

[Securities Regulation Daily Wrap Up, ARBITRATION—Reform or abandon expungement, NASAA demands, \(Sept. 8, 2015\)](#)

Securities Regulation Daily Wrap Up

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NASAA has stated that the process and standards for expunging customer dispute information from a stockbroker's record in the Central Registration Depository (CRD) must either be significantly improved or completely abandoned. In a [comment letter](#) to the FINRA Dispute Resolution Task Force, NASAA wrote that the current system of expungement under FINRA Rule 2080 has hampered the abilities of regulators to assess the qualifications of brokers for licensure while compromising the information that investors rely upon to make informed investment decisions.

From the extraordinary to the ordinary. NASAA noted that after an arduous multi-year process, state regulators had agreed to a very limited expungement process originally memorialized in the provisions of NASD Rule 2130, which was approved by the SEC in December 2003. Now codified at FINRA Rule 2080, these expungement standards were designed to ensure that the removal of customer complaint information from the CRD system would constitute an extraordinary remedy that would be applied judiciously. Now, however, expungement has become a routine, everyday occurrence, NASAA wrote. Since 2011, over 2,000 arbitration matters have resulted in expungement recommendations through the Rule 2080 process, with expungement being granted in at least 12 percent of all the arbitrations filed with FINRA during that time period.

Regulatory matter. In NASAA's view, the determination to remove any part of a stockbroker's record from the CRD is clearly a regulatory matter. NASAA had hoped that the arbitration-based approach in the Rule 2080 framework, under which arbitration panels are empowered to make findings of fact and expungement recommendations, would work as an appropriate substitute for direct regulator involvement. These findings and recommendations, however, are all too often based on uncontested testimony. Currently, NASAA stated, there is no advocate for the regulator's position as part of the expungement decision process, and despite training to the contrary, arbitrators routinely elevate the individual broker's concerns above regulatory imperatives.

NASAA noted that in order to become involved in expungement proceedings, state regulators must intervene in the process at the point the broker is seeking to confirm an award before a court, well after the arbitration panel has already made a recommendation on expungement. While state regulatory intervention was contemplated in the earlier days of the current expungement framework, the realities of a state regulator intervening has proven difficult, especially given the process constraints that exclude regulators from the initial arbitration proceedings and the timing challenges involved with notifying state regulators of the filing of the required court confirmation action.

Unreviewable deference. For example, NASAA included a letter from Delaware Investor Protection Director Owen Lefkon to FINRA CEO Richard Ketchum, in which Lefkon estimated that his staff spent nearly 400 attorney hours in opposing a recommendation for expungement that was ultimately confirmed by a Pennsylvania court. The court confirmed nearly every expungement sought by the broker, despite the fact that the arbitrator's recommendation was supported only by a cursory statement that treated the eight customer complaints against the broker as a whole and largely ignored the individualized nature of the individual allegations, some of which alleged deceit and unauthorized trading. Although the court's order was not accompanied by an opinion, Lefkon wrote that the broker's success in the action was likely due in large part to the fact that arbitration panels are accorded nearly unreviewable deference in the courts.

Either regulatory participation or abandonment. In NASAA's view, the current system of expungement must at a minimum be reformed and include regulatory participation. Although acknowledging that large-scale

reform will take time, NASAA recommends that the Taskforce endorse certain short-term solutions, such as an expungement-only arbitration panel, with additional opportunities for regulatory participation. In the short-term, these reforms could include a pre-notice to state regulators during an ongoing arbitration or a standardized protocol for states when FINRA waives its role as a party.

Ultimately, however, effective long-term solutions must be sought and thoroughly vetted and considered, NASAA wrote. NASAA believes that discontinuing altogether the expungement of records for arbitration-related matters (including settled customer claims) could provide an important benefit by changing the perception of brokers' records. NASAA reminded the Task Force that currently there are brokers who have an unblemished record on the CRD as the result of actively pursuing the expungement process, thus diminishing the value for brokers whose records never had complaints. Abandoning the expungement process would, after a transition period, be the fairest approach for both investors and brokers and would restore confidence in the CRD system, NASAA wrote.

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