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Ms. Vanessa Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090

RE: File No. SR-FINRA-2020-030 (Proposed Rule Change to Amend the FINRA Code of Arbitration Procedure for Customer Disputes and the FINRA Code of Arbitration Procedure for Industry Disputes to Modify the Current Process Relating to the Expungement of Customer Dispute Information, Including Creating a Special Arbitrator Roster to Decide Certain Expungement Requests)

Dear Ms. Countryman:

This letter responds to comments received by the Securities and Exchange Commission (“SEC” or “Commission”) to the above-referenced rule filing related to proposed amendments to the Code of Arbitration Procedure for Customer Disputes (“Customer Code”) and the Code of Arbitration Procedure for Industry Disputes (“Industry Code”) (together, “Codes”) to modify the current process relating to the expungement of customer dispute information, including creating a special arbitrator roster to decide certain expungement requests (“Proposal”).¹

Specifically, the Proposal would amend the Codes to: (1) impose requirements on expungement requests (a) filed during an investment-related, customer initiated arbitration (“customer arbitration”) by an associated person, or by a party to the customer arbitration on-behalf-of an unnamed associated person, or (b) filed by an associated person separate from a customer arbitration (“straight-in request”); (2) establish a roster of arbitrators with enhanced training and experience from which a three-person panel would be randomly selected to decide straight-in requests (“special

¹ See Securities Exchange Act Release No. 90000 (September 25, 2020), 85 FR 62142 (October 1, 2020) (Notice of Filing of File No. SR-FINRA-2020-030).

arbitrator roster”);² (3) establish procedural requirements for expungement hearings; and (4) codify and update the best practices of the Notice to Arbitrators and Parties on Expanded Expungement Guidance (“Guidance”) that arbitrators and parties must follow.³ In addition, the Proposal would amend the Customer Code to specify procedures for requesting expungement of customer dispute information arising from simplified arbitrations. The Proposal would also amend the Codes to establish requirements for notifying state securities regulators and customers of expungement requests.

The Commission published the Proposal for public comment in the Federal Register on October 1, 2020 and received eight comments in response to the Proposal.⁴

² To be eligible for the special arbitrator roster, arbitrators must: (1) be public arbitrators who are eligible for the chairperson roster; (2) have evidenced successful completion of, and agreement with, enhanced expungement training provided by FINRA; and (3) served as an arbitrator through award on at least four customer-initiated arbitrations administered by FINRA or by another self-regulatory organization in which a hearing was held. See proposed Rule 13806(b).

³ See Guidance, available at <https://www.finra.org/arbitration-mediation/notice-arbitrators-and-parties-expanded-expungement-guidance>.

⁴ See Letter from Steven B. Caruso, Maddox Hargett & Caruso, P.C., to Vanessa Countryman, Secretary, SEC, dated September 28, 2020 (“Caruso”); letter from Dochter D. Kennedy, President & Founder, AdvisorLaw, LLC, to J. Matthew DeLesDernier, Assistant Secretary, SEC, dated October 22, 2020 (“AdvisorLaw”); letter from Benjamin P. Edwards, Associate Professor of Law, University of Nevada, Las Vegas, William S. Boyd School of Law, to J. Matthew DeLesDernier, Assistant Secretary, SEC, dated October 12, 2020 (“Edwards”); letter from Lisa Hopkins, President, North American Securities Administrators Association, Inc., to Vanessa Countryman, Secretary, SEC, dated October 22, 2020 (“NASAA”); letter from Amanda Skrelja, Paige Guarino, William Lapadula, and Zachary Dukoff, Legal Interns & Elissa Germaine, Supervising Attorney, John Jay Legal Services, Inc., Elizabeth Haub School of Law, PACE University, to J. Matthew DeLesDernier, Assistant Secretary, SEC, dated October 22, 2020 (“PACE”); letter from Kevin M. Carroll, Managing Director and Associate General Counsel, SIFMA, to Vanessa A. Countryman, Secretary, SEC, dated October 22, 2020 (“SIFMA”); letter from Ruben Huertero, Legal Intern & Christine Lazaro, Director of the Securities Arbitration Clinic and Professor of Clinical Legal Education, St. John’s University School of Law, to Vanessa Countryman, Esq., Secretary, SEC, dated October 22, 2020 (“St. John’s”); and letter from David P. Meyer, President, Public Investors Advocate Bar Association, to Brent J. Fields, Secretary, SEC, dated October 23, 2020 (“PIABA”).

Five of the commenters expressed general support for the Proposal, but also expressed concerns with some aspects of the Proposal and suggested modifications.⁵ PIABA stated that the Proposal was “largely a step in the right direction” but did not go far enough. AdvisorLaw and Edwards opposed the proposal.

The following are FINRA’s responses to the commenters’ material concerns.

Special Arbitrator Roster Decides Expungement Requests if the Customer Arbitration Closes other than By Award or By Award Without a Hearing

Under the Proposal, if a named associated person or party on-behalf-of an unnamed person requests expungement during the customer arbitration and the arbitration closes other than by award (e.g., the parties settle the arbitration) or by award without a hearing, an associated person may only pursue an expungement request by filing a straight-in request under the Industry Code against the member firm at which the associated person was associated at the time the dispute arose.⁶ SIFMA suggested that in these cases, the associated person should continue to be allowed to request an expungement-only hearing before the same panel from the customer arbitration.⁷

FINRA disagrees with the commenter. As FINRA indicated in the Proposal, the customer arbitration may not always provide the necessary party input to develop a complete factual record on which a panel could base an expungement recommendation if the customer arbitration closes other than by award or by award without a hearing.⁸ For example, when a customer arbitration settles, which could be at any point during the customer arbitration including before a hearing has occurred, the panel selected by the parties in the customer arbitration may not have heard the full merits of the case and, therefore, may not bring to bear any special insights in determining whether to recommend expungement.⁹ In addition, the panel deciding the post-settlement

⁵ See Caruso, PACE, SIFMA, St. John’s and NASAA.

⁶ See proposed Rule 12805(a)(1)(D)(ii).

⁷ See also AdvisorLaw.

⁸ See Proposal, 85 FR 62142, 62167 (responding to comments to Regulatory Notice 17-42 disagreeing with the requirement that associated persons file a straight-in request if the customer arbitration closes other than by award or by award without a hearing).

⁹ Although in some settled cases the arbitrators may have been provided with briefing or other pre-hearing information, FINRA believes that the arbitrators should

expungement hearing is the panel selected by the parties for the customer arbitration and may not have direct experience with expungement hearings. These hearings are also often one-sided as the customer or the customer's representative has little incentive to participate if the customer's concerns have been resolved.

Thus, in these circumstances, FINRA believes it would be appropriate for arbitrators that have been randomly selected from the special arbitrator roster, who would be experienced, public chairpersons with enhanced expungement training, to serve as fact-finders to uncover material facts, when necessary. In addition, FINRA believes that the panel from the special arbitrator roster would be well situated to decide these requests because the Proposal would provide the panel with additional tools to help them develop the factual record, including by (i) directing the panel to inquire into potentially conditioned settlements,¹⁰ (ii) codifying the panel's authority to request from the associated person, the member firm at which he or she was associated at the time the customer dispute arose or other party requesting expungement, any documentary, testimonial or other evidence that it deems relevant to the expungement request, and (iii) including provisions to encourage and facilitate customer participation in expungement hearings.¹¹

generally base their expungement recommendations on the evidence presented at an expungement hearing, as contemplated by FINRA Rules 12805 and 13805. In addition, information from the customer's case may be requested and reviewed by the special arbitrator roster. See *infra* note 16 and accompanying text.

¹⁰ See also *infra* section "Confidentiality Provisions in Settlement Agreements."

¹¹ See proposed Rule 13805(c). SIFMA and AdvisorLaw noted that the Proposal would allow the arbitrator from the customer case to decide expungement requests in simplified arbitrations, regardless of how the simplified arbitration closes. Simplified arbitrations typically involve pro se customers and are often decided on the papers (i.e., without a hearing) to save time and expense to the customer. They may also be decided pursuant to a special proceeding, where each side is limited to two hours to present their case. Because of the special rules that govern simplified arbitrations, including the claim amount limit, they will typically result in the creation of less complex factual records than other cases. Given the nature of simplified arbitrations and FINRA's concern that a customer from a simplified arbitration may be less willing or able to participate in a straight-in request decided by the special arbitrator roster, despite the additional provisions in the Proposal to encourage and facilitate customer participation, FINRA believes it is appropriate, at this time, for the arbitrator from the simplified arbitration to also decide an expungement request made during a simplified arbitration. As noted in the Proposal, however, FINRA will continue to monitor expungement requests and

Non-Adversarial Nature of Straight-in Expungement Requests

Edwards stated that in expungement proceedings, the “adversarial system fails to function in any reliable way because expungement hearings generally proceed as one-sided affairs which are functionally *ex parte* proceedings.” Edwards stated further that, in straight-in requests where the associated person would be required to file the expungement request against the firm at which he or she was associated at the time the customer dispute arose, the associated person’s and firm’s interests align.

The Proposal includes several provisions that address the potentially non-adversarial nature of straight-in expungement requests.¹² For example, FINRA determined that the current process for selecting arbitrators (i.e., striking and combining ranked lists) would not be appropriate for selecting arbitrators to decide straight-in

decisions in simplified arbitrations to determine if such requests should be filed as straight-in requests decided by the special arbitrator roster. Proposal, 85 FR 62,142, 62,156.

¹² See Proposal, 85 FR 62142, 62167 (describing, in response to comments to Regulatory Notice 17-42, how the Proposal addresses concerns that straight-in requests filed against the member firm may be non-adversarial or lack customer participation). FINRA does not believe that it would be appropriate to adopt Edwards’ suggestion of imposing a duty of candor on associated persons and their representatives in straight-in requests. The duty of candor is, in general, a legal ethics principle that is applicable to attorneys pursuant to individual state Rules of Professional Conduct that FINRA does not regulate. In addition, FINRA does not believe that it would be practical or appropriate to impose this legal-ethics principle on non-attorney associated persons.

Edwards also mentioned a forthcoming article that he believes quantifies the risks that the expungement process poses to the public. Edwards notes that the Proposal cites to an earlier version of the article, rather than the most recent draft. See Proposal, 85 FR 62142, 62162. FINRA notes that, in the more recent version of the article, the authors report that brokers with a prior successful expungement are “3.3 times as likely to engage in future misconduct as the average broker in any given year.” See Colleen Honigsberg & Matthew Jacob, “Deleting Misconduct: The Expungement of BrokerCheck Records,” March 2020, *Journal of Financial Economics* (forthcoming), https://www-cdn.law.stanford.edu/wp-content/uploads/2018/11/Honigsberg_and_Jacob__2020_SSRN.pdf. The authors also no longer report the results, referenced in the Proposal, which suggest that an unsuccessful expungement attempt is associated with a higher probability of future misconduct than a successful expungement attempt.

requests.¹³ If the parties' interests are aligned, they could use the current arbitrator selection process to strike and rank arbitrators on the list to assemble a panel that could be more favorable to recommending expungement.¹⁴ Accordingly, the Proposal provides that the parties would not be permitted to stipulate to the use of pre-selected arbitrators, nor would they be permitted to strike any of the panelists; instead, the arbitrators would be randomly selected.¹⁵ In addition, to help ensure that the panel has all of the information necessary to make a fully-informed decision on the expungement request on the basis of a complete factual record, the Proposal codifies the ability of arbitrators to request from the associated person, the member firm at which he or she was associated at the time the customer dispute arose or other party requesting expungement, any documentary, testimonial or other evidence that they deem relevant to the expungement request.¹⁶

¹³ See generally FINRA Rules 12402 and 12403.

¹⁴ Contra AdvisorLaw (suggesting that associated persons who file straight-in requests receive a list of arbitrators from the special arbitrator roster and be given the ability to strike and rank).

¹⁵ See proposed Rules 13806(b)(1) and (4). The parties would also be prohibited from stipulating to the removal of a randomly selected panelist and would not be permitted to stipulate to fewer than three arbitrators on a panel. See proposed Rules 13806(b)(4) and (5).

Edwards suggests that the Proposal should segregate arbitrators on the expungement roster from customer arbitration pools to reduce the risk that bias against customers would carry over to customer cases, and to enable the arbitrators presiding over these hearings to more quickly accumulate expertise. FINRA notes that arbitrators on this roster would be public chairs, who are some of the more experienced arbitrators in the forum. If FINRA segregated them, it would prevent them from serving on customer arbitrations. FINRA believes it is important for arbitrators to serve on a variety of cases to gain experience in the forum. Limiting arbitrators to one type of case could affect how quickly arbitrators gain experience, which could lessen arbitrators' willingness to remain on the roster.

¹⁶ See proposed Rules 12805(c)(6) and 13805(c)(6).

Customer Participation in Expungement Proceedings

The Proposal includes several provisions to encourage and facilitate customer participation in expungement hearings.¹⁷ For example, the Proposal incorporates the best practices from the Guidance that would expressly entitle a customer to appear at the expungement hearing, allow the customer to choose his or her method of appearance, permit the customer to be represented, and allow the customer to testify, introduce evidence and make opening and closing arguments.¹⁸ Edwards and PACE urged FINRA to do more to increase customer participation in expungement hearings.

Create Financial Incentives for Customers to Participate

Edwards suggested providing “for attorneys’ fees and incentive awards for customers who participate in expungement proceedings.” Edwards also stated that “the Commission should affirmatively state” that it “believes that arbitrators conducting these hearings may, in exercising their equitable power, award attorney fees to customers who participate in expungement hearings.”

FINRA notes that arbitrators are currently authorized to award attorneys’ fees as a sanction under the Codes for a party’s failure to comply with any provision of the Code or any order of the panel.¹⁹ Arbitrators may also award attorneys’ fees when: (1) the parties’ contract includes a clause that provides for attorneys’ fees; (2) all of the parties request or agree to such fees; or (3) the fees are required as part of a statutory claim.²⁰ FINRA does not favor creating special incentive awards for participation in expungement hearings, as doing so would be inconsistent with FINRA’s neutral administration of the arbitration forum.

Initial Customer Notification by Associated Person

The Proposal would codify a best practice from the Guidance that requires the associated person who files a straight-in request to provide all customers whose

¹⁷ See Proposal, 85 FR 62142, 62153, 62157, 62161, 62172.

¹⁸ See generally proposed Rules 12805(c) and 13805(c).

¹⁹ See FINRA Rules 12212 and 13212.

²⁰ See The Neutral Corner, Considering Attorney’s Fees Using FINRA’s Award Information Sheet, Volume 4 (2014), https://www.finra.org/sites/default/files/Neutral%20Corner_Volume%204_2014.pdf

customer arbitrations, civil litigations and customer complaints gave rise to the customer dispute information that is a subject of the expungement request with notice of the expungement request by serving a copy of the statement of claim requesting expungement.²¹ Under the Proposal, the associated person would provide the notice before the first scheduled hearing session is held.²² Edwards suggested that the associated person also be required to disclose all documents filed in the proceeding to the customer, including a copy of the answer. Edwards also suggested that the notice be sent on the same day that the broker files the request and recommended giving customers 90 days from the notice to secure counsel and prepare a response.

FINRA agrees that a customer should receive notice of the expungement request as soon as practicable. FINRA also believes that customers would benefit from a copy of the answer in addition to the statement of claim. Accordingly, FINRA has determined to amend proposed Rule 13805(b)(1) to require that the associated person serve the customers with the statement of claim within 10 days of filing the statement of claim with FINRA and any answer within 10 days of filing each answer with FINRA. FINRA does not believe that it would be appropriate to mandate the disclosure of all other documents filed in the proceeding. After receiving the statement of claim or any answers, the customer would be able to determine whether to participate and respond. Where the customer does not actively participate in the expungement request, or the matter also involves issues unrelated to expungement, imposing the additional requirement of providing all other documents filed in the proceeding in all circumstances could be unnecessarily burdensome on the associated person.

Customer Participation in Prehearing Conferences

The Proposal provides that the Director shall notify all customers whose customer arbitrations, civil litigations, and customer complaints gave rise to the customer dispute information that is the subject of the expungement request of the time, date and place of the expungement hearing.²³ Edwards recommended that customers be

²¹ See proposed Rule 13805(b)(1)(A).

²² See proposed Rule 13805(b)(1). A hearing session is any meeting between the parties and arbitrators of four hours or less, including a hearing or prehearing conference. See FINRA Rules 12100(p) and 13100(p).

²³ See proposed Rule 13805(b)(2).

allowed to participate in all initial scheduling decisions and to communicate with the panel on these scheduling matters.²⁴

FINRA agrees that customers should be provided with information that would enable them to participate in prehearing conferences relating to straight-in requests. Accordingly, FINRA has determined to amend proposed Rule 13805(b)(2) to provide that the Director will notify these customers of the time, date and place of any prehearing conferences using the customers' current address provided by the party seeking expungement. FINRA has also determined to amend proposed Rule 13805(c)(3)(A) to clarify that the customer is entitled to appear at prehearing conferences.²⁵ FINRA will continue to consider customer participation in expungement hearings, including ways to further encourage customer participation.

Confidentiality Provisions in Settlement Agreements

Edwards expressed concern that customers may "fear to participate in expungement hearings because they have signed settlement agreements with confidentiality and non-disparagement clauses." Edwards suggested that FINRA require that the associated person's initial notice affirmatively state that neither the customer's testimony nor any documents produced would violate any settlement agreements that are subject to confidentiality orders.

FINRA believes that provisions in the Proposal making clear that customers can participate and encouraging and facilitating their participation, as well as existing FINRA Rule 2081 should help alleviate customer concerns about participating in an expungement hearing as a result of a settlement agreement. FINRA Rule 2081 provides that "[n]o member or associated person shall condition or seek to condition settlement of a dispute with a customer on, or to otherwise compensate the customer for, the customer's agreement to consent to, or not to oppose, the member's or associated

²⁴ In most arbitrations, including straight-in requests, once the panel has been selected, the Director will schedule an Initial Prehearing Conference ("IPHC") before the panel. See FINRA Rules 12500(a) and 13500(a). The parties may jointly agree to forgo the IPHC, provided certain conditions are met. See FINRA Rules 12500(c) and 13500(c).

²⁵ In addition, proposed Rule 13805(c)(4) would be amended to clarify that all parties from investment-related, customer-initiated arbitrations or civil litigations, and customers whose customer complaints gave rise to the customer dispute information that is a subject of the expungement request shall have the right to be represented at the prehearing conferences.

person's request to expunge such customer dispute information from the CRD system.”²⁶ A member's inclusion of broad confidentiality and non-disparagement language in a settlement agreement could violate this prohibition where the language has the effect of conditioning the settlement on non-opposition to an expungement request. In addition, the Proposal would require the associated person to file with the panel all documents provided by the associated person to the customers, including proof of service, and any responses received by the associated person from a customer.²⁷ An associated person or member firm's invocation of settlement agreement language in connection with the customer's potential participation in an expungement hearing could be evidence that the settlement agreement violates FINRA Rule 2081.²⁸

Majority Decision for Recommending Expungement

Under the Proposal, a recommendation to expunge customer dispute information would require a majority decision of the arbitrators. Three commenters opposed this requirement, stating that a majority decision fails to communicate that expungement should only be recommended in truly extraordinary cases.²⁹ PIABA and NASAA also suggested that a divided panel decision would indicate that there is doubt that the associated person has met this high burden.

²⁶ See also Prohibited Conditions Relating to Expungement of Customer Dispute Information FAQ, available at <https://www.finra.org/arbitration-mediation/faq/prohibited-conditions-relating-expungement-customer-dispute-information>.

²⁷ See proposed Rule 13805(b)(1)(C).

²⁸ FINRA has also stated that it is a violation of FINRA Rule 2010 to include confidentiality provisions in settlement agreements or any other documents, including confidentiality stipulations made during a FINRA arbitration proceeding, that prohibit or restrict a customer or any other person from communicating with the Commission, FINRA, or any federal or state regulatory authority regarding a possible securities law violation. See <https://www.finra.org/rules-guidance/notices/14-40>.

²⁹ See Edwards, PIABA, and NASAA.

As stated in the Proposal, a majority decision is consistent with what is required for other decisions in customer and industry arbitrations.³⁰ In addition, in light of the overall Proposal, FINRA does not believe that unanimous arbitrator decisions are necessary to help ensure that expungement is recommended in limited circumstances when one of the FINRA Rule 2080(b)(1) grounds is met. FINRA believes that a majority decision should help to balance the competing interests of providing regulators broad access to information about customer disputes to fulfill their regulatory obligations, providing a fair process that recognizes an associated person's interest in protecting their reputation and ensuring investors have access to accurate information about associated persons. In addition, as stated in the Proposal, FINRA intends to monitor the impact of the changes on the expungement process to determine if additional changes would be appropriate, including requiring a unanimous decision by the arbitrators.³¹

Standards for Recommending Expungement

Two commenters suggested requiring arbitrators to apply additional standards when considering expungement requests.³² Edwards suggested that the required standard of proof to obtain an expungement recommendation should be “at least clear and convincing evidence” because the “absence of guidance” creates “confusion and inconsistent application of the” Rule 2080 standards, and because of the generally non-adversarial nature of straight-in requests. PIABA recommended that the panel should be required to find “no investor protection or regulatory value” before recommending expungement because arbitrators may misapply the existing Rule 2080 standards.

Consistent with the requirements under the Codes today, the Proposal would require that to recommend expungement of customer dispute information, the arbitrator or panel must make an affirmative finding that (i) the claim, allegation or information is factually impossible or clearly erroneous; (ii) the associated person was not involved in the alleged investment-related sales practice violation, forgery, theft, misappropriation or conversion of funds; or (iii) the claim, allegation or information is false.³³ At this time, FINRA does not believe that adding a “clear and convincing evidence” standard

³⁰ See FINRA Rules 12904(a) and 13904(a); Proposal, 85 FR 62142, 62164, 62169 (explaining why FINRA is not proposing that arbitrators be required to recommend expungement unanimously).

³¹ Proposal, 85 FR 62142, 62169.

³² See Edwards and PIABA.

³³ See proposed Rules 12805(c)(8) and 13805(c)(8); FINRA Rule 2080(b)(1).

only for expungement decisions would aid arbitrator decision-making.³⁴ As stated above, FINRA seeks to balance the competing interests in the expungement process, including in providing a fair process and ensuring that information about associated persons that is available to investors is accurate. In addition, as stated in the Proposal, FINRA is concerned that codifying a “no investor protection or regulatory value” standard could create confusion and the potential for inconsistent results among different arbitrators.³⁵

FINRA believes that the overall Proposal, including, for example, the provisions that require additional training and qualifications for arbitrators on the special arbitrator roster, should help ensure that the existing standards are applied appropriately.³⁶ Accordingly, FINRA has determined not to revise the Proposal to require arbitrators to apply a “clear and convincing evidence” or “no investor protection or regulatory value” standard before recommending expungement.

Arbitrator Must Find Rule 2080(b)(1) Grounds for Expungement

SIFMA stated that the Proposal should not limit the grounds for recommending expungement to those contained in Rule 2080(b)(1), but should instead also allow arbitrators to recommend expungement if they find the grounds contained in FINRA Rule 2080(b)(2). SIFMA’s comment fails to recognize the key distinction in these two

³⁴ FINRA’s required Basic Arbitrator Training Program, which includes an Expungement Training Module, provides that, generally, the standard for determining whether a claimant has proven his or her case is by a preponderance of the evidence (“the greater weight of the evidence”).

³⁵ See Proposal, 85 FR 62142, 62170. In addition, as stated in the Proposal, FINRA notes that that in its Order approving NASD Rule 2130 (now FINRA Rule 2080), which describes the current findings that arbitrators must make to recommend expungement, the SEC stated that “it believes the proposal strikes the appropriate balance between permitting members and associated persons to remove information from the CRD system that holds no regulatory value, while at the same time preserving information on the CRD system that is valuable to investors and regulators.” See Securities Exchange Act Release No. 48933 (December 16, 2003) 68 FR 74667, 74672 (December 24, 2003) (Order Approving File No. SR-NASD-2002-168).

³⁶ In connection with the Proposal, FINRA is also considering revisions to the expungement-related training that is provided to all arbitrators, including the required Expungement Training Module that is part of the Basic Arbitrator Training Program. See also Proposal, 85 FR 62,142, 62,150 n. 82.

provisions; only under Rule 2080(b)(1) does FINRA base its determination on specific arbitral findings.³⁷

In particular, FINRA Rule 2080(b)(1) describes when FINRA may waive the obligation to name FINRA as a party in a court proceeding seeking judicial confirmation of an arbitration award containing expungement if FINRA determines that the expungement relief is based on three enumerated affirmative judicial or arbitral findings. FINRA Rule 2080(b)(2), in contrast, describes when FINRA, “in its sole discretion and under extraordinary circumstances,” may waive the requirement that it be named in a court proceeding if *it* determines that the request for expungement and accompanying award are meritorious and expungement would not have a material adverse effect on investor protection, the integrity of the CRD system, or regulatory requirements.

As the Proposal relates to the process for requesting an expungement recommendation in FINRA arbitration, not FINRA’s own discretionary determination, the Proposal properly clarifies that the arbitrator or panel must indicate which of the three grounds contained in FINRA Rule 2080(b)(1) serve as the basis for its expungement recommendation.³⁸

Explaining Denials of Expungement Requests

AdvisorLaw suggested that the Proposal require that arbitrators provide an explanation when expungement is denied, as is currently required when expungement is recommended.³⁹ Under FINRA Rule 2080(b)(1), however, only recommendations for

³⁷ See also Proposal, 85 FR 62,170 (explaining why FINRA is proposing to clarify that the FINRA Rule 2080 grounds for expungement that the panel must identify to recommend expungement are the grounds stated in paragraph (b)(1) of FINRA Rule 2080).

³⁸ The requirement that arbitrators find one of the three grounds contained in FINRA Rule 2080(b)(1) for recommending expungement was recognized when FINRA Rules 12805 and 13805 were enacted. See Securities Exchange Act Release No. 58886 (October 30, 2008), 73 FR 66086 (November 6, 2008) (stating that new Rules 12805 and 13805 required the arbitration panel to indicate “which of the grounds for expungement in Rule [2080](b)(1)(A)-(C) serves as the basis for the expungement”); Regulatory Notice 08-79 (December 2008) (stating that “[t]he arbitration panel must indicate which of the grounds for expungement under Rule 2130(b)(1)(A)-(C) serve as the basis for their expungement order, and provide a brief written explanation of the reasons for ordering expungement”).

expungement under Rule 2080(b)(1) may result in FINRA waiving the obligation to name it as a party. Since a denial, regardless of rationale, would not result in FINRA waiving the obligation under FINRA Rule 2080(b)(1), FINRA does not believe that it is necessary to require that denials of expungement requests be explained.

Time Limitations

Three commenters opposed the proposed time limitations that require associated persons to file straight-in requests within: (i) two years of the close of the customer arbitration or civil litigation that gave rise to the customer dispute information, and (ii) six years of the date the customer complaint was initially reported in the CRD system.⁴⁰ AdvisorLaw stated that the proposed limitations were “arbitrary” and that “the accuracy of the information contained within the CRD system has no relationship to the age of that information.” PIABA and NASAA, however, stated that they favored the shorter one-year limitation period for all expungement requests that FINRA had originally proposed in Regulatory Notice 17-42. PIABA stated that the additional time under the Proposal that would be allowed to file expungement requests would “degrade the quality of evidence for a panel to consider in making an expungement determination and decrease the likelihood that the customer will participate in the hearing.” PIABA also stated that firms do not “need *six years* to complete investigations of customer complaints and close them in the CRD system” (emphasis in original).

FINRA believes that the proposed time limitations appropriately address its concern that a number of expungement requests are currently filed many years after a customer arbitration closes or the reporting of a customer complaint in the CRD system.⁴¹ As described in the Proposal’s economic impact analysis, the majority of the straight-in requests filed between January 2016 and December 2019 would not have been permitted under the proposed time limits.⁴²

³⁹ FINRA notes that the Proposal would remove the limitation that the explanation for recommending expungement should be “brief.” See proposed Rules 12805(c)(8) and 13805(c)(8). Thus, the panel’s explanation should provide enough detail in the award to explain its rationale for recommending expungement.

⁴⁰ See proposed Rules 13805(a)(2)(A)(iv) and (v).

⁴¹ See also Proposal, 85 FR 62,142, 62170-71 (responding to comments suggesting that the time limits proposed in Regulatory Notice 17-42 were unwarranted, appropriate, too short, or too long, and explaining why FINRA is proposing revised time limits).

⁴² See Proposal, 85 FR 62,142, 62,158, 62,161.

FINRA also believes that allowing two years from the close of the customer arbitration or civil litigation (e.g., after the case settles) to bring an expungement request would provide a reasonable amount of time for associated persons and firms to gather the documents, information and other resources required to file the expungement request.⁴³ In addition, the two-year period would help ensure that the expungement hearing is held close enough in time to the customer arbitration, when information regarding the customer arbitration is available and in a timeframe that could increase the likelihood for the customer to participate if the customer chooses to do so.

The Proposal allows a longer six-year time period to seek expungement of customer complaints to allow firms to complete their investigation of the customer complaint and close it in the CRD system; the complaint to evolve, or not evolve, into an arbitration within the six-year general eligibility rule applicable to all arbitration claims;⁴⁴ and the associated person to determine whether to proceed with a request to expunge the complaint. Thus, the Proposal would help avoid unnecessary duplicative requests to expunge customer complaints that subsequently evolve into arbitrations or civil litigations.⁴⁵ The proposed six-year time limit would also provide a reasonable time limit, consistent with the general six-year eligibility rule, to encourage customer participation and help ensure the availability of evidence related to customer complaints. As noted above, however, FINRA intends to monitor the expungement process as amended by the Proposal, including the application of the time limits, to determine if additional modifications are warranted.

Fees Assessed When an Associated Person Requests Expungement

AdvisorLaw and SIFMA expressed concern about the fees that associated persons and firms would be assessed as a result of the Proposal. AdvisorLaw stated that associated persons would be required to pay the filing fee twice for the same expungement request if the associated person is named in a customer arbitration, the case settles or is dismissed, and the associated person files a straight-in request.

AdvisorLaw has misread the Proposal. If an associated person is named in a customer arbitration and requests expungement during the case, the associated person would be assessed the applicable fee.⁴⁶ However, as stated in the Proposal, FINRA

⁴³ Id.

⁴⁴ See FINRA Rules 12206(a) and 13206(a).

⁴⁵ See Proposal, 85 FR 62,142, 62,171.

⁴⁶ See FINRA Rule 12900(a)(3).

would not assess a second filing fee if the associated person subsequently files a straight-in request to expunge the same customer dispute information.⁴⁷

SIFMA and AdvisorLaw characterized the minimum member surcharge and process fees that would be assessed to firms if an associated person files a straight-in request as “duplicative” and suggested that these fees be eliminated. FINRA notes that the member surcharge and process fees that a member firm would be assessed if an associated person files a straight-in request are not duplicate fees.⁴⁸ Under the Codes, FINRA assesses the member surcharge and process fee for straight-in requests because they are separate arbitrations brought seeking different relief, in this case, expungement.⁴⁹ Consistent with straight-in requests today, the member firm, having not previously paid a member surcharge and process fee for the expungement request, is assessed these fees when and if a straight-in request is filed.⁵⁰ Accordingly, amendments to the expungement fees are not warranted.

Method of Associated Person’s Appearance at Expungement Hearing

The Proposal would authorize the arbitrators to determine how an associated person would be required to appear (by telephone, in person or by video conference) at the expungement hearing.⁵¹ NASAA expressed support for the requirement that the associated person personally appear at the expungement hearing, but stated that the

⁴⁷ See Proposal, 85 FR 62,142, 62,160 n.176.

⁴⁸ See Proposal, 85 FR 62142, 62169 (responding to comments to Regulatory Notice 17-42 stating that the member surcharge and process fee would be assessed “twice”).

⁴⁹ See FINRA Rules 12901(a)(3) (Member Surcharge) and 12903(c) (Process Fees Paid by Members); see also FINRA Rules 13901(c) (Member Surcharge) and 13903(c) (Process Fees Paid by Members).

⁵⁰ See also Securities Exchange Act Release No. 88945 (May 26, 2020), 85 FR 33212 (June 1, 2020) (Order Approving File No. SR-FINRA-2020-005) (approving amendments to the Codes to apply minimum fees to expungement requests, whether the request is made as part of the customer arbitration or the associated person files an expungement request in a separate arbitration). See also Regulatory Notice 20-25 (July 2020) (announcing a September 14, 2020 effective date) at <https://www.finra.org/rules-guidance/notices/20-25>.

⁵¹ See proposed Rule 12805(c)(2) and 13805(c)(2).

associated person should not be able to appear “by telephone or, as a matter of course, video conference.”

To encourage appropriate fact-finding by the arbitrators, FINRA believes that the panel should have the authority to decide which method of appearance would be the most appropriate for the particular case.⁵² Accordingly, FINRA declines to modify the panel’s ability to determine the associated person’s method of appearance.

Prohibition on Seeking Expungement in Simplified Arbitrations Where Liability Found

St. John’s suggested that, in a simplified arbitration, associated persons be prohibited from seeking expungement if there has been a finding of liability against that individual in the customer arbitration. FINRA believes that if expungement has been requested and accordingly will be decided in a simplified arbitration, the arbitrators are capable of making this determination.⁵³

State Notification of Complete Expungement Requests

Under the Proposal, FINRA would notify state securities regulators, in the manner determined by FINRA, of an expungement request within 30 days after receiving a complete request for expungement.⁵⁴ NASAA expressed appreciation for FINRA’s willingness to provide NASAA with earlier notice of requests for expungement. However, NASAA also stated that it “strongly prefers this relief be deferred” because “there would be no meaningful disclosure of information on which to assess the expungement request, nor would there be a legal mechanism to facilitate regulator involvement.”

⁵² See Proposal 85 FR 62142, 62172 (responding to comments to Regulatory Notice 17-42 on the appropriate method of appearance by the associated person).

⁵³ See also supra note 11. FINRA also notes that the Director may deny the forum, pursuant to FINRA Rules 12203 and 13203, “if the Director determines that, given the purposes of FINRA and the intent of the Code, the subject matter of the dispute is inappropriate, or that accepting the matter would pose a risk to the health or safety of arbitrators, staff, or parties or their representatives.” The Director uses this authority to deny the forum in appropriate circumstances.

⁵⁴ See proposed Rules 12805(b) and 13805(b)(3); see also Proposal, 85 FR 62,172 (describing proposed notification in response to NASAA’s comment to Regulatory Notice 17-42).

FINRA acknowledges that under the current expungement process, the ability for a state regulator to intervene occurs when an associated person seeks a court order confirming an arbitration award containing expungement or an associated person goes directly to court to seek expungement without first going through arbitration, and that this would not change under the Proposal.⁵⁵ Instead of replacing the current expungement process with a regulatory process as some commenters suggested,⁵⁶ the

⁵⁵ An associated person can seek expungement of customer dispute information by obtaining a court expungement order (1) by going through the FINRA arbitration process and securing an award recommending expungement (and then obtaining a court order confirming that arbitration award) or (2) by going directly to court (without first going through arbitration). Regardless of whether expungement of customer dispute information is sought directly through a court or by first going through arbitration, FINRA Rule 2080, which was developed in close consultation with representatives of NASAA and state regulators, requires an associated person seeking expungement to obtain an order of a court of competent jurisdiction directing such expungement or confirming an award containing expungement.

An associated person seeking expungement directly in court must name FINRA. An associated person seeking to confirm an arbitration award recommending expungement must name FINRA or request a waiver from naming FINRA pursuant to FINRA Rule 2080. Upon receipt of a complaint naming FINRA or a request for a waiver, FINRA will notify NASAA of the proceeding (in the case of a complaint) or the request for a waiver. NASAA in turn will notify the appropriate state securities regulator (our understanding is that, in the case of a lawsuit, NASAA notifies the state securities regulator where the lawsuit is pending, and the associated person's home state, if they are different). A state securities regulator or FINRA may determine to oppose a request that a court confirm an arbitration award containing expungement relief or a request for expungement initiated directly in court. FINRA may oppose such a request if FINRA determines that expungement is not consistent with FINRA rules. In cases where FINRA has opposed, FINRA's experience has been that the likelihood of a court denying expungement relief increases when a state regulator intervenes in an expungement proceeding, alongside FINRA, to represent the interests of resident investors.

⁵⁶ PIABA suggested "removing expungement decisions from the FINRA arbitration forum and hav[ing] securities regulators directly or through a regulatory tribunal established and agreed to by FINRA, NASAA and the SEC make these determinations." In addition, as noted above, NASAA also expressed a preference for greater regulator involvement. See also Proposal, 85 FR 62,142, 62,174 (responding to comments to Regulatory Notice 17-42 suggesting alternatives to the CRD disclosure and expungement framework).

Proposal seeks to enhance the current expungement process where an associated person seeks expungement of customer dispute information through FINRA arbitration.⁵⁷ It is FINRA's understanding, however, that earlier notice of expungement requests may still be of some benefit to state securities regulators.⁵⁸ Accordingly, FINRA has determined not to modify this requirement in the Proposal and plans to work with NASAA and state securities regulators on how best to implement a notification requirement.

Conclusion

The Proposal is intended to strengthen the current expungement process to help ensure that expungement is recommended by arbitrators in limited circumstances when one of the FINRA Rule 2080(b)(1) grounds is met. As FINRA gains experience with the expungement process as revised by the Proposal, FINRA will continue to evaluate whether there are ways to further enhance the process. To that end, FINRA intends to continue to monitor the expungement process, particularly straight-in requests, and to provide information on its website regarding expungement requests.⁵⁹ In addition, FINRA welcomes continued engagement with interested parties on expungement, including on potential alternative frameworks to the current expungement process.

* * * *

⁵⁷ SIFMA requested that FINRA “clarify the timing and type of regulator involvement in the expungement process that the rule envisions.” The Proposal does not change when state regulator involvement can occur in the expungement process. See supra note 55, and accompanying text. In addition, in response to SIFMA's question whether the Proposal is intended to preclude an associated person from seeking expungement relief in court, FINRA notes that the Proposal would not change the ability of an associated person to seek court confirmation of an arbitration award for expungement or to request expungement by going directly to court (without first going through FINRA arbitration).

⁵⁸ Following submission of their comment letter, NASAA informed FINRA that earlier notice of expungement requests under the current expungement process could still be of some benefit to state securities regulators.

⁵⁹ See Caruso (suggesting that FINRA publicly disclose relevant statistics regarding expungement requests); see also PACE (supporting Caruso's suggestion).

Ms. Vanessa Countryman
December 18, 2020
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FINRA believes that the foregoing responds to the commenters to the Proposal.
If you have any questions, please contact me on [REDACTED], email:

[REDACTED].

Sincerely,

/s/ Mignon McLemore

Mignon McLemore
Assistant General Counsel
Office of General Counsel