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Via Electronic Submission

Vanessa Countryman
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

RE: Comments on File No. SR-FINRA-2022-024 (Amendments to the Arbitration Procedure to Modify the Current Process Relating to the Expungement of Customer Dispute Information)

Dear Secretary Countryman:

The Cornell Law Securities Clinic (“Clinic”) submits this comment on FINRA’s rule proposal (the “Proposal”) to modify the current processes relating to the expungement of customer dispute information. The Clinic is a Cornell Law School curricular offering in which law students provide representation to public investors and provide public education regarding investment fraud to the largely rural “Southern Tier” region of upstate New York. For more information, please see: <http://securities.lawschool.cornell.edu>

The Clinic supports FINRA’s overall objective to maintain the integrity of the Central Registration Depository (CRD) system by limiting opportunities to circumvent the current expungement procedures. Expungement may remove valuable public information from the CRD that could otherwise inform the public about associated person and member conduct. Detailed below are reasons we support the Proposal along with our suggestions for additional rule modifications that could enhance investor protection.

I. The Clinic Supports the Requirement That a Straight-In Request Be Decided by A Three-Person Arbitrator Panel Selected from the Special Arbitrator Roster

FINRA proposes to have a three-person arbitrator panel selected from a Special Arbitrator Roster decide straight-in expungement requests.¹ This is because straight-in requests are usually unopposed² and the current success rate for straight-in expungement awards granted is above 80% (versus the 58% awarded when expungements are decided during a customer

¹ See Securities Exchange Act Release No. 95455 (August 9, 2022), 87 FR 50170, 50179 (August 15, 2022) (Notice of Filing of File No. SR-FINRA-2022-024).

² *Id.* at 50183.

arbitration).³ The Clinic supports FINRA’s measures to mitigate the impact of an unopposed expungement request by having this randomly selected panel from the Special Arbitrator Roster and limiting associated persons from striking any of the selected arbitrators, agreeing to fewer than three arbitrators, or stipulating to arbitrator selections.⁴

The Clinic also supports the expanded neutrality training that will be provided to arbitrators deciding expungement requests.⁵ This, along with the randomized selection using the Neutral List Selection Service (NLSS), will give the associated persons fewer causes for removal that are related to arbitrator bias.⁶

II. The Clinic Supports the Limitations on The Associated Person(s) Engaging in Arbitrator-Shopping

The Proposal states that if a named associated person requests expungement during a customer arbitration *and* the customer’s claim closes by award after a hearing, the same panel that decided the customer dispute must decide the expungement request.⁷ The Clinic supports this requirement. This is because the associated persons may choose not to have their expungements decided by the same panel, effectively engaging in “arbitrator shopping”. Without this requirement, associated persons could remove an expungement request after the panel becomes aware of evidence that could result in the denial of the expungement request. Additionally, arbitrator shopping potentially leads to a lack of uniformity in arbitration decisions, unnecessary expenses, and an overburdening of arbitration forums.⁸

Specifically, the Clinic agrees that a named associated person must request expungement during the customer arbitration or forfeit the ability to expunge the customer dispute information at a subsequent proceeding.⁹ This would prevent associated persons from withdrawing and later re-filing the same request in the hope of garnering a more favorable decision from a separate panel of arbitrators.¹⁰ Furthermore, the Clinic supports this mandate because it would ensure that the panel—which assessed input from all involved parties, weighed the evidence on the merits, and reviewed the pleadings—would be the same panel that ultimately decides the expungement request.¹¹

³ *Id.* at 50191.

⁴ *Id.* at 50180.

⁵ *Id.* at 50179.

⁶ *Id.* at 50180.

⁷ *Id.* at 50177.

⁸ Markus Petsche, *What's Wrong with Forum Shopping - An Attempt to Identify and Assess the Real Issues of a Controversial Practice*, 45 INT’L L. 1005-1010 (2011).

⁹ *See supra* note 1 at 50181.

¹⁰ *Id.* at 50177.

¹¹ *Id.*

III. The Clinic Supports the Enhanced Notification Requirements to Customers and State Regulators to Attend and Participate in Expungement Hearings

The Proposal mandates that associated persons would have to notify customers who were involved in the dispute about the expungement request.¹² FINRA hopes that this would encourage customers to participate and add to the record of the associated person's conduct.¹³ Further, associated person recidivism is also driven by previous successful and unopposed expungements of actual misconduct.¹⁴ For these reasons, the Clinic strongly supports FINRA's mandatory customer notification requirement. Specifically, the Clinic agrees with the mandates to file proof of service and all communications between associated persons and the customer regarding the expungement request.¹⁵

At present, expungement hearings do not provide for the participation of state securities regulators.¹⁶ These regulators argue that expungements limit their ability to identify bad actors.¹⁷ The Clinic supports the Proposal's provision to allow regulators to participate in the expungement hearings and provide input during an otherwise unopposed straight-in request hearing.¹⁸

IV. The Clinic Supports the Strict Time Limits on Filing Straight-In Requests

Under the proposed rule changes, (1) an associated person may file a straight-in request within two years of the close of a customer arbitration or a civil litigation associated with the customer dispute information, or (2) an associated person would be prohibited from filing a straight-in expungement request when more than three years have elapsed since the customer reported the complaint to the CRD system and there was no arbitration or civil litigation following the complaint.¹⁹ Currently, FINRA rules provide for the submission of an expungement request within six years from the occurrence of the event giving rise to the claim.²⁰ The Clinic supports enacting stricter time limits on filing straight-in requests and the removal of the six-year limit. This would promote timely filings of expungement requests and might prevent associated persons from bundling multiple unrelated expungement requests into a single straight-in request.²¹

Regarding the two-year limitation period, the Clinic agrees that two years should allow associated persons enough time to determine whether to seek expungement via a straight-in

¹² *Id.* at 50185.

¹³ *See id.*

¹⁴ *See* Colleen Honigsberg & Matthew Jacob, *Deleting Misconduct: The Expungement of BrokerCheck Records*, 139 *Journal of Financial Economics* 800-13 (2021) (discussing how expungements significantly predict future misconduct).

¹⁵ *See supra* note 12.

¹⁶ *Id.*

¹⁷ Honigsberg & Jacob, *supra* note 14.

¹⁸ *See supra* note 1 at 50185-86.

¹⁹ *Id.* at 50181.

²⁰ *See* FINRA Rules 12206(a) and 13206(a).

²¹ *See supra* note 19.

request. It provides enough time for associated persons to gather relevant documents, information, and other resources needed to file their expungement request. Lastly, a two-year period might prevent substantial time from elapsing between the expungement hearing and the arbitration or civil litigation. A shorter time gap could also increase the probability that the customer attends and participates in the hearing. For similar reasons, the Clinic also supports the three-year time limit when there is no arbitration or civil litigation.²²

V. The Clinic Supports the Unanimity Requirement for Awarding Expungement Relief

Under the proposed amendments, an arbitrator panel must unanimously agree to issue an award containing expungement relief, or no relief would be granted.²³ At present, the arbitrator panel will grant expungements when a majority of arbitrators vote in favor of granting it.²⁴ Despite the majority requirement, a large portion of cases (98%) that ultimately issue expungement awards do so with all three arbitrators in agreement. In fact, only 1% of cases show the arbitrator panel split two against one when issuing expungements.²⁵

For these reasons, the Clinic supports FINRA's proposal that only a unanimous three-person arbitrator panel may issue expungement relief. Alongside the fact that an overwhelming number of expungement decisions are already decided unanimously, the Clinic supports the Proposal's unanimity requirement because it would further safeguard the integrity of the information maintained in the CRD system.²⁶ Moreover, the Clinic agrees with FINRA that the expungement process should be used only as an exceptional remedy, aligning tightly with the standards outlined in the FINRA rules.²⁷

VI. Expungement Hearings During Simplified Customer Arbitration Proceedings Could be Further Enhanced to Maintain the Integrity of the CRD

There is no structure in place under current FINRA rules on how an expungement request during a simplified arbitration proceeding will be decided.²⁸ This could delay resolution and potential recovery for customers, especially those who choose the Option Two special proceeding, as their hearings may be held up by the expungement decisions interfering with the expedited procedure. For these reasons, the Clinic strongly supports FINRA's structuring of the hearings in the Proposal, specifically the bifurcation of the hearings where the customer dispute is decided first, and the expungement hearing is held separately after the dispute hearing.²⁹

During a simplified customer arbitration proceeding, the arbitrator is selected from the FINRA chairperson roster according to the NLSS, *unless the parties otherwise agree in*

²² *Id.*

²³ *Id.* at 50184.

²⁴ *See* FINRA Rules 12410 and 13414.

²⁵ *See supra* note 1 at 50195.

²⁶ *Id.* at 50197.

²⁷ *Id.* at 50173.

²⁸ *See id.* at 50186.

²⁹ *Id.* at 50187-88.

writing.³⁰ Therefore, the Clinic requests that FINRA add to the Proposal that if an expungement is requested during a simplified arbitration *and* if the parties agree to have a specific arbitrator, this arbitrator must be required to undergo the enhanced expungement training provided to the arbitrators on the Special Arbitrator Roster prior to considering the expungement request.³¹ The Clinic believes that this would further close the gap on associated persons engaging in arbitrator shopping by unfairly influencing the customer to agree to have a specific arbitrator who may decide the expungement issue (and not necessarily the customer dispute) in the associated person's favor.

Conclusion

The Clinic appreciates the opportunity to comment on FINRA's Proposal. For the foregoing reasons, the Clinic submits this letter in support of the Proposal. The Clinic believes that the changes proposed will maintain the integrity of the information in the CRD and advance the goals of investor protection.

Respectfully submitted,

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³⁰ See FINRA Rule 12800(b).

³¹ See *supra* note 1 at 50188.