice to Members 14-40 (emphasis added).

11 See Rule 21F-17 of Securities and Exchange Act of 1934 ("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.").

For more information about any of the topics covered in this issue of the Securities Alert, please contact:

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