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FINRA Plans Major Changes to Rules Governing the Expungement of Customer Complaint Information

FINRA recently issued Notice to Members 17-42, which proposes sweeping changes to the existing process for expunging reference to a customer complaint from a securities broker's record on the Central Registration Depository (CRD) system. The public comment period for the proposed rule amendments ended on Feb. 5, 2018. The proposed changes will now to go the SEC for review and approval. The proposal, if approved, would result in a major overhaul of the expungement process, and, as FINRA acknowledges, will likely increase the cost and difficulty for brokers making expungement requests.

Affected parties, including both broker dealers and their registered representatives, should consider expressing their comments or concerns to the SEC about this proposal.

The Existing Expungement Process

FINRA requires that all customer complaints be reported on a broker's Form U-4. This reporting results in a disclosure on the CRD system and on FINRA's publicly-available BrokerCheck website. Complaints must be disclosed regardless of whether there has been any determination that the complaint has merit, or that the broker was even involved in the alleged misconduct. Even if a customer complaint is later dismissed or denied by a panel of FINRA-appointed arbitrators, disclosure of the complaint on a broker's record will continue to remain on BrokerCheck, and it will not go away absent an effort by the broker to seek expungement of the disclosure.

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The expungement process, which FINRA considers an "extraordinary measure," is already governed by a layer of rules, primarily FINRA Rules 12805 and 2080. In brief, expungement relief may only be granted if an arbitration panel properly constituted under FINRA rules (a) holds a recorded hearing session, by telephone or in person, regarding the appropriateness of the relief, (b) if applicable, reviews settlement documents and considers the amount of payments made to any party and any other terms and conditions of settlement, and (c) indicates in the arbitration award the grounds for expungement and provides a written explanation of the reasons for its findings. The grounds for expungement set forth in the award must include one or more of the following findings: (1) the claim or allegation by the customer is factually impossible or clearly erroneous, (2) the broker was not involved in the alleged investment-related sales practice violation or other alleged misconduct, and/or (3) the claim or allegation is false. In addition, all forum fees for hearing sessions on expungement relief must be borne by the broker seeking expungement. After obtaining an arbitration award granting expungement relief, the broker must then seek judicial confirmation of the award from a court of competent jurisdiction, and then, after obtaining a court order, must go *back* to FINRA to have the disclosure expunged from the CRD system.

Under existing rules, a broker named as a party in an arbitration action filed by a customer may request expungement relief during the course of that proceeding, although the manner and timing of making such a request is not spelled out in the rules. The request for expungement relief is then heard by the same panel which was constituted for purposes of hearing the substantive allegations raised by the customer. Alternatively, the broker may file a separate action for expungement relief at any time after the conclusion of the initial action.

The Proposed Rule Amendments

The proposed rule amendments permit a broker named as a party in an existing arbitration to make an expungement request in his or her answer or any pleading at any time, but no later than 60 days before the first scheduled hearing session. After that point, he or she must file a motion seeking an extension of time to file an exclusion request (to which the claimant may object). With respect to a broker not named as a party in an existing arbitration, a party (presumably the firm defending the action) may file on behalf of the broker a request for expungement relief with the Director of the Office of Dispute Resolution (Director), with the same time limitations noted above. This request, a "Form Requesting Expungement Relief on Behalf of an Unnamed Person," must be signed by the nonparty broker whose CRD record would be expunged, agreeing to be bound by the panel's decision, and must include a statement requesting expungement relief.

In circumstances in which there is no existing arbitration case (such as a complaint for which no arbitration is filed), or in which the arbitration case has been closed by award, the proposed rule amendments would permit a broker to file an expungement request as a new, independent claim, subject to a new set of requirements. Among other things, the broker must name as a respondent the firm at which he or she was associated at the time of the events giving rise to the customer dispute. This is a change from existing practice, in which a broker generally names the customer as the respondent in an expungement action. In addition, a three-person panel selected from an exclusive "Expungement Arbitrator Roster" would decide this new claim. The three arbitrators, all of whom must be qualified as public chairpersons, must also have the following additional qualifications: (1) completed enhanced expungement training; (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. This is a change from current practice, in which a panel in an expungement matter is subject to the same selection process as in a customer case, and the panelists are not required to be attorneys or possess any special skills. According

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to FINRA, "[t]he 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."

Under the proposed rule amendments, once a panel is selected, it must hold a recorded hearing session on the request for expungement. The broker must appear at the hearing, either in person or by videoconference. This is a change from existing practice, in which a hearing on expungement relief may be conducted telephonically. Additionally, the Director will notify the parties from the underlying case or complaint of the time and place of the expungement hearing, and the customer(s) who made the underlying complaint may appear at the expungement hearing, including by telephone. In other words, a broker seeking to expunge a customer complaint from his record must appear in person or by videoconference, but the customer who made the complaint may choose to appear by telephone, or not at all.

Further, under the proposed rule amendments, a panel may grant expungement relief only if the panel agrees unanimously. This is a change from existing practice, in which a majority is sufficient for any arbitral decision. As with the existing rule, the panel must identify at least one of the grounds for expungement listed in Rule 2080 and provide a brief written explanation of the reasons for its findings. Additionally, however, the panel must now also find that "the customer dispute information has no investor protection or regulatory value."

In addition, there will be additional costs associated with expungement requests under the proposed rule amendments. For any such request – either in an existing arbitration case or a new filing – the broker must pay a filing fee of $1,425 or the applicable filing fee provided in Rule 12900(a)(1), whichever is greater. Moreover, there will be an assessment of a member surcharge and process fee against each member that is named as a party or respondent, or that employed the broker at the time of the events giving rise to the dispute.

Lastly, the proposed rule amendments mandate a strict, one-year time limitation for expungement claims not made and decided in the course of an existing arbitration case. For an expungement request to be considered timely, it must be filed within one year after the closing of any underlying arbitration case, or, in situations where a customer complaint is made but no arbitration is filed, within one year from the date that a member firm initially reported the customer complaint to CRD. These limitations would apply to cases that are closed or complaints that are reported after the effective date of the rules amendments. For cases which close, or complaints which are reported, on or before the effective date of the rules amendments, the broker would have only six months from the effective date within which to make a request for expungement relief.

These aspects of the proposed rule amendments would also apply to any existing arbitration case which is closed other than by award (*i.e.*, any case in which the parties agree to a settlement and/or dismissal of the claims prior to award). In such circumstances, a broker who makes a proper request for expungement during the course of the underlying case but then agrees to a settlement which results in the closure of the action must wait (but not too long) and file an entirely new case, against the firm with which he is or was associated, subject to a different panel composition and different rules than the underlying arbitration case which prompted the request for expungement in the first place.

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Summary and Analysis

The proposed rule amendments will make it more difficult and costly for a broker to seek expungement relief, particularly when he or she is not named as a party to an existing arbitration case, or when a case is closed as a result of settlement. In such circumstances, the broker must (1) pay a fee of at least $1,450 to seek expungement relief, (2) file suit within a compressed time frame, (3) name his or her own firm (or former firm) as a respondent, (resulting in member surcharges and processing fees for the respondent firm), (4) submit to a different arbitration panel than that which was empaneled to hear the customer's complaint, (5) show up in person at the expungement hearing, or make arrangements to appear by videoconference, and (7) convince the panel not only that there are grounds for expungement relief, but also that the customer complaint "has no investor protection or regulatory value."

The proposed rule amendments will result in additional, significant changes to the expungement process.

First, a broker must bring an expungement claim within one year of the closing of any customer complaint or arbitration action. FINRA contends that this limited period "would ensure that the expungement request 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." FINRA does not explain why a customer has up to six years to file a suitability claim, and a broker subject to such a claim must seek expungement within one year or "forfeit" his ability to protect his right to clear his name and public record.

Second, the proposed rule amendments would require a broker's expungement claim to be heard by an "attorney-only" panel of litigators, regulators, and/or former judges. A customer filing an arbitration case can, under FINRA rules, proceed with an all-public panel which might consist of arbitrators who may be teachers, nurses, accountants, scientists, or lawyers. FINRA suggests that such experienced panel for the expungement claim will "better understand the unique nature of this extraordinary remedy and the importance of maintaining the integrity of the public record," but does not address why the same type of panel should not be required for *all* arbitration claims. In this regard, FINRA appears to be treating expungement as more "unique" and "extraordinary" than any underlying claim (*e.g.*, for suitability, churning, selling away, or fraud), without any explanation as to why.

Third, a broker who makes a proper expungement request in the course of an arbitration but then agrees to settle the claim at any time (including on the eve of an arbitration hearing) would have no ability to have the expungement claim heard by the same panel which is already familiar with the underlying matter. Instead, he or she must file an entirely separate action to be heard by an entirely new panel – subject to an additional cost and different rules. Arguably, in many cases, the existing arbitration panel is well-qualified to hear an expungement request, because it has seen the progress of the underlying case – pleadings, motions, pre-hearing conferences, discovery disputes and arguments of counsel – and it may have a good sense, based on its familiarity with the matter, of whether expungement relief is appropriate. Putting all of that institutional knowledge to the side and starting over with a new panel could be considered a poor use of resources, with little benefit to the "integrity and reliability of the customer dispute information."

Fourth, under the proposed rule amendments a broker must secure a unanimous decision from the panel, while a customer who makes a complaint against him may prevail with only a majority decision.

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Lastly, under the proposed rule amendments a broker seeking expungement must file an action naming the firm with which he is or was associated as the respondent, and "would no longer be able to name the customer as the opposing party." According to FINRA, "customers would therefore no longer incur the costs and inconvenience to be a party to these claims." Although it was the customer who initiated the claim in the first place, a broker must always bear the cost of defending a customer complaint, no matter the merits.

FINRA notes that 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." FINRA, however, does not provide any data to demonstrate that the quality or timeliness of information presented in association with expungement requests is problematic. Indeed, NTM 17-42 does not contain any data showing that the existing expungement process is not working properly or is in need of a drastic overhaul which, as FINRA concedes, could result in both increased costs and an increase in difficulty for brokers seeking to obtain expungement relief. The entire basis for the proposed rule amendments appears to be anecdotal complaints from unnamed "critics of expungement" who have "raised specific concerns," none of which are included in the Notice.

Towards the end of NTM 17-42, FINRA states that:

> "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."

Notwithstanding FINRA's statement of purpose for the proposed rule amendments, the regulator does not include any evidence that existing expungement cases or awards are not meritorious, or that the frequency with which panels recommend expungement is problematic or concerning. In fact, the data which FINRA *does* provide seems to indicate just the opposite. FINRA counted 18,331 customer claims filed from 2014 to 2016 (in arbitration or otherwise) that were closed as of June 30, 2017, and which "could be the subject of an expungement request by an associated person." During that same time period, FINRA identified 2,232 "customer arbitration cases involving an expungement request," and only 808 cases in which "arbitrators made a determination regarding the expungement of customer dispute information." Arbitrators recommended expungement in 608 of those 808 cases. In other words, out of 18,331 customer claims during the relevant time period which "could have formed the basis for an expungement request," expungement relief was actually awarded by a FINRA arbitration panel only 608 times, or with respect to only three percent of all customer complaints.

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