

Notice to Members

MARCH 2004

SUGGESTED ROUTING

Legal & Compliance
Registered Representatives
Senior Management

KEY TOPICS

Arbitration
Central Registration Depository (CRD®)
Customer Dispute Information
Dispute Resolution
Expungement
Rule 2130

INFORMATIONAL

Expungement

NASD Adopts Rule 2130 Regarding Expungement of Customer Dispute Information From The Central Registration Depository; **Effective Date: April 12, 2004**

Executive Summary

On December 16, 2003, the Securities and Exchange Commission (SEC) approved new Rule 2130 concerning the expungement of customer dispute information from the Central Registration Depository (CRD® or the CRD system).¹ As further discussed below, Rule 2130 will apply to any request made to a court of competent jurisdiction to expunge customer dispute information from the CRD system that has its basis in an arbitration or civil lawsuit filed on or after April 12, 2004. All requests to expunge customer dispute information from the CRD system arising from arbitrations or civil lawsuits filed before April 12, 2004, including any settlements arising therefrom, will continue to be subject to the terms of the moratorium in effect as of January 19, 1999, as discussed in *Notice to Members 99-09* (February 1999).

The text of Rule 2130 is provided in Attachment A.

Questions/Further Information

Questions concerning this *Notice* may be directed to Richard E. Pullano, Associate Vice President/Chief Counsel, Registration and Disclosure, at (240) 386-4821; Jean I. Feeney, Vice President and Chief Counsel, NASD Dispute Resolution, at (202) 728-6959; or Shirley H. Weiss, Associate General Counsel, Office of General Counsel, Regulatory Policy and Oversight, at (202) 728-8844. Technical and procedural questions may be directed to Ann E. Bushey, Director, Registration and Disclosure, at (240) 386-4724. In addition, questions and answers concerning the application of Rule 2130 soon will be available from NASD's Registration and Disclosure Department at http://www.nasdr.com/3400_filing_online.asp.

04-16

Background

Rule 2130 establishes procedures for expunging customer dispute information from the CRD system. For purposes of Rule 2130, “customer dispute information” includes customer complaints, arbitration claims, and court filings made by customers, and the arbitration awards or court judgments that may result from those claims or filings. Customer dispute information generally contains allegations that a member or one or more of its associated persons has violated securities laws, rules, or regulations.

The CRD system is an online registration and licensing system for the U.S. securities industry, state and federal regulators, and self-regulatory organizations (SROs). The CRD system contains broker/dealer information filed on Forms BD and BDW and information on associated persons filed on Forms U4 and U5. The CRD system also contains information filed by regulators via Form U6. The CRD system contains administrative information (e.g., personal, organizational, employment history, registration, and other information) and disclosure information (e.g., criminal matters, regulatory disciplinary actions, civil judicial actions, and information relating to customer disputes) filed on these forms.

NASD operates the CRD system pursuant to policies developed jointly with the North American Securities Administrators Association (NASAA). NASD works with the SEC, NASAA, other members of the regulatory community, and member firms to establish policies and procedures reasonably designed to ensure that information submitted to and maintained on the CRD system is accurate and complete. These procedures, among other things, cover expungement of information from the CRD system in narrowly defined circumstances.

In January 1999, after consultation with NASAA, NASD imposed a moratorium on arbitrator-ordered expungements of customer dispute information from the CRD system. Under the moratorium, NASD would expunge such information from the CRD system only when a directive contained in an arbitration award rendered in a dispute between a public customer and a firm or its associated persons was confirmed by a court of competent jurisdiction. After imposing the moratorium, NASD began considering how to craft an approach to expungement that would allow NASD, in its capacity as an SRO and as operator of the CRD system, effectively to challenge expungement directives that might diminish or impair the integrity of the system and to ensure the maintenance of essential information for regulators and investors.² NASD concluded that such an approach necessarily required a balancing of three competing interests: (1) the interests of NASD, the states, and other regulators in retaining broad access to customer dispute information to fulfill their regulatory responsibilities and investor protection obligations; (2) the interests of the brokerage community and others in a fair process that recognizes their stake in protecting their reputations and permits expungement from the CRD system when appropriate; and (3) the interests of investors in having access to accurate and meaningful information about brokers with whom they conduct, or may conduct, business.³

In crafting Rule 2130, NASD was guided by these competing interests and the investor protection, data integrity and fairness principles that these interests represent. Underlying Rule 2130 is NASD's commitment to maintaining a CRD system that provides public investors and regulators access to accurate information about firms and brokers and maintains the integrity of the arbitration process. Although public investors, broker/dealers and their associated persons, and regulators may have competing interests, all of these groups share a common interest in a CRD system that contains accurate and meaningful information.

NASD believes that Rule 2130 accomplishes that goal. Rule 2130 will protect regulators' and investors' ability to obtain meaningful data about the members and associated persons with whom they do, or plan to do, business by permitting customer dispute information to be expunged from the CRD system only when arbitrators and a court have affirmatively found that: (1) the claim, allegation, or information is factually impossible or clearly erroneous; (2) the registered person was not involved in the alleged investment-related sales practice violation, forgery, theft, misappropriation, or conversion of funds; or (3) the claim, allegation, or information is false.

Expungement Procedures Under Rule 2130

Rule 2130 establishes procedures for members and associated persons to obtain expungement of customer dispute information. For purposes of Rule 2130, "customer dispute information" includes customer complaints, arbitration claims, and court filings made by customers, and the arbitration awards or court judgments that may result from those claims or filings. Customer dispute information generally contains allegations that a member or one or more of its associated persons has violated securities laws, rules, or regulations.

Rule 2130 continues the requirement started with the January 1999 moratorium that a court of competent jurisdiction must order or confirm all expungement directives before NASD will expunge customer dispute information from the CRD system. Under Rule 2130, members and associated persons seeking to expunge from the CRD system information arising from disputes with customers must obtain an order from a court of competent jurisdiction directing such expungement or confirming an arbitration award containing expungement relief.⁴

A respondent seeking expungement relief in an arbitration would ask for expungement in his or her prayer for relief. In the event the arbitrators dismiss the claim against the respondent, the arbitrators would then decide whether to grant expungement on the basis of one or more of the standards in Rule 2130; *i.e.*, the expungement relief is based on an **affirmative** arbitral finding that: (1) the claim, allegation, or information is factually impossible or clearly erroneous; (2) the registered person was not involved in the alleged investment-related sales practice violation, forgery, theft, misappropriation, or conversion of funds; or (3) the claim, allegation, or information is false. The award would state whether expungement is granted, and if so, on what basis.

If the parties settle the arbitration, they may jointly ask the arbitration panel for a stipulated award and request that the panel make affirmative findings and order expungement based on one or more of the standards in Rule 2130. The arbitrators would determine whether to grant expungement relief and, if so, state in the award the basis on which the expungement relief was granted. The arbitrators may require the submission of documents or a brief evidentiary hearing to gather the information necessary to make such findings.

The next step would be to obtain a court order. Members and associated persons seeking a court order to expunge **must** name NASD as an additional party and serve NASD with all appropriate documents unless NASD waives that requirement. To obtain NASD's waiver, the party seeking expungement would send the necessary documents (*i.e.*, the waiver request and the arbitration award containing the expungement directive and finding indicating the basis on which the expungement was granted) to NASD at the following address:

Rule 2130 - Expungement Notice/Waiver Request
NASD Registration and Disclosure Department - 2nd Floor
9509 Key West Ave.
Rockville, MD 20850

Upon receipt of a request for a waiver, NASD staff will notify the States where the individual is registered or seeking registration of the expungement notice/waiver request. NASD staff will then examine the basis on which the fact finder ordered expungement to determine whether the expungement was based on one or more of the standards in Rule 2130. NASD will waive the obligation to be named as a party if NASD determines that the expungement relief is based on an affirmative finding that the expungement meets one or more of the standards in the rule.⁵ Therefore, parties may save time and expense by sending the arbitration award to NASD staff prior to naming NASD as a party, thereby giving NASD the opportunity to waive its right to be named as a party.

If NASD staff determines that the expungement was not based on one or more of the standards in Rule 2130, it will advise the parties that NASD will not waive the requirement to be named as a party in the court confirmation process. The parties would then name NASD as a party, and NASD would oppose the expungement. Parties may serve NASD by serving "CT Corporation" in the jurisdiction in which the lawsuit is being filed.

Persons who have been sued in court may seek expungement relief from the court; however, they will not be able to avail themselves of the rule's waiver provision and will be required to name NASD as a party.⁶ NASD will determine whether to oppose the expungement based on the ground(s) on which the person is seeking the expungement.

Endnotes

- 1 SEC Order Granting Approval of Proposed Rule Change and Amendment No. 1, Thereto, and Notice of Filing and Order Granting Accelerated Approval to Amendment No. 2, Thereto, Relating to Proposed NASD Rule 2130 Concerning the Expungement of Customer Dispute Information From the Central Registration Depository System, 68 Fed. Reg. 74667 (Dec. 24, 2003) Exchange Act Release No. 48933 (File No. SR-NASD-2000-168 (Dec. 16, 2003), 68 Fed. Reg. 74667 (Dec. 24, 2003).
- 2 NASD sought comment on possible approaches to addressing arbitrator-ordered expungements of information from the CRD system in 1999 (*Notice to Members 99-54*) and 2001 (*Notice to Members 01-65*).
- 3 Although public investors do not have access to the CRD system, the information in that system is available to investors through NASD BrokerCheck and individual state disclosure programs.
- 4 Consistent with the 1999 moratorium, NASD may continue to expunge, without a court order, arbitration awards rendered in disputes between registered representatives and firms that contain expungement directives in which the arbitration panel states that expungement relief is being granted because of the defamatory nature of the information.
- 5 In addition to the three standards discussed above, NASD, in its sole discretion and under extraordinary circumstances, also may waive the obligation to name NASD as a party if it determines that:
 - the expungement relief and accompanying findings on which it is based are meritorious; and
 - the expungement would have no material adverse effect on investor protection, the integrity of the CRD system, or regulatory requirements.
- 6 Although a judge may make the affirmative finding required under Rule 2130, NASD expects that arbitrators will consider the overwhelming majority of expungement requests.

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ATTACHMENT A

New rule language is underlined.

* * * * *

2130. Obtaining an Order of Expungement of Customer Dispute Information from the Central Registration Depository (CRD System)

(a) Members or associated persons seeking to expunge information from the CRD system arising from disputes with [public] customers must obtain an order from a court of competent jurisdiction directing such expungement or confirming an arbitration award containing expungement relief.

(b) Members or associated persons petitioning a court for expungement relief or seeking judicial confirmation of an arbitration award containing expungement relief must name NASD as an additional party and serve NASD with all appropriate documents unless this requirement is waived pursuant to subparagraph (1) or (2) below.

(1) Upon request, NASD may waive the obligation to name NASD as a party if NASD determines that the expungement relief is based on affirmative judicial or arbitral findings that:

(A) the claim, allegation, or information is factually impossible or clearly erroneous;

(B) the registered person was not involved in the alleged investment-related sales practice violation, forgery, theft, misappropriation, or conversion of funds; or

(C) the claim, allegation, or information is false.

(2) If the expungement relief is based on judicial or arbitral findings other than those described above, NASD, in its sole discretion and under extraordinary circumstances, also may waive the obligation to name NASD as a party if it determines that:

(A) the expungement relief and accompanying findings on which it is based are meritorious; and

(B) the expungement would have no material adverse effect on investor protection, the integrity of the CRD system, or regulatory requirements.

(c) For purposes of this rule, the terms “sales practice violation,” “investment-related,” and “involved” shall have the meanings set forth in the Uniform Application for Securities Industry Registration of Transfer (“Form U4”) in effect at the time of issuance of the subject expungement order.