

## Expungement of Customer Dispute Information

### FINRA Requests Comment on Proposed Amendments to the Codes of Arbitration Procedure Relating to Requests to Expunge Customer Dispute Information

Comment Period Expires: February 5, 2018

#### Summary

FINRA seeks comment on establishing a roster of arbitrators with additional training and specific backgrounds or experience from which a panel would be selected to decide an associated person's request for expungement of customer dispute information.<sup>1</sup> The arbitrators from this roster would decide expungement requests where the underlying customer-initiated arbitration is not resolved on the merits or the associated person files a separate claim requesting expungement of customer dispute information. The *Notice* also proposes additional changes to the expungement process that would apply to all requests for expungement of customer dispute information.

This proposal is one in a series of regulatory initiatives that FINRA is considering related to the expungement process. For example, the FINRA Board of Governors has approved filing with the Securities and Exchange Commission (SEC) proposed amendments to the Codes of Arbitration Procedure for Customer and Industry Disputes (Codes) to make the best practices from the Notice to Arbitrators and Parties on Expanded Expungement Guidance<sup>2</sup> (Guidance) rules that arbitrators must follow when considering expungement requests. In addition, FINRA staff has been working with the North American Securities Administrators Association (NASAA) on various expungement issues, including potential amendments to the existing regulatory review process.

The text of the proposed amendments can be found at [www.finra.org/notices/17-42](http://www.finra.org/notices/17-42).

December 6, 2017

#### Notice Type

- ▶ Request for Comment

#### Suggested Routing

- ▶ Compliance
- ▶ Legal
- ▶ Operations
- ▶ Registered Representatives
- ▶ Senior Management

#### Key Topics

- ▶ Arbitration
- ▶ Associated Person
- ▶ Code of Arbitration Procedure
- ▶ Dispute Resolution

#### Referenced Rules & Notices

- ▶ Code of Arbitration Procedure for Customer Disputes, Rule 12000 Series
- ▶ Code of Arbitration Procedure for Industry Disputes, Rule 13000 Series
- ▶ FINRA Rule 12100
- ▶ FINRA Rule 12805
- ▶ FINRA Rule 13805
- ▶ FINRA Rule 13806

Questions concerning this *Notice* should be directed to:

- ▶ Kenneth L. Andrichik, Senior Vice President and Chief Counsel, Office of Dispute Resolution, at (212) 858-3915;
- ▶ Victoria Crane, Associate General Counsel, Office of General Counsel, at (202) 728-8104; or
- ▶ Mignon McLemore, Assistant Chief Counsel, Office of Dispute Resolution, at (202) 728-8151.

## Action Requested

FINRA encourages all interested parties to comment on the proposal. Comments must be received by February 5, 2018.

Member firms and other interested parties can submit their comments using the following methods:

- ▶ Emailing comments to [pubcom@finra.org](mailto:pubcom@finra.org); or
- ▶ Mailing comments in hard copy to:  
Marcia E. Asquith  
Office of the Corporate Secretary  
FINRA  
1735 K Street, NW  
Washington, DC 20006-1506

To help FINRA process and review comments more efficiently, persons should use only one method to comment on the proposal.

**Important Notes:** The only comments that FINRA will consider are those submitted pursuant to the methods described above. All comments received in response to this *Notice* will be made available to the public on the FINRA website. Generally, FINRA will post comments as they are received.<sup>3</sup>

Before becoming effective, a proposed rule change must be authorized for filing with the SEC by the FINRA Board of Governors, and then must be filed with the SEC pursuant to Section 19(b) of the Securities Exchange Act of 1934 (SEA).<sup>4</sup>

## Background & Discussion

Through the expungement process, associated persons may seek to remove allegations made by customers from the Central Registration Depository (CRD<sup>®</sup>) system and hence from the FINRA BrokerCheck (BrokerCheck<sup>®</sup>) system.<sup>5</sup> It has been FINRA's long-held position that expungement of customer dispute information is an extraordinary measure, but it may be appropriate in certain circumstances.

CRD is the central licensing and registration system for the U.S. securities industry. In general, registered securities firms and regulatory authorities submit information in CRD in response to questions on the uniform registration forms.<sup>6</sup> These forms collect administrative, disciplinary and other information about registered personnel, including customer complaints, arbitration claims and court filings made by customers, and the arbitration awards or court judgments that may result from those claims or filings (*i.e.*, customer dispute information).<sup>7</sup> The SEC, FINRA, state and other regulators use this information in connection with their licensing and regulatory activities. Most of the CRD information is made publicly available through BrokerCheck. Associated persons may seek to have customer dispute information removed from CRD (and thereby, from BrokerCheck) pursuant to FINRA Rule 2080 because the claim or allegation is factually impossible, clearly erroneous or false, or if the associated person was not involved in the alleged investment-related sales practice violation.<sup>8</sup>

Critics of expungement have raised specific concerns about expungement hearings held after a settlement in the customer's arbitration case that gave rise to the customer dispute information (Underlying Customer Case). In these instances, critics argue that the panel from the Underlying Customer Case has not heard the full merits of that case and, therefore, may not have any special insights in determining whether to grant a request for expungement of customer dispute information under Rule 2080. Further, claimants and their counsel have little incentive to participate in an expungement hearing after the Underlying Customer Case settles and typically do not participate in such hearings. Thus, during these expungement hearings, the panel may receive information that is one-sided, which may favor the associated person requesting expungement.

The proposed amendments to the Codes would make a number of important changes to the current framework related to the expungement of customer dispute information. Among other things, the proposed amendments would:

### ***All Requests for Expungement of Customer Dispute Information***

- ▶ amend the Codes to require that for all requests for expungement of customer dispute information:
  - ▶ the associated person who is seeking to have his or her CRD record expunged must appear at the expungement hearing; and
  - ▶ to grant expungement, a three-person panel of arbitrators must unanimously agree that expungement is appropriate under Rule 2080(b)(1) and find that the customer dispute information has no investor protection or regulatory value.

***Expungement Requests During the Underlying Customer Case***

- ▶ limit an associated person who is named as a party to one opportunity to request expungement, and that opportunity must be exercised during the Underlying Customer Case;
- ▶ create limitations on requests for expungement of customer dispute information, including a one-year limitation period after the Underlying Customer Case closes for an associated person to file an expungement request that was not decided during the Underlying Customer Case;
- ▶ codify a party's ability to request expungement on behalf of an associated person not named as a respondent in the Underlying Customer Case (hereinafter referred to as an unnamed person)<sup>9</sup> during the Underlying Customer Case, and establish procedures for such requests;
- ▶ require associated persons who file expungement requests outside of the Underlying Customer Case to file the request under the Industry Code against the firm at which he or she was associated at the time of the events giving rise to the customer dispute;
- ▶ remove the option to file an expungement request outside of the Underlying Customer Case against a customer; and
- ▶ specify a minimum filing fee of \$1,425 for expungement requests.

***Expungement Arbitrator Roster***

- ▶ establish a roster of public chairpersons with additional qualifications to decide expungement requests (Expungement Arbitrator Roster) filed against a firm under the Industry Code.

***Expungement Requests in Simplified Arbitration Cases***

- ▶ require that an associated person or an unnamed person wait until the conclusion of a customer's simplified arbitration case to file an expungement request, which must be filed against the firm not the customer and would be heard by a panel selected from the Expungement Arbitrator Roster.

***Expungement Requests relating to Customer Complaints that Do Not Result in an Arbitration Claim***

- ▶ require that the associated person seek expungement of the customer dispute information relating to a customer complaint within one year of the member firm initially reporting the customer complaint to CRD.

## I. Requesting Expungement Relief During the Underlying Customer Case

Current FINRA Rule 12805 provides a list of requirements that arbitrators must meet before they may grant expungement.<sup>10</sup> The rule does not, however, provide any guidance for associated persons on how and when an associated person may request expungement relief during the Underlying Customer Case. As discussed further below, the proposal would amend Rule 12805 to set forth requirements for expungement requests filed by an associated person as a party as well as on behalf of an unnamed person.

### A. *Expungement Requests by an Associated Person Named as a Party*

#### 1. Applicability

Currently, under FINRA Rule 12805, an associated person who is a named party in an arbitration may request expungement during that arbitration, but is not required to do so. Some associated persons have filed requests seeking to expunge customer dispute information years after FINRA closed the Underlying Customer Case. Given the length of time between case closure and filing of the request, in many of these instances, the customers cannot be located and any documentation that could explain what happened in the case is not available or cannot be located. Thus, under the proposal, an associated person who is named as a party would be required to request expungement in the Underlying Customer Case. If the associated person does not request expungement in the Underlying Customer Case, the associated person would be prohibited from seeking to expunge the customer dispute information arising from the customer's statement of claim during any subsequent proceeding under the Codes. Requiring an associated person who is named in an arbitration to request expungement of the customer dispute information during the Underlying Customer Case would eliminate expungement requests filed years after the Underlying Customer Case concludes.

#### 2. Method of Request and Fees

The proposed amendments would permit the associated person to file an expungement request or include such request in the answer or any pleading.<sup>11</sup> The associated person would be permitted to file the request no later than 60 days before the first scheduled hearing session,<sup>12</sup> otherwise, the associated person would be required to file a motion<sup>13</sup> to seek an extension to file the expungement request. Thus, if an associated person files an expungement request after the 60-day timeframe, the non-moving parties could object and the panel would be required to decide the associated person's motion.

Along with the expungement request, the associated person would be required to pay a filing fee of \$1,425 or the applicable filing fee provided in Rule 12900(a)(1), whichever is greater.<sup>14</sup> In addition, consistent with existing provisions under the Codes, there would be an assessment of a member surcharge<sup>15</sup> and process fee<sup>16</sup> against each member that is named as a party or respondent, or that employed the associated person named as a respondent or party at the time of the events giving rise to the dispute, as applicable.<sup>17</sup>

### 3. Underlying Customer Case Closes by Award

If the Underlying Customer Case closes by award, the panel would be required to consider and decide the expungement request during the Underlying Customer Case. The panel must, among other things, agree unanimously to grant expungement and in the arbitration award: (1) identify at least one of the Rule 2080(b)(1) grounds for expungement that serves as the basis for expungement and provide a brief written explanation of the reasons for its finding that one or more Rule 2080(b)(1) grounds for expungement applies to the facts of the case; and (2) find that the customer dispute information has no investor protection or regulatory value.

The unanimity requirement would apply to all requests for expungement of customer dispute information. Thus, when a panel decides an associated person's expungement request during the Underlying Customer Case, the panel would be required to agree unanimously to grant expungement. In deciding the customer's claims, however, a majority agreement of the panel would continue to be sufficient.

### 4. Underlying Customer Case Closes Other than by Award

If the Underlying Customer Case closes other than by award (*e.g.*, the parties settle the arbitration), the panel in the Underlying Customer Case would not decide the associated person's expungement request. In this situation, the associated person would be permitted to file the expungement request as a new claim under the Industry Code against the firm at which he or she was associated at the time of the events giving rise to the customer dispute.<sup>18</sup> Under the proposal, an associated person would not be permitted to file the new expungement request against the customer because the customer should not be asked to participate in another arbitration hearing that could increase the customer's costs and expenses. Instead, the associated person would be required to name the firm at which he or she was associated at the time of the events giving rise to the customer dispute with the goal of having a more robust expungement proceeding that will help the panel determine whether to grant expungement. As discussed in further detail below, this new claim would be decided by a three-person panel selected from the Expungement Arbitrator Roster.

### 5. Limitations on Expungement Requests

For the expungement request to be considered after the Underlying Customer Case closes other than by award, the associated person would be required to file the request within one year after FINRA closes the Underlying Customer Case, provided the expungement request is not barred. Under the proposal, an associated person would be barred from requesting expungement relief if: (1) a panel or arbitrator in the Underlying Customer Case issued a decision on the expungement request for the same customer dispute information; (2) the associated person requested expungement of the same customer dispute information in court and the court denied the request; (3) the Underlying Customer Case has not concluded; (4) it has been more than a year since FINRA closed the Underlying Customer Case; or (5) if there was no Underlying Customer Case involving the customer dispute information, more than one year has elapsed since the date that the member firm initially reported the customer complaint to CRD.<sup>19</sup>

The first two limitations would prevent an associated person from forum shopping to garner a favorable outcome on his or her expungement request. Under the proposal, these limitations would apply to all requests for expungement of customer dispute information filed in the forum, including requests decided prior to the effective date of the proposal.

With respect to the third limitation, if an associated person's expungement request was not decided during the Underlying Customer Case, the associated person would be required to wait until the Underlying Customer Case concludes before filing a request for expungement. Thus, under the proposal, if the Underlying Customer Case has not concluded and an associated person has filed a request for expungement of the customer dispute information at issue in the Underlying Customer Case, FINRA would stay the associated person's expungement request until the Underlying Customer Case concludes and permit the associated person to refile it under the Industry Code so that it could be heard by a panel from the Expungement Arbitrator Roster.

With respect to the fourth limitation, if the expungement request is not filed within a year after the Underlying Customer Case closes, the associated person would forfeit his or her right to request expungement. The one-year limitation period would ensure that the expungement hearing is held close in time to the Underlying Customer Case, when information regarding the Underlying Customer Case is available and in a timeframe that would increase the likelihood for the customer to participate if he or she chooses to do so.

Under the proposal, the one-year limitation period would apply where the Underlying Customer Case closes after the effective date of the proposal. If the Underlying Customer Case closes on or prior to the effective date of the proposal, the associated person would have six months from the effective date to file the expungement request.

The fifth limitation would establish a one-year period for associated persons to expunge customer dispute information that arose from a customer complaint and did not result in an arbitration claim. Under the proposal, the associated person would have a year from the date that a member firm initially reported a customer complaint to CRD to file an expungement request.<sup>20</sup> If a member firm initially reports a customer complaint to CRD on or prior to the effective date of the proposal, the associated person would have six months from the effective date of the proposal to file the expungement request.

#### *B. Expungement Requests by a Party on Behalf of an Unnamed Person*

##### *1. Applicability*

The proposal would define an unnamed person to mean an associated person or formerly associated person who is identified in Forms U4 or U5 as having been the subject of an investment-related customer-initiated arbitration that alleged that he or she was involved in one or more sales practice violations, but who was not named as a respondent in the arbitration.<sup>21</sup>

Currently, unnamed persons have three arbitration avenues to pursue expungement under the Codes: (1) a party to an arbitration may request expungement on their behalf during the Underlying Customer Case; (2) the unnamed persons may try to intervene in the Underlying Customer Case; and (3) the unnamed persons may file a separate arbitration case seeking expungement after the Underlying Customer Case closes.

As explained further below, the proposed amendments would codify the ability of a party in the Underlying Customer Case to request expungement on behalf of an unnamed person with the written approval of the unnamed person. The proposed amendments would also codify procedures regarding when and how an unnamed person may file a separate case seeking expungement of customer dispute information after the Underlying Customer Case closes.

As these would be the only avenues by which an unnamed person may request expungement of customer dispute information under the Codes, the proposed amendments would foreclose the option for an unnamed person to intervene in the Underlying Customer Case and thereby remove the potential for the unnamed person to become a party in the Underlying Customer Case.

## 2. Procedural Similarities to Expungement Requests by an Associated Person Named as a Party

The proposed procedures discussed above that would apply to expungement requests by an associated person named as a party (*i.e.*, method of request and fees, customer case closure either by award or otherwise, and one-year limitation period) would also apply to expungement requests by a party on behalf of an unnamed person, with some modifications as explained below.

First, a party requesting expungement relief on behalf of an unnamed person would be required to file with the Director of the Office of Dispute Resolution<sup>22</sup> (Director) and serve on all parties no later than 60 days before the first scheduled hearing session: (1) a Form Requesting Expungement Relief on Behalf of an Unnamed Person, signed by the unnamed person whose CRD record would be expunged;<sup>23</sup> and (2) a statement requesting expungement relief.<sup>24</sup> The signed form would represent an acknowledgement by the unnamed person that he or she agrees to be bound by the panel's decision on the request for expungement relief. If the party does not request expungement within the 60-day timeframe, the party would be required to file a motion seeking an extension to file the expungement request.

Second, if the Underlying Customer Case closes other than by award, FINRA would notify the unnamed person in writing that the case has closed. This milestone in the customer's case would start the one-year limitation period for the unnamed person to seek expungement of the customer dispute information against the firm at which he or she was associated at the time of the events giving rise to the customer dispute, in a separate action under the Industry Code (as discussed in further detail below).

Finally, if a party from the Underlying Customer Case does not request expungement relief on behalf of the unnamed person, the unnamed person would be permitted to file an expungement request under the Industry Code against the firm at which he or she was associated at the time of the events giving rise to the customer dispute, within one year of the Underlying Customer Case closure, provided the expungement request is not barred.<sup>25</sup>

## II. Proposed Changes that Apply to All Requests for Expungement of Customer Dispute Information

Currently, the Codes provide criteria that a panel must follow before it may decide an expungement request.<sup>26</sup> As explained in further detail below, under the proposal, the current requirements to hold a hearing session and to provide a basis for expungement in an arbitration award would be expanded to clarify the process and guide further the arbitrators' decision-making. The proposed changes would apply to all requests to expunge customer dispute information filed under the Codes.

### A. *Hold a Hearing Session*

Currently, the Codes require a panel that is deciding an expungement request to hold a recorded hearing session (by telephone or in person) regarding the appropriateness of expungement.<sup>27</sup> The proposed amendments would require that an associated person who is seeking to have his or her CRD record expunged appear at the expungement hearing, either in person or by videoconference; appearance by telephone would not be an option. As the associated person is requesting the permanent removal of information from CRD, FINRA believes that the associated person should be available in person or by videoconference to present his or her case and respond to questions from the panel.

### B. *Unanimity and Additional Finding Required to Grant Expungement of Customer Dispute Information*

Currently, the Codes require that the panel indicate in the arbitration award which of the Rule 2080 grounds for expungement serves as the basis for its expungement order and provide a brief written explanation of the reasons for its finding that one or more Rule 2080 grounds for expungement applies to the facts of the case.<sup>28</sup>

The proposed amendments would require that the panel agree unanimously to grant expungement and in the arbitration award: (1) identify at least one of the Rule 2080(b)(1) grounds for expungement that serves as the basis for expungement and provide a brief written explanation of the reasons for its finding that one or more Rule 2080(b)(1) grounds for expungement applies to the facts of the case; and (2) find that the customer dispute information has no investor protection or regulatory value.

The proposal would clarify for arbitrators that the standard for granting the permanent removal of customer dispute information from CRD is a finding that the customer dispute information has no investor protection or regulatory value. Since Rule 2080 has been in effect, FINRA has implemented policies and procedures to strengthen the expungement process. For example, in 2008, FINRA adopted Rule 12805 to require arbitrators to perform additional fact finding before granting expungement of customer dispute information.<sup>29</sup> After the approval of FINRA Rule 12805, FINRA staff updated the arbitrator training materials and all arbitrators were required to certify that they had familiarized themselves with the requirements of the expungement rules.<sup>30</sup> In 2013, in response to FINRA staff's concerns about the number of expungement requests granted after the Underlying Customer Case settles, FINRA published the Guidance for arbitrators to use when considering expungement requests.<sup>31</sup>

Based on FINRA's review of awards where expungement has been granted, arbitrators appear to be following the practices identified in the Guidance and have a heightened awareness that expungement is an extraordinary remedy. FINRA has noticed a marked improvement in the quality of the awards in which expungement is granted. Notwithstanding these positive results, FINRA believes that expanding the findings that arbitrators must make before granting expungement of customer dispute information would help FINRA maintain the accuracy of the data that appears in CRD by ensuring that only information that is not valuable to regulators and investors is expunged from CRD.<sup>32</sup>

### **III. Requests for Expungement of Customer Dispute Information Under the Industry Code and the Expungement Arbitrator Roster**

As explained above, if an expungement request is not decided during the Underlying Customer Case, the proposal would permit an associated person to file the expungement request as a new claim against the firm<sup>33</sup> at which he or she was associated at the time of the events giving rise to the customer dispute, provided the claim is not barred.<sup>34</sup> A three-person panel selected from the Expungement Arbitrator Roster would decide this new claim.

#### *A. Selection of Panel*

Under the proposal, the Neutral List Selection System<sup>35</sup> (NLSS) would randomly select three public chairpersons<sup>36</sup> from the Expungement Arbitrator Roster to decide an expungement request.<sup>37</sup> To be on the Expungement Arbitrator Roster, the public chairpersons would be required to have the following additional qualifications:

- (1) completed enhanced expungement training;<sup>38</sup>
- (2) admitted to practice law in at least one jurisdiction; and
- (3) five years' experience in any one of the following disciplines:
  - (a) litigation;
  - (b) federal or state securities regulation;
  - (b) administrative law;
  - (c) service as a securities regulator; or
  - (d) service as a judge.

The proposed changes to the expungement framework would help arbitrators on the Expungement Arbitrator Roster better understand the unique nature of this extraordinary remedy and the importance of maintaining the integrity of the public record. The proposed roster composition and the proposed additional requirements to grant expungement, taken together, should help FINRA maintain the integrity of its CRD records and ensure that expungement is only granted in appropriate circumstances.

### *B. Expungement Hearing*

Under the proposal, once the panel is selected from the Expungement Arbitrator Roster, it must hold a recorded hearing session regarding the appropriateness of the associated person's request for expungement of customer dispute information. With respect to the hearing session, the proposal provides that: (1) the associated person whose CRD record would be expunged must appear at the expungement hearing either in person or by videoconference;<sup>39</sup> (2) the Director would notify the parties from the Underlying Customer Case or the customer complaint of the time and place of the expungement hearing; and (3) all customers in the Underlying Customer Case or customers who filed a customer complaint are entitled to appear at the expungement hearing. At the customer's option, the customer may appear by telephone.

As discussed above in connection with expungement hearings in the Underlying Customer Case, FINRA believes that as the associated person is requesting the permanent removal of information from CRD, the associated person should be available in person to present his or her case and respond to questions from the panel. In addition, FINRA believes that allowing customers to appear by telephone would make it easier for them to participate in the expungement hearing and, therefore, could encourage them to participate.

### *C. Unanimity and Additional Finding Required to Grant Expungement*

Consistent with requests for expungement relief considered by a panel under the Customer Code, a panel selected from the Expungement Arbitrator Roster under the Industry Code may grant expungement of customer dispute information only if the panel agrees unanimously. In addition, in the arbitration award the panel must: (1) identify at least one of the Rule 2080(b)(1) grounds for expungement that serves as the basis for expungement and provide a brief written explanation of the reasons for its finding that one or more Rule 2080(b)(1) grounds for expungement applies to the facts of the case; and (2) find that the customer dispute information has no investor protection or regulatory value.

## **IV. Expungement Requests in Simplified Arbitrations**

Under the Codes, arbitrations involving \$50,000 or less are decided by a single arbitrator without a hearing, also referred to as a decision "on the papers," and are called simplified arbitrations.<sup>40</sup> The Codes provide that the requirement to hold a hearing to decide an expungement request applies to expungement requests made in simplified arbitrations.<sup>41</sup>

Under the proposal, an associated person or unnamed person would be required to file an expungement request under the Industry Code against the firm at which he or she was associated at the time of the events giving rise to the customer dispute, and only at the conclusion of the simplified case. Thus, a panel from the Expungement Arbitrator Roster would consider and decide the expungement request.<sup>42</sup>

The proposed amendments would address a concern raised by customers that when an associated person requests expungement during a simplified case, the arbitrator holds a hearing during the simplified case to decide the appropriateness of expungement. When the arbitrator conducts a hearing in this situation, the customer is forced to participate in a hearing that he or she did not request, which delays the customer's case and the rendering of an award in the customer's simplified case. The proposed amendments would ensure that expungement requests would not be heard during a simplified case.<sup>43</sup>

## **V. Preliminary Economic Impact Analysis**

### *A. Regulatory Need*

Associated persons can request expungement of customer dispute information from CRD. As discussed above, some critics have raised concerns about arbitration panels granting requests for expungement of customer dispute information when the panel has not heard the full merits of the Underlying Customer Case. Claimants and their counsel may not have the incentive to participate in expungement hearings. Panels, therefore, may receive information that is one-sided, which could favor the associated person seeking expungement. The proposed amendments would provide for an increased opportunity for customer participation in expungement decisions, make information regarding the Underlying Customer Case more readily available, make the expungement decision more timely relative to the Underlying Customer Case, and establish an Expungement Arbitrator Roster to decide expungement requests when expungement has not been decided as part of the Underlying Customer Case.

### *B. Economic Baseline*

The economic baseline for the proposed amendments is the current rules under the Codes that address the process for associated persons to expunge customer dispute information from CRD. The proposed amendments are expected to affect associated persons; firms; customers to complaints or arbitration cases; customers that publicly view CRD information through BrokerCheck; and the SEC, FINRA, state and other regulators that use CRD.

Associated persons have incentive to file for expungement relief to remove customer dispute information from CRD. By removing customer dispute information from CRD, associated persons would also remove customer dispute information from BrokerCheck. Customer dispute information on CRD and BrokerCheck may impact the business of associated persons and reduce their professional opportunities. Investors (including current and prospective customers) use BrokerCheck to learn about the professional background and conduct of associated persons. Current and prospective customers may be less likely to select or remain with associated persons who have customer dispute information on their records. Current and future employers can also consider customer dispute information when making employment decisions.

Although panels that decide expungement requests receive information related to the expungement request from associated persons, they may not receive such information from customers. Panels are likely to receive information from customers if the panel decides the expungement request during the Underlying Customer Case. Panels are less likely to receive such information if the Underlying Customer Case is settled or withdrawn. Panels may also not receive information from customers if associated persons file separate claims requesting expungement and the customers are unwilling or unable to participate. In these instances, customers and their counsel may not have the incentive to participate in the separate expungement hearing. Associated persons may also request expungement of customer dispute information long after the Underlying Customer Case closes, making it potentially more difficult for customers to participate and the panel to verify or validate the information provided.

One-sided information could favor the associated persons seeking expungement, which has the potential to reduce the integrity and reliability of the information on CRD and BrokerCheck. As noted above, investors use that information to make decisions about associated persons with whom they may wish to do business. The SEC, FINRA, state and other regulators use CRD information for licensing and regulatory activities. Accordingly, the integrity and reliability of CRD information is critical to the needs of these stakeholders.

FINRA staff is able to identify 5,482 customer claims in arbitration that were filed from 2014 to 2016, and that were closed as of June 30, 2017. FINRA staff is also able to identify 12,849 customer complaints that were filed against associated persons and closed during the same time period but did not result in an arbitration claim. These customer claims and complaints are available in the CRD system and disclosed through BrokerCheck and, therefore, could be the subject of an expungement request by an associated person.

FINRA staff is able to identify 2,232 customer arbitration cases involving an expungement request that were filed from 2014 to 2016 and closed as of June 30, 2017. Among the 2,232 cases, 1,738 (78 percent) were closed by settlement or mediation. Another 384 (17 percent) of the 2,232 cases were closed by hearing or on the papers; another 92 (4 percent) were withdrawn; and 18 (less than 1 percent) were closed by other means. In addition to the 2,232 customer arbitration cases, FINRA staff is also able to identify 183 intra-industry arbitration cases that involve an expungement request of customer dispute information.

Among the cases containing a request for expungement of customer dispute information that were filed from 2014 to 2016 and closed as of June 30, 2017, arbitrators made a determination regarding the expungement of customer dispute information in 808 of these cases. The 808 cases include decisions regarding expungement requests as part of the Underlying Customer Case as well as decisions regarding expungement requests when associated persons filed a separate claim for expungement following the close of the Underlying Customer Case.

Arbitrators recommended expungement for at least one associated person in 608 (75 percent) of the 808 cases. In another 213 (26 percent) of the 808 cases, arbitrators did not grant expungement for at least one associated person. In a few of the 808 cases where more than one associated person sought expungement relief, arbitrators both granted and did not grant expungement relief for at least one associated person. Among the 808 cases in which arbitrators made a determination regarding the expungement of customer dispute information, the Underlying Customer Case closed by settlement in 436 of the cases. Arbitrators recommended expungement for at least one associated person in 88 percent of these 436 cases.

If an arbitration panel grants expungement of customer dispute information, the associated person must obtain an order from a court of competent jurisdiction confirming the arbitration award containing expungement relief. In the experience of FINRA staff, courts typically confirm arbitration awards containing expungement relief. Associated persons that obtain a court order confirming the arbitration award must then serve the confirmed award on FINRA to have the customer dispute information expunged. Not all panel expungement recommendations result in the expungement of customer dispute information from CRD and BrokerCheck. Some associated persons may determine not to confirm the award in court. As of June 30, 2017, FINRA had expunged customer dispute information in connection with 391 (64 percent) of the 608 cases pursuant to a court order. As of that date, associated persons may have not yet sought or obtained a court order for the remaining 217 of the 608 cases. Other associated persons may have not yet served the confirmed award on FINRA.

Lastly, the current fee structure for filing a request to expunge customer dispute information provides incentives for associated persons to file a request separately from the Underlying Customer Case and add a small monetary claim, thus making it a simplified claim, to reduce the filing fee to \$50 from \$1,575 (*i.e.*, the filing fee for a non-monetary/ unspecified claim). Further, by making the request a simplified claim, the case can be heard by one arbitrator as opposed to the default of a three-arbitrator panel for non-monetary or unspecified claims.<sup>44</sup>

### *C. Economic Impacts*

The proposed amendments are designed, among other things, to improve the quality and timeliness of the information available to panels determining requests for expungement. The panels assigned to the Underlying Customer Case would be more likely to decide expungement requests, if any. In addition, expungement decisions would occur soon after the Underlying Customer Case closes or a member firm initially reports a customer complaint to CRD. The proposed amendments would therefore increase the opportunity for or likelihood that panels would receive information from customers when considering expungement requests. The information is therefore less likely to be one-sided and favor associated persons. The proposed amendments would also establish qualifications for those arbitrators on the Expungement Arbitrator Roster who decide expungement requests when customers are less likely to provide information in connection with an expungement request. With these additional qualifications, the arbitrators should be better able to evaluate the information they receive in a more judicious and discerning manner.

The proposed amendments would benefit investors, member firms, and regulators by helping to ensure that the customer dispute information on CRD and, therefore, BrokerCheck more accurately reflects those customer disputes that have investor protection or regulatory value. Stakeholders would be more confident in the reliability of the customer dispute information contained on CRD and BrokerCheck. The customer dispute information contained on CRD and BrokerCheck would also be more meaningful and valuable to stakeholders.

Customers would benefit from the proposed amendments that restrict the manner and timing of associated persons' requests for expungement of customer dispute information. Associated persons would have one year after a customer complaint was initially reported to CRD to request expungement of the information. For customer complaints that result in an arbitration claim, associated persons named in an Underlying Customer Case would be required to request expungement during the Underlying Customer Case. Associated persons whose expungement request is not determined during the Underlying Customer Case would then have one year following the close of the Underlying Customer Case to request expungement of the customer dispute information. Customers would therefore have a greater ability to participate in the expungement hearings, if they so choose. In addition, if a separate expungement case were filed, the associated person would no longer be able to name the customer as the opposing party. Customers would therefore no longer incur the costs and inconvenience to be a party to these claims. Lastly, expungement requests would not be heard during a simplified case. As a result, customer claimants in simplified cases would no longer experience delays in the resolution of their cases as a result of expungement hearings, and would not be forced to attend a hearing in a case that the customer chose to be decided on the papers.

The proposed amendments would impose costs on associated persons, primarily by restricting how and when they could file an expungement request and, in some cases, by increasing the cost of filing an expungement request. The stricter requirements for requesting expungement of customer dispute information are meant to improve the quality and timeliness of the information that the panel hearing the request receives. The information that panels receive is less likely to be one-sided from associated persons only. The information is therefore less likely to favor the associated persons requesting expungement.

The requirement that the decision be unanimous, rather than a majority decision, could also increase the difficulty for an associated person to obtain expungement. To the extent that customers and firms use customer dispute information to make business and employment decisions, if customer dispute information is not expunged as frequently, associated persons could experience a loss of business and professional opportunities, loss of employment at their current firm, and thus, decreased income.<sup>45</sup>

Associated persons could also incur additional fees to file expungement requests. The associated person would be required to pay a filing fee of \$1,425 or the applicable filing fee provided in Rule 12900(a)(1), whichever is greater. This aspect of the proposed amendments would end the practice of associated persons adding a monetary claim of less than \$1,000 to separately filed expungement requests to reduce their filing fee to the minimum of \$50.<sup>46</sup>

Associated persons would also be required to attend expungement hearings in person, either by traveling to the hearing location or by videoconference, depending on the method permitted by the arbitration panel. Traveling to the hearing location could significantly increase the cost of having their request heard, by increasing both transportation and room and board costs as well as lost time in transit. Attendance by videoconference would eliminate many of these costs.

The potential decrease in the frequency in which panels recommend expungement and the potential increase in costs to file and to attend hearings could reduce the incentive of associated persons to request expungement of customer dispute information. Associated persons could continue to request expungement relief if they believe that the request is likely to be granted and that any reduction to their income potential is greater than any costs that they could incur. Accordingly, the types of expungement cases that arbitration panels would consider under the proposed amendments would likely be more meritorious.

The proposed amendments would also impose additional costs on member firms. If associated persons file a separate claim for expungement, they would be required to file the claim against the firm at which he or she was associated at the time of the events giving rise to the customer dispute, rather than against the customer. To the extent that member firms would become a party to the expungement case more frequently, they could experience higher costs associated with those cases.

The magnitude of the benefits and costs of the proposed amendments depends on the change in the number of associated persons requesting expungement of customer dispute information, the number of arbitration awards that grant expungement, and the number of expungement awards confirmed by the courts. The extent to which awards granting expungement become more informed would enhance the integrity and reliability of the customer dispute information on CRD and, therefore, BrokerCheck and the ability of customers and regulators to rely on the information as an accurate description of the conduct of associated persons. The magnitude of the benefits and costs also depends on the extent to which the record of associated persons decreases their business or professional opportunities. A greater decrease in business or professional opportunities would result in a greater economic transfer between associated persons. The proposed amendments would have no effect on associated persons that do not have future customer claims or complaints.

#### D. *Alternatives Considered*

As noted above, FINRA staff has been working with NASAA on various expungement issues, including potential amendments to the existing regulatory review process. The proposed amendments in this *Notice* reflect just one approach. FINRA requests comment below to inform subsequent revisions to the proposed amendments, including other approaches that could reduce the potential that panels receive information that is one-sided, which may favor the associated person requesting expungement.

### Request for Comment

FINRA is interested in receiving comments on all aspects of the proposed amendments. In particular, FINRA seeks comment on the following questions:

1. FINRA Rules 12805 and 13805 provide, in relevant part that, in order to grant expungement of customer dispute information under Rule 2080, the panel must comply with the requirements stated in the rule. (Emphasis added.) FINRA notes, however, that if a panel issues an arbitration award containing expungement relief, the award must be confirmed by a court of competent jurisdiction and FINRA could decide to oppose the confirmation. Thus, as the associated person is required to complete additional steps after the arbitrators make their finding in the award before FINRA will expunge the customer dispute information, FINRA believes the word “grant” may not be an appropriate description of the panel’s authority in the expungement process. FINRA is considering changing the word to “recommend.” Please discuss whether the rule should retain “grant” or change to “recommend” or some other description to more accurately reflect the panel’s authority in the expungement process.
2. Would named associated persons request expungement in every case to preserve the right to have the expungement claim heard and decided, either in the Underlying Customer Case or as a new claim under the Industry Code? If so, what would be the potential costs and benefits of a named person requesting expungement in every case?
3. Should FINRA consider bifurcating the expungement request from the customer’s claim in all cases relating to customer disputes? What would be the costs and benefits of such an approach?
4. What are the costs and benefits of requiring the unanimous consent of a three-person panel to grant all requests for expungement of customer dispute information?
5. Is the one-year limitation on being able to request expungement of customer dispute information appropriate? Should the time period be longer or shorter? Please discuss.

6. Should the associated person who is requesting expungement be required to appear in person or by videoconference, rather than by phone, at the expungement hearing?
7. Should the arbitrators on the Expungement Arbitrator Roster have specific qualifications? If so, are the proposed additional qualifications appropriate or should FINRA consider other qualifications?
8. Should the arbitrators on the Expungement Arbitrator Roster be lawyers only or could the experience of serving on three arbitrations through award be a sufficient substitute?
9. How would the proposed amendments affect the granting or denying of expungement requests? Which aspect of the proposed amendments would have the largest impact on expungement determinations? Why?
10. The proposal would establish a one-year limitation period for associated persons to expunge customer dispute information that arose from a customer complaint. The limitation period would start on the date that the member firm initially reported the customer complaint to CRD. Should the one-year limitation period be based on a different milestone? If so, what should it be?
11. The proposal would clarify for arbitrators that the standard for granting the permanent removal of customer dispute information from CRD is a finding that at least one of the Rule 2080(b)(1) factors applies and that the customer dispute information has “no investor protection or regulatory value.” Are there specific factors that arbitrators should consider when making a finding that the customer dispute information has “no investor protection or regulatory value”?
12. In a simplified arbitration case, if a customer requests a hearing, should the single arbitrator be permitted to decide an expungement request, if a request is filed?

## Endnotes

1. On December 16, 2015, the FINRA Dispute Resolution Task Force (Task Force) issued its Final Report and Recommendations (Final Report). One of the recommendations was that FINRA create a special arbitrator roster to handle expungement requests in settled cases and in cases when a claimant did not name the associated person as a respondent. A list of the Task Force members is available at <http://www.finra.org/arbitration-and-mediation/finra-dispute-resolution-task-force>. The Final Report is available at <http://www.finra.org/sites/default/files/Final-DR-task-force-report.pdf>.
2. See Expanded Expungement Guidance (September 2017), available at <http://www.finra.org/arbitration-and-mediation/notice-arbitrators-and-parties-expanded-expungement-guidance>.
3. Persons submitting comments are cautioned that FINRA does not redact or edit personal identifying information, such as names or email addresses, from comment submissions. Persons should submit only information that they wish to make publicly available. See *Notice to Members 03-73* (Online Availability of Comments) (November 2003) for more information.
4. See Section 19 and rules thereunder. After a proposed rule change is filed with the SEC, the proposed rule change generally is published for public comment in the *Federal Register*. Certain limited types of proposed rule changes take effect upon filing with the SEC. See SEA Section 19(b)(3) and SEA Rule 19b-4.
5. FINRA operates the CRD system pursuant to policies developed jointly with NASAA. FINRA works with the SEC, NASAA, other members of the regulatory community, and member firms to establish policies and procedures reasonably designed to ensure that information submitted and maintained on the CRD system is accurate and complete. These procedures, among other things, cover expungement of customer dispute information from the CRD system in narrowly defined circumstances.
6. For example, broker-dealers use the Uniform Application for Securities Industry Registration or Transfer, referred to as Form U4, to register or transfer the registrations of, associated persons with self-regulatory organizations (SROs), and with states, commonwealths and territories. Also, broker-dealers use the Uniform Termination Notice for Securities Industry Registration, referred to as Form U5, to terminate the registrations of associated persons with SROs, and with states, commonwealths and territories.
7. See *Notice to Members 04-16* (March 2004).
8. FINRA Rule 2080 requires members or associated persons seeking expungement of customer dispute information to obtain an order from a court of competent jurisdiction directing expungement or confirming an arbitration award recommending expungement relief and requires the member or associated person to name FINRA as a party in any judicial proceeding seeking expungement relief. FINRA may, however, waive the requirement to name it as a party if it determines that the requested expungement relief is based on affirmative judicial or arbitral findings that: (1) the claim, allegation or information is factually impossible or clearly erroneous, (2) the associated person was not involved in the alleged investment-

- related sales practice violation, forgery, theft, misappropriation or conversion of funds, or (3) the claim, allegation, or information is false. In addition, FINRA has sole discretion “under extraordinary circumstances” to waive the requirement if the expungement request is meritorious and expungement would not have a material adverse effect on investor protection, the integrity of the CRD system, or regulatory requirements.
9. In 2009, Forms U4 and U5 were amended to add questions that required registered persons to report allegations of sales practice violations made in customer-initiated arbitrations even if they were not named as a respondent in the arbitration. *See Securities Exchange Act Release No. 59916 (May 13, 2009), 74 FR 23750 (May 20, 2009) (Order Approving SR-FINRA-2009-008); see also Regulatory Notice 09-23 (May 2009).* Such persons may believe these allegations are unfounded and seek to have them expunged. Because they are not parties to the customer-initiated arbitration, they are unable to seek expungement relief in the Underlying Customer Case.
  10. FINRA Rule 12805 provides that a panel must comply with the following criteria before granting expungement: (1) hold a hearing to decide the issue of expungement; (2) review settlement documents, and consider the amount of payments made to any party, and any other terms and conditions of the settlement; (3) indicate in the award which of the grounds in FINRA Rule 2080 is the basis for expungement and provide a brief written explanation of the reasons for granting expungement; and (4) assess all forum fees for hearing sessions in which the sole topic is the determination of the appropriateness of expungement against the parties requesting expungement relief. *See also FINRA Rule 13805.*
  11. Under the Codes, a pleading is a statement describing a party’s causes of action or defenses (*e.g.*, statement of claim, answer, or counterclaim). *See FINRA Rule 12100(v).*
  12. A hearing session is any meeting between the parties and the arbitrator(s) of four hours or less, including a hearing or prehearing conference. *See FINRA Rules 12100(p) and 13100(p).*
  13. *See FINRA Rule 12503.*
  14. Currently, if an associated person requests expungement relief only in a claim filed separately, the filing fee would be the non-monetary/unspecified claim amount, or \$1,575. *See FINRA Rules 12900(a) and 13900(a).* Associated persons have been adding a monetary claim of less than \$1,000 to a request for expungement relief to reduce the filing fee to \$50. By converting the non-monetary/unspecified claim into a simplified claim, the associated person reduces the number of arbitrators who would hear and consider a complex matter like expungement from three to one. *See FINRA Rules 12401 and 13401.*
  15. A surcharge is assessed against each member that is named as a respondent in or employed, at the time the dispute arose, an associated person who is named as a respondent in a claim, counterclaim, cross claim, or third party claim filed and served under the Codes. *See FINRA Rules 12901(a)(1)(B) and 12901(a)(1)(C) and FINRA Rules 13901(a)(2) and 13901(a)(3).*
  16. Each member that is a party to an arbitration claim in which more than \$25,000 is in dispute is required to pay a process fee based on the amount of the claim. In addition, if an associated person of a member is a party, the member that employed the associated person at the time the dispute arose is charged the process fee, even if the member is not a party. *See FINRA Rules 12903(a) and (b) and FINRA Rules 13903(a) and (b).*

17. Under the Codes, no member is assessed more than a single surcharge or one process fee in any arbitration. *See* FINRA Rules 12901(a)(4) and 12903(b) and FINRA Rules 13901(d) and 13903(b).
18. The proposed amendments would not allow an associated person named in the Underlying Customer Case to file the claim requesting expungement relief against the customer from the Underlying Customer Case.
19. *See* proposed FINRA Rule 13805(a)(3).
20. A customer complaint can be reported to the CRD system via a Form U4 or Form U5. Pursuant to the requirements of FINRA Rule 1010, an associated person should be aware of the filing of a Form U4 by the associated person's member firm, as well as any amendments to the Form U4 to report a customer complaint involving that person. Article V, Section 3 of FINRA's By-Laws requires that a member firm provide an associated person a copy of an amended Form U5, including one reporting a customer complaint involving the associated person. Moreover, FINRA provides several methods for associated persons and former associated persons to check their records (*e.g.*, by requesting an Individual Snapshot or by checking BrokerCheck).
21. *See* proposed FINRA Rule 12100(dd). *See also supra* note 9.
22. The term "Director" means the Director of the Office of Dispute Resolution. Unless the Codes provide that the Director may not delegate a specific function, the term includes staff to whom the Director has delegated authority. *See* FINRA Rules 12100(m) and 13100(m).
23. The text of the form can be found at [www.finra.org/notices/17-42](http://www.finra.org/notices/17-42).
24. Under the proposal, the party may include the request for expungement relief in an answer or pleading.
25. *See* proposed FINRA Rule 13805(a)(3). The unnamed person also would be prohibited from filing an expungement request against a customer.
26. *See supra* note 10.
27. *See* FINRA Rules 12805(a) and 13805(a).
28. *See* FINRA Rules 12805(c) and 13805(c).
29. *Id.*
30. In 2014, FINRA staff revamped the arbitrator training materials and amended them again in 2016.
31. *See supra* note 2.
32. *See* Securities Exchange Act Release No. 48933 (Dec. 16, 2003), 68 FR 74667, 74672 (Dec. 24, 2003) (Order Approving File No. SR-NASD-2002-168).
33. A firm, named as a respondent, would be assessed a member surcharge and process fee as provided under the Codes. *See supra* notes 15, 16 and 17.
34. *See* proposed FINRA Rule 13805(a)(3).
35. *See* FINRA Rule 13400.
36. A public arbitrator is an individual who does not have significant ties to the securities industry. *See* FINRA Rule 13100(x). Arbitrators are eligible to serve as chairpersons if they have completed chairperson training and: (1) have a law degree and are a member of a bar of at least one jurisdiction and have served as an arbitrator through award on at least one arbitration administered by an SRO in which hearings were held; or (2) have served as an arbitrator through award on at least three arbitrations administered by an SRO in which hearings were held. *See* FINRA Rule 13400(c).

37. The first arbitrator selected by NLSS would be the chairperson of the panel. The parties would not be permitted to strike any arbitrators selected by NLSS, but would be permitted to challenge any arbitrator selected for cause, pursuant to FINRA Rule 13410. If an arbitrator is removed, NLSS would randomly select a replacement subject only to a challenge for cause. The parties would not be permitted to agree to fewer than three arbitrators on the panel, and the parties would not be permitted to stipulate to the use of pre-selected arbitrators. Finally, if the associated person withdraws the claim after a panel is appointed, the case would be closed with prejudice, unless the panel decides otherwise. *See proposed FINRA Rule 13806.*
38. The Task Force suggested that the arbitrators be chair-qualified. In addition, it suggested that the arbitrators who would serve on the special arbitrator panel complete enhanced expungement training. FINRA agrees that the training for arbitrators selected for the Expungement Arbitrator Roster should be expanded. Thus, FINRA would create training for these arbitrators, which would emphasize that, if there is no party opposing the associated person's request for expungement relief, the panel would need to review more proactively the request and documentation and, if necessary, ask questions and for more information, before making a decision. The training would also focus on the need to identify one or more of the grounds for expungement in FINRA Rule 2080(b)(1) as the basis for expungement.
39. The panel would determine the method of appearance.
40. *See FINRA Rules 12800(a) – (c); see also FINRA Rules 13800(a) – (c).*
41. *See FINRA Rules 12805(a) and 13805(a).*
42. *See proposed FINRA Rule 12800.* FINRA Rule 13800 would also be amended to require that an associated person may only request expungement of customer dispute information under Rule 2080 by filing the request pursuant to Rule 13805(a) at the conclusion of the simplified arbitration case.
43. FINRA Rule 12800(c)(1) permits a customer to request a hearing. Under the proposal, if a customer requests a hearing, the arbitrator would decide the customer's case and at the conclusion of the customer's case, the associated person could file the expungement request against the firm and a panel from the Expungement Arbitrator Roster would decide the request. *See also FINRA Rule 13800(c)(1).*
44. Among the 2,232 customer arbitration cases and 183 intra-industry arbitration cases (mentioned above) that involve an expungement request of customer dispute information, 67 (3 percent) of the cases had an initial filing fee of \$50.
45. Researchers find a negative relationship between misconduct disclosures on CRD and the employment opportunities of associated persons. The misconduct disclosures in their analysis, however, include more than just customer allegations. *See Mark Egan, Gregor Matvos, and Amit Seru, The Market for Financial Adviser Misconduct, 2016.*
46. Among the 2,232 customer arbitration cases and 183 intra-industry arbitration cases (mentioned above) that involve an expungement request of customer dispute information, approximately one-fifth of the expungement filing fees would have increased to \$1,425 under the proposed amendments. The increase in fees would range from \$450, for claims greater than \$50,000 but less than or equal to \$100,000 which currently have a filing fee of \$975, to \$1,375, for claims with a monetary value of less than or equal to \$1,000 which currently have a filing fee of \$50.