Via Email to *pubcom@finra.org*
Ms. Jennifer Piorko Mitchell
Office of the Corporate Secretary FINRA
1735 K Street, NW Washington, DC 20006-1506

Re: FINRA Regulatory Notice 18-22

Dear Ms. Mitchell:

I write in support of the proposed amendment to the Discovery Guide to require routine disclosure of liability insurance coverage by broker/dealers who are thinly capitalized or not self-insured. I have represented investors in FINRA arbitration for over 30 years. Since 1970, almost 50 years ago, the federal courts, under Rule 26, required all parties in litigation to disclose insurance coverage. Now that almost 50 years has past, it is well past the time for the financial services industry and FINRA regulation to catch up with this rule: Rule 26. Duty to Disclose; General Provisions Governing Discovery (a) Required Disclosures. (1) Initial Disclosure. (A) In General. Except as exempted by Rule 26(a)(1)(B) or as otherwise stipulated or ordered by the court, a party must, without awaiting a discovery request, provide to the other parties: (iv) for inspection and copying as under Rule 34, any insurance agreement under which an insurance business may be liable to satisfy all or part of a possible judgment in the action or to indemnify or reimburse for payments made to satisfy the judgment.

The practical significance of insurance in the decisions lawyers make about settlement and trial preparation cannot be understated. As the comments to the federal rule 26 said almost 50 years ago: "Disclosure of insurance coverage will enable counsel for both sides to make the same realistic appraisal of the case, so that settlement and litigation strategy are based on knowledge and not speculation. It will conduce to settlement and avoid protracted litigation in some cases, though in others it may have an opposite effect. The amendment is limited to insurance coverage, which should be distinguished from any other facts concerning defendant's financial status (1) because insurance is an asset created specifically to satisfy the claim; (2) because the insurance company ordinarily controls the litigation; (3) because information about coverage is available only from defendant or his insurer; and (4) because disclosure does not involve a significant invasion of privacy." The proposed FINRA rule would "require a party seeking the production of insurance information to expressly request that an opposing party produce insurance information." See NTM 18-22. There is no reason for a party to have to "expressly request" the insurance information. Insurance policy information should be automatically disclosed, just as it is required to be in the Federal Rule of Civil Procedure 26. The problem with having to make a request, is that it will likely be met with a creative denial or delay, as broker dealer attorneys routinely "object" and fail to disclose presumptively discoverable items required by the Discovery Guide. So while the idea is a good one, the proposed rule that requires a request should be changed to an automatic disclosure rule, without an express request.

It is sad that the financial services industry has waited 50 years to recognize what the federal courts have known for so long. Disclosure of insurance coverage actually aids the parties in settlement and trial preparation, and can actually speed up the resolution of claims. Brokerage firms that are insured rarely make the decisions about settlement; those settlement decisions are often controlled by the insurance adjusters and insurance defense attorneys. Moreover, a failure to disclose can lead to bad faith settlement practices that actually harm smaller broker dealers. Where liability is clear, and the damages exceed the insurance, a failure to tender the policy may be considered bad faith by the insurance company. Often, smaller broker dealers are being counseled by insurance defense attorneys that will

not counsel them on coverage issues, because they are hired and paid by the insurance company and are prevented by conflict of interest rules to provide insurance coverage advice. But when insurance is disclosed, claimants can make a policy demand for the insurance coverage limits, where appropriate, and then the broker dealer will have the opportunity to consult with private insurance coverage counsel to decide what is in their best interests—and not what is necessarily in the best interests of the insurance company. The failure of disclosure to date has resulted in some cases where prior disclosure would have led to a settlement, and not a verdict that is in excess of the policy limits, which then sometimes leads to the closure of a broker dealer due to the inability to pay. I have seen that exact scenario happen first hand. Claimants end up with unpaid arbitration awards and broker dealers are forced to close.

Disclosure of policy limits will also help prevent B/Ds from threatening bankruptcy or from filing Form BDW in the face of customer complaints. If insurance information is disclosed to the claimant's attorney in discovery, then appropriate actions can be taken to protect the rights of the claimant with coverage counsel. The least FINRA can do is to require its members to disclose scope and amount of insurance coverage, if it exists.

It is also suggested that the rule require that broker dealers disclose a copy of any coverage denial or reservation of rights letter from the insurance company. Reservation of rights letters mainly inform the insured of coverage and policy defenses, thereby preserving the insurer's right to assert such defenses. In many jurisdictions, the reservation of rights may allow the insurer to withdraw from the defense when there is no potential for coverage under the policy. The ROR letters allow insurers to decline indemnifying the insured for any portion of a judgment not covered under the policy. Some states, such as California, have statutory provisions, mandating that if and when a potential conflict of interest arises between the insured and the insurer, the insurer must inform the insured of its right to independent counsel and must provide independent counsel to the insured, unless the insured expressly waives, in writing, its right to independent counsel, California Civil Code 2860 (a).In these states, the insurer should advise the insured of its right to independent counsel if the reservation of rights gives rise to a conflict of interest between the insurer and the insured. Popovich v. Gonzales, (no right to rely on coverage defense where insured was not advised that reservation created a conflict of interest). When a reservation of rights creates a potential conflict of interest, insurers in many states are required to notify the insured of the potential conflict and offer to provide the insured with independent counsel, paid for by the insurer. California Civil Code 2860; San Deigo Navy Fed. Credit Union v. Cumis Ins. Society, Inc., Am. Family Life Assurance Co. of Columbus, Ga v. U.S. Fire Ins. Co., Union Ins. Co. v. Knife Co., Inc., Moeller v. Am. Guarantee and Liability Ins. Co., N. County Mut. Ins. Co. v. Davalos, Twin City Fire Ins. Co. v. Ben Arnold-Sunbelt Co. of So. Carolina, Popovich v. Gonzales, (no right to rely on coverage defense where insured was not advised that reservation created a conflict of interest). The insured is not obligated to accept the offer of independent counsel. In many states, the insured is entitled to select the independent counsel, but in some states the insurer retains this right. Cent. Mich. Bd. Of Trustees v. Employees Reins. Corp., (insurer retains right to select counsel).Although a reservation of rights protects an insurer's interests, it also alerts an insured to the fact that some elements of a claim may not be covered, thereby allowing the insured, and the claimants, to into consideration the availability of coverage in settlement negotiations and decisions prior to a final hearing. It allows all parties to take necessary steps to protect potentially uninsured interests.

As you can see, a reservation of rights letter often presents serious issues that both the broker-dealer(the insured) and claimants must consider before and during any settlement negotiation. As such, it is requested that FINRA amend its proposed rule to require the disclosure of any and all reservation of

rights letters. Further, it would be helpful for FINRA to caution its members to obtain their own private coverage counsel when faced with reservation of rights letters and coverage issues, because we have often seen broker dealers caught offguard, right before trial, during a mediation, when they are first told there is not enough coverage for the claim and they have to contribute to pay any settlement. This often causes problems that could have been avoided had insurance coverage and reservation of rights letters been disclosed at the beginning of the case, and not the end.

If you have any questions about any of the matters contained herein, please do not hesitate contact me.

Sincerely,
Jeffrey Sonn, Esq.
Sonn Law