

FINRA BROKER EXPUNGEMENT RULES -2015 UPDATE

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In the past several years, FINRA, the Securities and Exchange Commission and a number of investor protection groups including PIABA (the Public Investor Arbitration Bar Association) have made a concerted effort to expand and publicize the availability of broker background and CRD records (known as “BrokerCheck”) on the FINRA portal (www.finra.org) and to make the BrokerCheck portal more robust, user friendly and transparent. As a result, more and more of the investing public is aware of, and routinely accesses the BrokerCheck feature on the FINRA web portal to investigate the background of a prospective or existing registered representative. What information appears on a broker’s BrokerCheck, therefore, has become increasingly important to all registered representatives, particularly those with negative disclosure items on their CRD reports, who have an increased desire to seek to expunge some or all of the disclosure items from their CRD and BrokerCheck records.

BrokerCheck is a collection of data and information about every FINRA licensed registered representative. FINRA collects that information from member firms and brokers, generally through information reported by the member firms on form U-4’s and

U-5's. That information is maintained by FINRA in its CRD, Central Registration Depository and FINRA BrokerCheck makes some, not all of that information available to the public through BrokerCheck. Anyone can instantly access BrokerCheck records through the FINRA portal. While a great deal of information about a registered representative is available through the FINRA BrokerCheck portal, CRD records contain much more information than what is available through BrokerCheck. While the public can obtain a complete CRD record by, for example, requesting a copy from New York State's Department of Securities and paying a nominal fee (\$5 at current writing), very, very few investors know or even obtain such complete records. It is, more often than not, the domain of attorneys and other professionals. Most of what the investing public learns about a broker is through BrokerCheck and only learns what is actually disclosed on the BrokerCheck site.

Brokers who seek to expunge, or remove, disclosure information from their CRD record and, thereby, from public disclosure through FINRA's BrokerCheck, generally try to remove negative information about prior customer complaints; employment related terminations; personal, negative financial information (i.e. bankruptcy; judgments; foreclosures, etc.), internal reviews from their current or former firms or regulatory actions. When a client makes a complaint (written or oral) to a member firm about a broker; the broker is named as a respondent in FINRA arbitration, or is identified by name or description in a customer arbitration complaint but not named as a party, the employing firm is obligated to disclose that claim or complaint to FINRA through a U-4

filing. Once reported, those disclosure items remain in the broker's CRD report, and are viewable through BrokerCheck unless the broker takes affirmative steps to remove or "expunge" that information from the CRD records.

FINRA, by design, makes it difficult to expunge disclosure items from its CRD records. Expungement is very much an uphill battle. It is FINRA's stated position that:

"Expungement is an extraordinary remedy that should be recommended only under appropriate circumstances. Customer dispute information should be expunged only when it has no meaningful investor protection or regulatory value. Once information is expunged from the CRD system, it is permanently deleted and thus no longer available to the investing public, regulators or prospective broker-dealer employers." (*FINRA Notice to Arbitrators and Parties on Expanded Expungement Guidance, December, 2014, found at <http://www.finra.org/arbitration-and-mediation/notice-arbitrators-and-parties-expanded-expungement-guidance>*)

This article will address the current rules of expungement, for both customer complaints and intra-industry, employment related items and provide suggestions of how, and when, to seek expungement.

Expungement of Customer Complaints and Arbitrations under FINRA Rule 2080-

FINRA Rule 2080 (formerly Rule 2130) establishes the procedures that arbitrators must follow for securities firms and brokers to obtain expungement of customer complaint and customer arbitration disputes from the CRD system. Customer complaints which are reportable to FINRA's CRD under a mandatory U-4 filing, fall into two categories:

1. The individual broker is the named subject of a customer complaint (written or oral) or is named as a party in a customer initiated FINRA arbitration; or

2. While not specifically named as a party in the FINRA arbitration, it is clear from the statement of claim filed that a particular broker or brokers were involved in the securities related transaction that is the subject of the arbitration.

Section 2 above covers the fairly common situation where a customer files a FINRA arbitration but does not name the actual broker or brokers as actual defendants. If the Statement of Claim, however, refers to or identifies a broker or brokers by name or other identifying means, but the broker is not specifically made a party to the arbitration, the employing firm nonetheless is obligated to disclose to FINRA, through a mandatory U-4 filing, that the broker(s) was a subject of a customer complaint.

Many practitioners name only the firm and not the individual broker in the FINRA arbitration, particularly if the firm is a large, financially viable wire house where collectability is not an issue and the case does not involve a "selling away" claim. There are several reasons why individual brokers are not named as parties to a FINRA arbitration, including a desire to keep the broker from sitting through all hearing sessions and listening to all of the witnesses testify, often a tactical decision by the customer's counsel; potentially avoiding or minimizing a panel's sympathy for an otherwise sympathetic broker; or situations where the customer and the broker have a long standing, personal relationship and the loss or complaint results from a product or firm wide practice not related to or the fault of a specific broker. Or the actual broker may have left the industry; be judgment proof or otherwise unavailable to FINRA jurisdiction and customer's counsel does not want to risk "diluting" the claim against the firm by having a

panel assess part of the loss to the firm and the bulk of the loss to the broker who no longer is financially viable.

Even when the individual broker is not named as a party to the arbitration, the claim may still wind up on the broker's CRD records, reportable by the employing firm on a U-4, if the broker's conduct is the subject of the arbitration complaint or the employing firm can determine, from the face of the arbitration complaint, that a particular broker or brokers were involved in the transactions at issue.

Rule 2080 contains three, specific and limited grounds that can support an expungement order by an arbitration Panel. Those are:

1. The claim, allegation or information is factually impossible or clearly erroneous (*Rule 2080(b)(1)A*);
2. The registered person was not involved in the alleged investment-related sales practice violation, forgery, theft, misappropriation or conversion of funds (*Rule 2080(b)(1)B*); or
3. The claim, allegation or information is false (*Rule 2080(b)(1)C*).

Before recommending expungement under Rule 2080, the arbitrators must indicate within the arbitration award which of these three grounds for expungement serves as the basis for expungement. If the award does not contain this information, the broker must name FINRA as a party in a subsequent court proceeding seeking to confirm the ordered expungement relief. FINRA's CRD may not and will not expunge or redact any CRD information arising out of a customer complaint based solely on an arbitration award. It will only expunge if that FINRA arbitration award ultimately is confirmed by a court.

If the arbitrators did, however, specify which of the three grounds they relied on in ordering expungement, FINRA must be notified of a subsequent litigation to confirm the award and obtain a court-ordered expungement of CRD records but FINRA may waive its right to be named as a party to the judicial expungement process.

In the case of customer complaints, expungement of CRD records *only* can be made by a court that confirms and adopts the findings of the arbitrators. Unlike industry dispute expungements, which only require a finding and direction of expungement from the arbitrators.

Per the direction of FINRA, before arbitrators order expungement of a customer related complaint or arbitration from a broker's CRD records under Rule 2080, the panel must comply with Code of Arbitration Procedure Rules 20805 and:

1. Hold a recorded hearing session, by telephone or in person, regarding the appropriateness of expungement, regardless of whether the claimant customer objects or consents to the expungement;
2. Regardless of whether the customer does not object to the expungement, the individual or firm requesting expungement must demonstrate to the arbitrators that the facts provide a basis for expungement under one of the three grounds of Rule 2080;
3. Where the underlying customer dispute has been settled, and the customer does not appear at the expungement hearing, the party seeking expungement must still demonstrate to the arbitrators that expungement would be appropriate under one of the three grounds of Rule 2080. FINRA directs arbitrators not to rely on the fact the customer does not appear at the expungement hearing as a factor weighing in favor of or against expungement;
4. In the case of settled claims, the arbitrators must inquire into the terms of the settlement, and review settlement documents, to ensure that a condition of the

settlement was not a prohibited agreement not to contest or object to the expungement, (discussed below);

5. If the arbitrators deem that expungement is appropriate and warranted, they must provide a brief written explanation of their reasons for granting expungement requests. That written explanation should provide insight into why the arbitrators recommended expungement and any facts and circumstances they found in support of their expungement recommendation;
6. Under Rules 12805(d) and 13805(d), arbitrators must assess forum fees for hearing sessions held solely for the purpose of considering expungement against the party or parties making the request; and
7. While not mandatory, arbitrators are encouraged by FINRA to obtain a complete BrokerCheck report on the registered representative to view all disclosures in determining whether expungement is warranted and appropriate.

Rule 2081: Prohibited Settlement Provisions Relating to Expungement-

Effective July 30, 2014, FINRA adopted Rule 2081 to end the long-standing practice of customers agreeing not to oppose, or to join in a request for expungement in exchange for a financial settlement of their claims. There were substantial abuses noted in the settlement and expungement process. Most customers only want to recover money and readily agreed to expungement requests, or agreed not to oppose them, as a condition of obtaining a money settlement. Rule 2081, however, now prohibits firms and registered representatives from conditioning settlements of a customer complaint or dispute, or compensating a customer for the customer's agreement to consent to or not oppose an expungement request. This prohibition applies to both oral and written settlement agreements including any "side" agreements. The rule also prohibits firms and registered persons from compensating the customer in return for not opposing the expungement request.

Violation of Rule 2081 not only is the death knell for any expungement request but may result in a disciplinary referral by an arbitration panel.

Expungement in Intra-Industry Disputes-

Expungement of CRD information in intra-industry disputes is much different, and easier to obtain than expungement in customer disputes or arbitrations. Rules 2080, 2081, 12805 and 13805 do not apply to intra-industry disputes unless the information sought to be expunged involves customer complaint information.

So long as what the registered representative asks to be expunged is not customer related complaints, arbitrators may order expungement without the need for a subsequent court order confirming the arbitrators' award. Brokers or firms seeking to expunge non-customer complaint information from their CRD reports should be prepared to establish to the panel that the information shown on their CRD is defamatory in nature and portrays the broker in a negative light. There is no specific guidance of what industry-related CRD information can be expunged.

Information That Cannot Be Expunged from a CRD record-

There is, however, certain information that cannot be expunged from the CRD records. FINRA specifically instructs its arbitrators they *cannot* order the following information be expunged from the CRD records:

1. **Civil Judicial Actions.** Proceedings in which a domestic or foreign court has enjoined a broker in connection with any investment related activity; found that a broker was involved in a violation of any investment-related statutes or regulations; or dismissed, pursuant to a settlement agreement, an investment-related civil action brought against a broker by a state or foreign financial regulatory authority;

2. **Criminal Matters.** Including charges and convictions for any felony and for those misdemeanors referenced on Form U-4 and U-5, such as fraud, wrongful taking of property or bribery;
3. **Financial Matters.** Financial disclosures involving compromises with creditors and bankruptcies occurring within the prior 10 years; a bonding company's denial, payment on or revocation of a bond for a broker and any unsatisfied judgments or liens.
4. **Investigations.** Including investigations or proceedings by a domestic or foreign governmental body or SRO with jurisdiction over investment related businesses.
5. **Regulatory Actions.** Proceedings brought against a broker by a state or federal regulatory authority, financial regulatory authority or SRO. These events include actions where a regulator has made certain enumerated findings or imposed civil penalties against a broker. The regulatory action disclosure category also includes instances where a broker's authorization to act as an attorney, accountant or federal contractor has been revoked or suspended.

While all of these disclosures cannot be expunged from the CRD records, there are circumstances under which some of them may no longer be disclosed under the FINRA Broker-Check through the FINRA website portal.

Practical Considerations in Expunging Customer Complaints from CRD Records-

Given FINRA's strong public policy of making negative information regarding broker's as publicly available as possible, how does a broker, with one or more customer complaints or arbitrations, expunge that information from his CRD? These are our suggestions based on our experience in handling many expungement matters:

1. First, consult with competent and experienced FINRA counsel and determine if, at the end of the day, the customer complaint is one that will, or at least may arguably fall within the ambit of one of the three enumerated grounds contained within Rule 2080 which can support an arbitration panel's order of expungement. There is no point pursuing expungement, which can be costly and span many months, if there is little likelihood of obtaining an expungement order from a panel and, ultimately, having that award confirmed

- by a court after naming FINRA or attempting to seek its waiver from the confirmation process;
2. Second, assuming the complaint is one that could fall within one of those three areas, commence FINRA arbitration against the firm that reported the complaint, not necessarily your current, employing firm. Quite often, the former firm may be out of business and will not oppose the application. Or, since the broker may no longer work for the reporting firm, the former employer which reported the complaint, may not have a stake or any interest in objecting to expungement, ensuring a more simplified, less expensive and less time consuming expungement process;
 3. Only seek an order of expungement; not any money damages. By not asking for money damages, neither the former, employing firm that reported the complaint, nor the current employing firm if that is who reported the complaint, has any financial incentive to fight or object to the expungement request;
 4. Do not name the former customer who made the complaint but do mail or serve a copy of the statement of claim on the former customer so they are aware of the process and have the right (although rarely any interest) to intervene or object to the expungement application. There is no requirement under the FINRA rules that the complaining customer actually be made a party to the arbitration; only that the former customer receive notice of the expungement application and have an opportunity to object if he or she wishes.

This is FINRA's stated policy on expungement only arbitrations:

"In some instances, an associated person will file an arbitration claim against a member firm solely for the purpose of seeking expungement, without naming the customer in the underlying dispute as a respondent. To ensure that customers know about the expungement request, arbitrators should order the associated persons to provide a copy of their Statement of Claim to the customer(s) involved in the underlying arbitration.

It is particularly important to note that without this directive from the arbitrators, the customer(s) may not even be aware that an expungement claim is pending regarding their prior dispute. Additionally, notice provides the customer(s) with the opportunity to advise the arbitrators and parties of their position on the expungement request, which may assist arbitrators in making the appropriate finding under Rule 2080. The position of the customer(s) can be made known in writing or through

participation in the expungement hearing, as set forth in 1-5 above (or both). (*FINRA Notice to Arbitrators and Parties on Expanded Expungement Guidance, December, 2014, found at <http://www.finra.org/arbitration-and-mediation/notice-arbitrators-and-parties-expanded-expungement-guidance>*)

5. By not asking for monetary damages, and limiting the expungement request only to expungement of CRD disclosures, the hearing will proceed under the simplified hearing rules contained within Code of Arbitration Procedure Rule 12800, applicable to simplified hearings where there is less than \$50,000.00 in issue. A simplified hearing involves only one arbitrator and progresses much more quickly than a three person panel case. Moreover, since a party requesting expungement is responsible for paying all of the arbitration costs, including the panel's fees, the costs of an expungement proceeding will be less in a simplified hearing.

Former customers, not made actual parties to the expungement arbitration, rarely, if ever have any motivation to hire an attorney and incur legal fees when all that is at stake is an expungement request for a complaint they may have made years ago. There is no requirement to name the customer and we counsel against naming them.

Practical Considerations in Expunging Intra-Industry-

As stated above, rule 2080 does not apply to expungement requests for intra-industry information contained within a CRD report. Nor do arbitration awards that direct expungement of intra-industry information need to be confirmed by a court in a subsequent confirmation process. Intra-industry expungements, therefore, are much easier, less expensive and more likely to be obtained. These are our suggestions for expunging negative or potentially embarrassing intra-industry information from a CRD report:

1. First, consult with experienced and knowledgeable counsel to determine if the information sought to be expunged is, in fact, of the nature that a panel can order it expunged and FINRA's CRD is obligated to expunge;
2. If the negative information was reported by a former employer, the chances for obtaining expungement are higher, particularly if the former employer no longer is in business, or does not have any financial motivation to hire counsel and spend money to fight the expungement request. Again, as with expungement of customer complaints, do not ask for monetary damages and limit the request only to expungement. If there is no money at stake, very few firms, if still in business, will spend the time or money fighting a pure expungement request; and
3. By not asking for monetary damages, and limiting the expungement request only to expungement of CRD disclosures, the hearing will proceed under the simplified hearing rules contained within Code of Arbitration Procedure Rule 13800, applicable to simplified hearings where there is less than \$50,000.00 in issue. A simplified hearing involves only one arbitrator and progresses much more quickly than a three person panel case. Moreover, since a party requesting expungement is responsible for paying all of the arbitration costs, including the panel's fees, the costs of an expungement proceeding will be less in a simplified hearing.

Shustak & Partners, P.C. has extensive experience in FINRA arbitrations and FINRA expungement issues. Contact Managing Partner Erwin J. Shustak with any questions.

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