

Current NASD Expungement Rules; Keeping Your Record Clean

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The NASD maintains a computerized data bank of the backgrounds, qualifications, employment and disciplinary/arbitration histories of over 5,000 brokerage firms and more than 650,000 registered representatives. This system is called the CRD (Central Registration Depository). The NASD maintains and operates the CRD system pursuant to an agreement between the NASD and the North American Securities Administrators Association (NASAA), an association of state and other securities regulators throughout the country. The CRD system was established in 1981 and, in 1999, it transitioned to a web-based system. Today, virtually all registration forms are filed online via the Internet.

At the same time, the NASD has undertaken a concerted effort to educate the investing public to the existence of the CRD and make the information contained within brokerage firms and registered persons' records readily available to the public. Any customer, with any interest in knowing something about his or her broker or their brokerage firm, can obtain vital information about the firm and the rep through the NASD's web site, www.nasdr.com. Brokers who have not visited the NASD site recently will be surprised at how easy, and how much information, is available to any customer, potential customer or potential employer. Try it; see what anyone can find out about you by visiting the NASD web site and doing a search on yourself. You may be shocked to see what is readily available to your customers and the public.

Brokerage firms and registered persons are required to keep their respective applications and relevant information current and accurate. Firms and reps are required to report certain criminal charges and convictions; regulatory actions and bankruptcies and other, relevant information that might be material to a person or firm interested in doing business with the broker or his firm. Since this information is becoming increasingly easy for investors to access via the Internet, it is even more important that firms and registered persons be familiar with the transparency of the system and understand the rules relating to expunging or deleting certain negative information, most significantly customer complaints, suits and arbitrations.

When a firm or registered person is named as a respondent in a customer-initiated arbitration proceeding, no matter how frivolous, that fact **must** be reported on the registered person's Form U-4. Once reported, it automatically and electronically is recorded to the reps' CRD and becomes a matter of public record available for anyone to obtain and review.

What is Expungement?

Expungement is the extraordinary relief of actually removing specific information (i.e. a falsely filed claim; false information) from the registered person's CRD. If a claim proceeds to arbitration and the firm or the broker prevails, the existence of the claim is not expunged (i.e. removed) from the publicly available CRD records but the fact that the broker or firm prevailed is recorded.

To a firm or broker, therefore, having the mere filing of the claim- regardless of the outcome- removed from his or her CRD record is preferable than having the claim and the ultimate outcome reported. The question, therefore, is how to have a CRD reported event expunged and removed from the CRD records?

Current Expungement Rules

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In the past several years, there was much disagreement and controversy over how and when a matter of public record- typically a customer initiated arbitration- could be removed from a firm or broker's CRD record. In many instances, arbitrations were settled with the Stipulation that the Claimant would cause the NASD to actually expunge the claim from the broker or firm's record, only to have the NASD refuse to do so. There was a fair amount of abuse of the system with firms settling cases on the condition that the broker's record is expunged to protect the broker's history. The NASD noticed this pattern of abuse and issued Notice to Members 04-43 in June, 2004 to clarify the rules of Expungement.

For arbitration claims filed on and after April 12, 2004, NASD will expunge customer-initiated complaints and arbitrations from a broker or firm's CRD **only** if ordered to do so by a Court.² The new Code of Arbitration Procedure specifically requires that before a Court order expungement, there be certain affirmative findings by the Arbitrator(s) to support the expungement order or, if there are no such findings, that NASD be named as a party in any court proceeding seeking or attempting to confirm expungement relief.

The specific findings, which must be adopted by the arbitrator or arbitration panel, are the following:

- the claim, allegation or information is factually impossible or clearly erroneous;
- the registered person was not involved in the alleged investment-related sales practice violation, forgery, theft, misappropriation, or conversion of funds; or
- the claim, allegation or information is false.

If a customer complaint proceeds to hearings and there is any finding of liability against the firm or the broker, it is unlikely- in fact virtually impossible- for there to be any grounds for expungement. **The fact the firm or broker prevailed in arbitration, however, is not, in and of itself, grounds for an automatic order of expungement of the claim from the CRD records.** The existence of the claim, therefore, only will be expunged if the arbitrator or arbitration Panel makes an appropriate order directing the expungement based upon one of the three grounds cited above.

In the NASD's Dispute Resolution Arbitrator Training course on Expungement, arbitrators are cautioned that expungement is an extraordinary form of relief not to be lightly granted or automatically given. The three grounds for expungement cannot be implied in the Award; they must be affirmatively stated, otherwise the NASD will oppose expungement. Moreover, once the arbitrator or Panel has ordered expungement, a court of competent jurisdiction must confirm that award.

How Best To Expunge A Customer Initiated Complaint

Since prevailing on a customer-initiated arbitration, in and of itself, is not a sufficient basis for expungement, and proceeding to hearings involves the cost of defense and the risk of an adverse award which not only will appear on the firm or broker's CRD but will almost automatically exclude any chance of expunging the existence of the claim from public records, a stipulated award based upon a settlement is the best approach is the claim is such that expungement is of paramount concern.

² Per the Notice to Members, the new rules apply to arbitration claims filed **prior** to that date as well, although for earlier filed claims the procedure is not mandatory. This author, however, recommends following the new rules for earlier filed claims, particularly where the case is settled, since the rules are clearer and arbitrators and panels are more familiar with the new rules.

If the parties can reach a settlement, they can ask the arbitrator or Panel to incorporate their settlement into a "stipulated award". That stipulated award, drafted by the parties, particularly the broker or firm's counsel, will contain the "magical" language mandated by the NASD for any expungement order. But arbitrators are not bound to blindly accept the language of any stipulation. The *Code of Ethics for Commercial Arbitrators, Canon V(D)* specifically mandates that arbitrators are not required to embody within a stipulated award a settlement of issues, including an expungement order, unless the arbitrator or Panel is "satisfied with the propriety of the settlement".

As an example, assume a broker, named as a respondent, makes a financial settlement but insists on a Stipulation of Settlement that requires the Claimant to submit an affidavit in support of the stipulated award to the effect that claims alleged in the Complaint were false. Clearly, in that situation, the arbitrator or Panel would be obligated to elicit more information to confirm the veracity of the affidavit since it would clearly be at odds with the reality of the settlement. The *NASD Dispute Resolution Arbitrator Training* materials on Expungement specifically provide that "An arbitrator who is unconvinced that expungement is warranted should not sign a stipulated award that contains an expungement order".

The best opportunity for obtaining an expungement order is in those cases where both the firm and the broker have been named and the firm- for whatever reason- wishes to protect the broker's record and assume the financial and reporting obligations of a monetary settlement with the claimant. In those cases, the firm can enter into a settlement with the Claimant and the Claimant, in turn, can execute an affidavit to the effect that the broker was not involved in the transaction that gave rise to the claim or the claims against the broker were factually impossible to prove. The stipulated award, however, must contain the specific language quoted above; must be palatable to the arbitrator or the Panel and there is no guarantee that the arbitrator or Panel will sign the stipulated award and order the expungement.

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