

Securities Litigation & Enforcement News

Current Legal Developments in the Broker-Dealer Arena

December 24, 2013

FINRA Again Presses for Expungement Limits Outside of Formal Rulemaking Process

Although FINRA has not announced any proposed changes to the rules governing expungement of broker information from the Central Registration Depository (CRD), let alone has the SEC approved such rulemaking, FINRA is taking informal steps to limit arbitrators' recommendations of expungement.

Under the formal rulemaking process set forth in Section 19(b) of the Exchange Act and Rule 19b-4 thereunder, a self-regulatory organization (SRO) such as FINRA must first submit any proposed rule change to the SEC, which then allows for public comment and reviews and approves or disapproves the proposed change. These requirements apply to any change that is not reasonably and fairly implied by an existing rule of the SRO or concerned solely with the administration of the SRO.

FINRA's efforts to describe expungement as "extraordinary" and encourage arbitrators to limit expungement awards to "narrow" circumstances have not been subject to any formal rulemaking process. The latest such effort is a December 18, 2013 [email](#) to arbitrators, in which FINRA Dispute Resolution on its own again describes expungement as an "extraordinary remedy." Further, FINRA's recent issue of The Neutral Corner appears to be counseling arbitrators to "question whether expungement is appropriate in situations where the registered person, or his or her firm, has agreed to pay a large monetary settlement." These new statements from FINRA echo a [notice](#) that FINRA sent to arbitrators in October 2013, which called expungement "extraordinary" and described the grounds for relief as "narrow." Notably, none of the SEC-approved rules governing expungement (FINRA Rules 2080, 12805, and 13805) describe expungement in these terms but, rather, leave it to the arbitrators to make such evaluations.

FINRA's most recent announcement was published shortly after a joint letter was submitted by U.S. Senators Chuck Grassley and Jack Reed. They called for changes in the expungement process following a critical report from the Public Investors Arbitration Bar Association (PIABA). Indeed, the October Notice from FINRA in which it for the first time describes expungement as "extraordinary" was published at the same time as the critical piece from PIABA.

FINRA's cautionary statements appear to be adding a headwind to arbitrators' expungement decisions. In one recent award (*Ayers v. Clarke*, No. 12-03403), the arbitrators refused to grant complete expungement, even though they denied claimant's claims in their entirety, because they were "unable to conclude [the claim] was false for purposes of an expungement." And in another recent award (*Otis v. Morgan Stanley Smith Barney, LLC*, No. 11-04820), an arbitrator dissented from the decision to grant expungement, stating he was "not convinced that the narrowly tailored guidelines for granting expungement were met."

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