



February 5, 2018

Submitted electronically to [pubcom@finra.org](mailto:pubcom@finra.org)

Marcia E. Asquith  
FINRA Office of the Corporate Secretary  
1735 K Street, NW  
Washington, DC 20006-1506

**RE: FINRA Regulatory Notice – 17-42 – Proposed Amendments to the Codes of Arbitration Procedure Relating to Requests to Expunge Customer Dispute Information**

Dear Ms. Asquith,

On behalf of the North American Securities Administrators Association (“NASAA”),<sup>1</sup> I hereby submit the following comments in response to FINRA Regulatory Notice 17-42 (“the Proposal”), issued on December 6, 2017.<sup>2</sup> NASAA has a long-standing interest in ensuring that there is no compromise in the integrity of the information housed on the Central Registration Depository (“CRD”) and its investment adviser equivalent, the Investment Adviser Registration Depository (“IARD”).<sup>3</sup> Each system contains the information filed with state securities administrators by applicants for registration as broker-dealers, investment advisers, and their representatives. In addition to using that information as part of licensing and ongoing oversight responsibilities,<sup>4</sup> state securities administrators are obligated under state securities and public records laws to ensure that records are maintained in accordance with those laws. These laws almost universally require the retention of all information filed as part of a registration application and amendments to the application. NASAA has gained a unique expertise in this area, as we have been involved in developing—and reforming—the expungement process since its inception, and are pleased to offer our comments on the Proposal.<sup>5</sup>

<sup>1</sup> NASAA is the association of the 67 state, provincial, and territorial securities regulatory agencies of the United States, Canada, and Mexico. NASAA serves as the forum for these regulators to work with each other in an effort to protect investors at the grassroots level and to promote fair and open capital markets.

<sup>2</sup> FINRA Regulatory Notice 17-42 – *Expungement of Customer Dispute Information – Proposed Amendments to the Codes of Arbitration Procedure Relating to Requests to Expunge Customer Dispute Information* (Dec. 6, 2017), available at [http://www.finra.org/sites/default/files/notice\\_doc\\_file\\_ref/Regulatory-Notice-17-42.pdf](http://www.finra.org/sites/default/files/notice_doc_file_ref/Regulatory-Notice-17-42.pdf).

<sup>3</sup> FINRA, NASAA, and state securities regulators developed the CRD system collaboratively and jointly administer policies related to the jointly owned licensing information held on CRD. The IARD is an electronic filing system for investment advisers sponsored by the Securities and Exchange Commission and NASAA, with FINRA serving as the developer and operator of the system. See [www.iard.com](http://www.iard.com).

<sup>4</sup> E.g. completing broker-dealer and investment adviser examinations and bringing enforcement actions.

<sup>5</sup> Most recently, NASAA laid out its views regarding expungement in a letter to FINRA’s Arbitration Task Force. See Letter from William Beatty, NASAA President and Washington Director of Securities, to Barbara Black, FINRA Dispute Resolution Taskforce, Re, NASAA Comments on Expungement of Matters from the Central

NASAA's position on expungement is clear: expungement is an extraordinary remedy to be granted solely in limited circumstances and the current process has failed to properly maintain the limited scope of this remedy.<sup>6</sup> In its 2015 letter, NASAA urged FINRA's Arbitration Taskforce, at a minimum, to endorse short-term solutions that would improve the existing expungement process, while regulators worked on more substantial reforms.<sup>7</sup> In the current Proposal, FINRA has taken a necessary first step towards those short-term solutions in meaningful expungement reform by proposing thoughtful amendments designed to mitigate some of the long-recognized issues with the existing expungement process. We appreciate and agree with the recognition that the Proposal is only a first step and reiterate our commitment to work with FINRA to implement more substantial regulatory reforms than those contemplated by the Proposal.

NASAA supports FINRA's efforts in the Proposal, but, along with FINRA, remains concerned with how far the current expungement process has strayed from the original intent of Rule 2080 and related arbitration rules. FINRA Rule 2080 and prior versions of the rule established a process designed to end the practice of arbitration panels granting expungement without clear criteria, regulatory participation, and court involvement.<sup>8</sup> The Proposal builds upon the original procedural framework by adding beneficial requirements and limitations related to the procedure of expungement. While NASAA supports the Proposal as an important first step, certain aspects of the proposed changes require further consideration.

#### Unanimity and In-Person Requirements

NASAA supports the proposed requirement that all expungement recommendations be made unanimously by a three-person arbitration panel. Given the extraordinary nature of expungement relief, it is inappropriate to recommend expungement without the agreement of the full arbitration panel. A divided panel indicates that there is doubt that the broker has met the

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Registration Depository, ("2015 Letter") (Aug. 31, 2015), available at <http://nasaa.cdn.s3.amazonaws.com/wp-content/uploads/2011/07/NASAA-Expungement-Letter-enclosure.pdf>.

<sup>6</sup> *Id.* See also, Letter from Joseph Borg, NASAA President, to Barbara Sweeney, Secretary NASD Regulation, Inc., Re, Request for Comments – 01-65 Proposed Rules and Policies Relating to the Expungement of Information from the Central Registration Depository (December 31, 2001) available at <http://www.nasaa.org/wp-content/uploads/2011/07/95-Letter.37262-47637.pdf> ("NASAA 2001 Letter"); Letter from Deborah Bortner, NASAA CRD Steering Committee Co-Chair, to Margaret H. McFarland, Deputy Secretary, U.S. Securities and Exchange Commission, Re, File No. SR-NASD-2002-168; Proposed Rule 2130 Concerning the Expungement of Customer Dispute Information from CRD (June 4, 2003) available at <http://www.nasaa.org/wp-content/uploads/2011/07/82-ProposedNASDRule-202130.37775-72237.pdf> ("NASAA 2003 Letter"); Letter from Karen Tyler, NASAA President, to Nancy M. Morris, Secretary, U.S. Securities and Exchange Commission, Re, Release No. 34-57572; File No. SR-FINRA-2008-010, Notice of Filing of Proposed Rule Change Relating to Amendments to the Codes of Arbitration Procedure To Establish New Procedures for Arbitrators To Follow When Considering Requests for Expungement Relief (April 24, 2008) available at <http://www.nasaa.org/wp-content/uploads/2011/07/31-Release-No34-57572SR-FINRA-2008-010NASAA.pdf> ("NASAA 2008 Letter"); Letter from Andrea Seidt, NASAA President, to Elizabeth M. Murphy, Secretary, U.S. Securities and Exchange Commission, Re, Release No. 34-71959, File No. SR-FINRA-2014-020 Notice of Filing of a Proposed Rule Change to Adopt FINRA Rule 2081 (Prohibited Conditions Relating to Expungement of Customer Dispute Information) (May 14, 2014) available at <http://www.nasaa.org/wp-content/uploads/2011/07/NASAA-Comment-Letter-Release-No-34-71959-File-No-SR-FINRA-2014-020.pdf> ("NASAA 2014 Letter").

<sup>7</sup> See NASAA 2015 Letter, *supra* note 4, at 6.

<sup>8</sup> See *id.* at 3-6 (discussing the original intent of Rule 2080 and its predecessor rule).

higher burden attendant to eligibility for extraordinary relief, and thus should not merit an expungement recommendation. NASAA supports FINRA's recognition of the import of this decision and supports FINRA's corresponding proposal to eliminate the option to have a single arbitrator in a simplified arbitration proceeding make an expungement recommendation.

NASAA also supports the Proposal's requirement that a broker requesting expungement be present for an in-person hearing on his or her request. NASAA does not believe, however, that the proposed in-person requirement should be satisfied by appearing via video conference. Requiring a broker to be physically present during an expungement hearing is not an unreasonable burden given the extraordinary relief the broker is seeking.

As discussed in more detail below, however, NASAA opposes the inclusion of what it sees as a new "prong" to Rule 2080 by way of proposed changes to the expungement rules in the Code of Arbitration; namely, that arbitrators be required to make a finding that the customer dispute information that is the subject of the expungement petition has no regulatory or investor protection value. This "value" determination should be reserved for regulators.

#### Expungement-Only Arbitration Panels

NASAA also supports the Proposal's requirement that arbitration matters involving an expungement request that are not decided during the underlying customer case be heard by a specialized panel of arbitrators with particular expertise and training. In NASAA's experience, the majority of expungement requests are made in arbitration matters in which the underlying customer dispute is settled. As NASAA has noted previously, post-settlement expungement hearings often consist of a one-sided presentation of the facts, as investors and their counsel—the only other party in the case—have little incentive to participate after the investor's concerns have been resolved.<sup>9</sup> While an expungement-only arbitration panel does not fully address NASAA's concerns related to expungement recommendations based on one-sided proceedings, requiring such requests be heard by specially trained and experienced arbitrators is a good first step.<sup>10</sup>

In the Proposal, FINRA lays out the necessary qualifications for arbitrators on expungement-only panels.<sup>11</sup> NASAA supports the proposed additional qualifications.<sup>12</sup> NASAA generally agrees with FINRA's assessment that individuals meeting the proposed requirements would "better understand the unique nature of this extraordinary remedy and the importance of

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<sup>9</sup> *Id.* at 4-5. See also NASAA 2003 Letter, *supra* note 5.

<sup>10</sup> NASAA has previously advocated that an expungement-only panel is an important interim step in expungement reform. See 2015 NASAA Letter, *supra* note 4, at 7.

<sup>11</sup> See the Proposal, *supra* note 2, at 10 (requiring that the Expungement Arbitrator Roster only include public chairpersons that have completed advanced expungement training, licensed to practice law, and have at least five years of relevant experience).

<sup>12</sup> FINRA recently changed its definition of public arbitrators to exclude certain lawyers from serving as public arbitrators if their practice involves representing clients in certain investment related actions. In NASAA's view, this limitation could create an artificially shallow pool of arbitrators for expungement-only panels due to the requirement that these arbitrators be attorneys and potentially have regulatory experience. FINRA should consider allowing lawyers that represent clients in investment-related cases serve on expungement-only panels.

maintaining the integrity of the public record.”<sup>13</sup> However, the extent to which these expungement-only panels truly appreciate the nuanced regulatory issues related to expungement largely depends on the content and effectiveness of the proposed “enhanced expungement training” and future substantive changes to the qualification prongs in Rule 2080. NASAA encourages FINRA to consult with state regulators when developing this new training program.

#### Requiring Named Brokers to Request Expungement during the Underlying Customer Case

If adopted, the Proposal would require brokers named as a party in a customer-initiated arbitration to request expungement in the course of the underlying dispute. NASAA supports this proposed change. As the Proposal notes, “some associated persons have filed requests seeking to expunge customer dispute information years after FINRA has closed the Underlying Customer Case.”<sup>14</sup> This lack of timeliness of expungement requests is a significant concern for NASAA and its members. As more time passes, evaluating the merits of a request for expungement becomes more challenging. When expungement requests lack timeliness, it can be difficult or impossible to locate relevant individuals or documents, as FINRA notes in the Proposal.<sup>15</sup> Requiring named brokers to bring their expungement requests during the underlying customer case goes a long way at closing a significant loophole in the current expungement process.

While this amendment, if adopted, would likely result in timelier expungement requests, it does not fully address—and nor do the other aspects of the Proposal—the problems created by the current Rule 2080’s procedural nature. Correcting these issues is a main focus of NASAA’s continued work to reform expungement. Further, because the Proposal does not fully address the shortcomings of the current Rule 2080 process due to its procedural nature, it is imperative that FINRA, as it has acknowledged in the Proposal, views the proposed changes as the starting point, not the finish line, for expungement reform.

#### Changes for Unnamed or “Subject of” Brokers

The Proposal would codify a FINRA-member firm’s ability, with the broker’s consent, to request expungement on behalf of a broker who is unnamed in a customer arbitration but is the “subject of” the dispute.<sup>16</sup> In the event that a firm does not request expungement on behalf of an unnamed broker, the unnamed broker would be required to bring a request for expungement within one year after the closing of the underlying customer case.<sup>17</sup> As further steps toward reforming the expungement process, NASAA supports this requirement along with the provision in the Proposal that would prevent an unnamed broker from filing an arbitration claim seeking expungement against an investor.

While NASAA supports the proposed changes related to expungement requests by unnamed or “subject of” brokers, particularly the one-year time limitation and prohibition on

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<sup>13</sup> See the Proposal, *supra* note 2, at 10.

<sup>14</sup> *Id.* at 5.

<sup>15</sup> *Id.*

<sup>16</sup> *Id.* at 7-8.

<sup>17</sup> *Id.* at 8.

actions against investors, there are challenges in allowing firms to bring actions on behalf of brokers. Such an approach would require cooperation between the firms and the relevant brokers. This cooperation may not always exist, particularly in cases in which brokers are no longer associated with the relevant firm or the firm's and the broker's pecuniary interests diverge. As a result, the processes and procedures used by FINRA to notify unnamed brokers about closed matters is particularly important as that notice triggers the proposed one-year time limitation. If the Proposal is adopted, FINRA would be required to develop robust, mandated notification procedures to limit potential disputes regarding whether subsequent expungement requests are timely.<sup>18</sup>

### Increased Fees

The Proposal would also require brokers seeking expungement to pay additional fees. FINRA and the states expend significant resources in reviewing expungement requests. While the increase in fees does not directly offset those costs, the increased fees would at least in part reduce the costs FINRA incurs in responding and processing expungements. NASAA therefore supports this proposed change.

### Further Expungement Reform is Required

In 2003, NASAA agreed with the very limited expungement process for removing certain limited information from the CRD originally memorialized in the provisions of Rule 2130. At the time, Rule 2130 appeared to provide a better solution for expunging a broker's CRD records, as the then-NASD was expunging records solely based on recommendations from arbitrators without the standards of factual impossibility, lack of involvement, and false claims or allegations as set forth in the rule.<sup>19</sup> Unfortunately, this framework has failed, and is applied in a way that favors the interests of a single registrant over regulatory imperatives and the public interest. As indicated above, the Proposal, if implemented, would improve the existing expungement process, and NASAA applauds FINRA for this step towards meaningful expungement reform.

Expungement of a broker's CRD record is an extraordinary remedy. If the remedy remains commonplace and routine grants are not curtailed, the ongoing deletion of disclosure information from CRD will result in a loss of confidence in the CRD system.<sup>20</sup> Moreover, regularly expunging this information could lead to distrust in the other regulatory safeguards that rely on the information housed in the CRD. Without more significant reforms, the existing expungement process will continue to result in the deletion of critically valuable regulatory information from the

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<sup>18</sup> NASAA also notes the potential for workability complications related to brokers bringing actions against firms that are out of business and/or no longer FINRA members. This issue is also presented by the Proposal's formal expansion of the Rule 2080 process to mere customer complaints, which is addressed in more detail below. In this context, NASAA again sees practical concerns with the requirement that brokers bring claims against the firm they were associated with at the time of the customer complaint.

<sup>19</sup> Currently codified in Rule 2080(b)(1).

<sup>20</sup> In the Proposal, FINRA acknowledges that between 2014 and 2016 arbitrators granted 75% of the expungement requests they decided. See The Proposal, *supra* note 2, at 13-14. This makes clear that expungement is no longer an extraordinary remedy.

CRD. If such information continues to be removed without meaningful consideration as to its regulatory value, regulators, industry, and investors can no longer trust that the data in the CRD contains all of the information necessary to make licensing and hiring decisions or to determine which financial professional to entrust with an investor's financial future.

The Proposal attempts to recognize the important regulatory value of customer complaint information by requiring arbitrators make a specific finding that information that is the subject of an expungement request has no regulatory or investor protection value before granting an expungement request.<sup>21</sup> NASAA appreciates FINRA's efforts to enhance its expungement rules by requiring arbitrators to make this important determination before granting an expungement request. However, this is a regulatory determination, which cannot be shifted to arbitrators selected to resolve a dispute pursuant to a contract between private parties. It would be inappropriate to deputize arbitrators and usurp a regulator's responsibilities.

In fact, regulators have already determined that customer complaint information has investor protection and regulatory value by requiring brokers to disclose it. By requiring the disclosure of this information on uniform registration forms, securities regulators—state and federal—have concluded that *all* customer complaint information within defined parameters is *presumptively* valuable. The presumptive value of this information underpins the premise that the expungement of any information is an extraordinary remedy.

NASAA, however, recognizes that there are certain very narrow situations in which customer complaint information should be expunged; namely, when, as the result of an error in responding to the questions on registration forms soliciting customer complaint information, such information is reported and subsequently disclosed publicly. Despite the intended rare recommendation contemplated by the original rules, expungement under the current Rule 2080 process is all too frequently recommended. NASAA can point FINRA to myriad examples where the current process has failed by recommending that valuable regulatory information be removed from the system, and is willing to provide these cases should FINRA find them useful. Because regulators have already determined the presumptive value of customer complaint information by requiring that it be disclosed, regulators have a responsibility to ensure such information is in fact disclosed and maintained. The expungement process cannot be used to routinely reverse these important regulatory disclosures.

Consequently, NASAA opposes the Proposal's expansion of the types of customer complaint information that would be subject to expungement under the Rule 2080 process. We recognize that there is increasing use of the expungement process beyond the scope originally intended with the rules now being used to address expungement requests related to customer *complaints* that were *not* the subject of arbitration. NASAA objects to expanding the scope of Rule 2080 to apply to all information related to customer complaints. Such an approach would further embed a flawed process that does not afford regulators the ability to preserve information already considered to have regulatory value and provide investor protection.

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<sup>21</sup> See *id.* at 3, 9-10.

The Proposal would reward brokers who capitalize on the procedural nature of the rule and seek to expand its scope beyond arbitrated complaints. In NASAA's view, now is not the time to codify and expand an already broken process. Despite the Proposal's attempt to apply some limitations, formalizing a process to expunge customer *complaints* without a full vetting of the policy implications and collateral consequences of such a rule is not appropriate.<sup>22</sup> While this is an issue that FINRA and NASAA need to address as we continue to rework the expungement issue, expanding the scope of a flawed approach through this Proposal is not the appropriate approach to address this matter.

Finally, one of the primary areas that the amendments in the Proposal does not, and as a procedural proposal cannot, successfully address is the fact that more and more brokers are bypassing the Rule 2080 process entirely by going directly to court. Again, NASAA can point FINRA to many examples of cases purposely pursued in court to avoid the procedures—although flawed—in place in the arbitration expungement context. This is a significant concern for NASAA and its members, and for all the good ideas put forth by FINRA in the Proposal, none of them address this issue. Only substantive changes to broker's behavioral rules will curtail the rapid erosion of information from CRD and IARD. In its current form neither Rule 2080 nor the Proposal would prevent this unfortunate reality. In NASAA's view, such a mechanism is required, and its absence highlights the problems with Rule 2080's procedural nature. To truly fix the expungement process, wholesale reform is necessary.

### The Path Forward

As noted in the Proposal, NASAA and FINRA have been working together to explore potential amendments to the expungement process. NASAA appreciates the time and effort FINRA staff have dedicated to this important issue. While this work is ongoing and many issues must still be resolved, in NASAA's view, a workable expungement framework that truly preserves expungement as an extraordinary remedy would be built around the following core principles:

- Substantive standards that properly limit the scope of expungement requests, including a clearer presentation of new standards that replace the flawed and misapplied prongs outlined in Rule 2080;
- Mandatory process, meaning all expungement requests must be made pursuant to the new process, which would be designed to close loopholes in and avoid unintended outcomes of the current process;
- Increased regulatory participation, allowing for both a regulatory determination regarding the merits of an expungement request and the legal process to protect the data;
- Earlier notices to state regulators of an expungement request to better facilitate regulator involvement where appropriate;

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<sup>22</sup> Further, other means are available today for brokers to address their concerns related to customer complaints. When customer complaints are disclosed on the Form U4, brokers have the ability to provide their own responses to rebut the allegations in the complaints.

- Leverage the efficiencies of arbitration in fact finding, but limit the ability of arbitrators to “grant” expungement requests, instead only allowing factual, not legal, recommendations that are not considered awards;<sup>23</sup>
- Preserve the requirement that a court order the expungement of records prior to the removal of any information from the CRD.

NASAA has engaged FINRA with these core principles in mind, and pledges to work towards meaningful expungement reform.

### Conclusion

NASAA appreciates the opportunity to offer its comments in support of the Proposal, as it is a significant first step in meaningful expungement reform. The current expungement process is broken: a fact on which NASAA and FINRA agree. And as stated above, NASAA is prepared to provide and discuss with FINRA examples of expungement requests illustrating many of the problems unsolved by the changes in the Proposal. While NASAA looks forward to its continued dialog with FINRA on expungement, this dialog cannot continue indefinitely, while stop-gap fixes are applied to a fundamentally flawed expungement foundation. It is critical that a long-term solution to the expungement problem be reached, so as to stop the abuses that cannot be stopped by the Proposal. Should you have any questions regarding the comments in this letter, please do not hesitate to contact A. Valerie Mirko, ([vm@nasaa.org](mailto:vm@nasaa.org)), NASAA General Counsel, via email or by phone at 202-737-0900 or Melanie Senter Lubin ([mlubin@oag.state.md.us](mailto:mlubin@oag.state.md.us)), Maryland Securities Commissioner, Chair, NASAA’s CRD/IARD Steering Committee, via email or by phone at 410-576-6365.

Sincerely,



Joseph Borg  
Alabama Securities Director  
NASAA President

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<sup>23</sup> In the Proposal, FINRA specifically seeks comment on whether it should remove the concept of “granting expungement” in favor of “recommending expungement.” See the Proposal, *supra* note 2, at 17. In NASAA’s view, FINRA should make this change. As explained in prior comment letters, *supra* notes 4-5, the structure of Rule 2080 requires the confirmation of an arbitration award in a court of competent jurisdiction. This structure significantly limits a state regulator’s ability to present arguments opposing the merits of an expungement request during a confirmation proceeding in state court due to the deference courts are required to give arbitration awards under the Federal Arbitration Act. See Federal Arbitration Act, 9 U.S.C. § 10-11 (explaining the limited circumstances a court can vacate or modify an arbitration award).