

February 5, 2018

By email to pubcom@finra.org

Marcia E. Asquith
Office of the Corporate Secretary
FINRA
1735 K. Street, NW
Washington, DC 20006-1506

Re: FINRA Regulatory Notice 17-42
Expungement of Customer Dispute Information

Dear Ms. Asquith:

On behalf of the Investor Protection Clinic at the William S. Boyd School of Law at the University of Nevada, Las Vegas, we write to comment on FINRA Regulatory Notice 17-42. We represent investors who have suffered losses resulting from unsuitable financial advice. We provide pro bono assistance to investors who cannot secure private legal representation because of the size of their claims. Our clients have a direct interest in the rules promulgated by the Financial Industry Regulatory Authority ("FINRA").

We thank you for the chance to comment on proposed changes to FINRA's rules governing the expungement of customer dispute information from an associated person's Central Registration Depository ("CRD") record. Below are our Clinic's comments on several of the questions.

Request for Comment No. 3. *Should FINRA consider bifurcating the expungement request from the customer's claim in all cases relating to customer disputes? What would be the costs and benefits of such an approach?*

FINRA should bifurcate expungement requests from the customer's claim in all cases. As explained below, bifurcation would promote FINRA's goal of preventing expungement requests from inappropriately interfering with the arbitration process or an arbitrators' authority to award appropriate remedies.¹

First, a natural distinction exists between FINRA's standards and policies governing expungement compared to all other arbitration awards. For example, the central focus for deciding whether to grant an expungement request is the protection of future customers of an

¹ Notice of Filing of Proposed Rule Change and Amendment Concerning the Expungement of Customer Dispute Information from the Central Registration Depository System, 73 Fed. Reg. 18308 (April 3, 2008), <https://www.sec.gov/rules/sro/34-47435.htm> (last visited Jan. 26, 2018).

associated person;² but nearly all other remedies under FINRA’s arbitration process focus on a narrower dispute between a customer and a firm or associated person. Bifurcation would clarify this distinction because it ensures that the public’s interests would remain the central focus in expungement requests.

Similarly, the standard of review for granting expungement requests differs significantly from other FINRA remedies. Under FINRA Rule 2080, arbitrators may recommend expungement only when “the information is found to have no meaningful investor protection or regulatory value.”³ This is a relatively high standard—demanding certainty for any expungement request approval. In contrast, most other remedies in FINRA’s arbitration program use a “preponderance of the evidence standard.”⁴ These different standards have likely confused arbitrators in the past.⁵ Bifurcation, however, would prevent this confusion by ensuring that these legal standards remain distinct.

FINRA should also recognize that requiring bifurcation in all cases will not diminish arbitrators’ ability to collect the information that they need to evaluate expungement requests. FINRA’s Arbitrator’s Guide states that “arbitrators should request any documentary or other evidence they believe is relevant to the expungement request,” and “arbitrators should ensure they have all the information necessary to make an informed and appropriate recommendation on expungement.”⁶ These guidelines show that during any bifurcated expungement request, arbitrators would have the means necessary to gather relevant information.

Finally, a bifurcation requirement aligns directly with FINRA’s proposal to establish specially trained Expungement Arbitrators. These Expungement Arbitrators would have enhanced qualifications and expungement training.⁷ Bifurcation would thus ensure that all expungement requests are decided under equal standards—through the specialized analysis and skill of these Expungement Arbitrators.

Request for Comment No. 4. *What are the costs and benefits of requiring the unanimous consent of a three-person panel to grant all requests for expungement of customer dispute information?*

FINRA should require unanimous consent of a three-person panel to grant all requests for the expungement of customer dispute information. Requiring unanimous consent is critical, because

² Hammad Qureshi & Jonathan Sokobin, *Do Investors Have Valuable Information About Brokers?*, 2–3 (FINRA Office of the Chief Economist, Working Paper, Aug. 2015), <http://www.finra.org/sites/default/files/OCE-Working-Paper.pdf> (last visited Jan. 26, 2018) (“To help investors make informed choices about the brokers with whom they conduct business, [FINRA] provides . . . BrokerCheck . . . to investors.”).

³ See FINRA, Regulatory Notice 09-33, 2009 WL 1701937 [hereinafter FINRA Rule 2080].

⁴ FIN. INDUSTRY REG. AUTHORITY, DISPUTE RESOLUTION ARBITRATOR’S GUIDE 62 (2014) [hereinafter ARBITRATOR’S GUIDE].

⁵ See Christine Lazaro, *Has Expungement Broker Brokercheck?*, 14 J. BUS. & SECURITIES L. 123, 146 (2013) (“Expungements continue to be too readily granted by arbitrators. This does not appear to be solely a result of customers not opposing the expungement requests because they have settled their claims. This is more likely a result of arbitrators not fully understanding the standards pursuant to which expungements should be granted.”).

⁶ ARBITRATOR’S GUIDE, *supra* note 4, at 70.

⁷ See FINRA Regulatory Notice 17-42, *Expungement of Customer Dispute Information* 10, www.finra.org/sites/default/files/notice_doc_file_ref/Regulatory-Notice-17-42.pdf (last visited Jan. 26, 2018).

if FINRA holds expungement out to be an *extraordinary* remedy, then it must be guided by a higher standard of review and certainty than all other matters.⁸ FINRA has even recognized a need for a higher standard of review with expungement requests in its current Rules and its Dispute Resolution Arbitrator’s Guide. FINRA Rule 2080 and the Arbitrator’s Guide state that expungement may only be granted “when the arbitrators find and document one of [the following] narrow grounds:”

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.⁹

Rule 2080 also requires that “arbitrators recommend expungement only when the information is found to have no meaningful investor protection or regulatory value.”¹⁰ These requirements demand far more certainty than any other remedy in FINRA’s arbitration process—certainly higher than the “preponderance of the evidence standard” for damage awards on the merits.¹¹ FINRA’s future rules to recommend expungement should maintain these already established, high standards.

Looking to the potential costs of a unanimous agreement standard, opponents generally argue that unanimity is unfair given that other arbitral awards only require a panel’s majority vote.¹² This contention misses the point, however, because FINRA designed expungement to be unique from all other arbitral decisions. Compare, for example, the process to grant expungement requests with the process to grant an award of damages on the merits of a claim. On one hand, FINRA’s rules currently allow a majority of arbitrators to *refuse* an expungement request although a majority denies damages;¹³ but, on the other hand, arbitrators can *grant* an expungement request even when the arbitrators award damages.¹⁴ This comparison shows that FINRA designed expungement to be isolated from all other parts of a claim. So, in keeping with this design, FINRA should not be guided by any other arbitral standards in promulgating this proposed rule—expungement procedures must remain unique to the remedy.

⁸ *Id.*; *Expungement: an “Extraordinary Remedy,”* NEW ENGLAND SEC. LITIG. & ARB. BLOG, <http://pretisecuritieslitigationarbitration.blogspot.com/2017/07/expungement-extraordinary-remedy.html> (last visited Feb. 1, 2018) (explaining that “the net result [of FINRA Rules 2080, 12805, and 13805] is a strong default rule against expungement”).

⁹ ARBITRATOR’S GUIDE, *supra* note 4, at 73.

¹⁰ FINRA Rule 2080, *supra* note 1.

¹¹ ARBITRATOR’S GUIDE, *supra* note 4, at 62.

¹² *See* Kaufman, Gildin & Robbins LLP, Comment on FINRA’s Proposed Amendments to Its Expungement Arbitration 4, www.finra.org/sites/default/files/notice_comment_file_ref/17-42_Robbins_Comment.pdf (last visited Feb. 1, 2018).

¹³ FIN. INDUSTRY REG. AUTHORITY, DISPUTE RESOLUTION: EXPUNGEMENT TRAINING 19 (2015), www.finra.org/sites/default/files/FINRA-Expungement-Training-May-2015.pdf (last visited Jan. 26, 2018) (“when a broker prevails in an arbitration case, that is not, in and of itself, an appropriate ground for expunging information . . .”).

¹⁴ *See* FINRA Rule 2080, *supra* note 1 (explaining that when multiple associated persons are named in a claim, an arbitrator can grant expungement for one of those persons if the arbitrator determines that “the registered person was not involved in the alleged investment-related sales practice violation”).

In sum, a unanimous panel requirement would align directly with the high level of certainty that FINRA currently requires for granting a request for expungement. A unanimous panel requirement would also ensure that expungement truly is an extraordinary remedy—granted only when arbitrators find that a claim has no meaningful investor protection or regulatory value.

Request for Comment No. 6. *Should the associated person who is requesting expungement be required to appear in person or by videoconference, rather than by phone, at the expungement hearing?*

FINRA should require that an associated person who requests expungement appear either in person or by videoconference rather than by phone. Unlike appearing in person or by videoconference, telephonic appearance limits arbitrators' ability to assess the credibility and sincerity of the associated person's testimony during the expungement process.¹⁵

Psychological research indicates that witness sincerity is observable through non-verbal cues.¹⁶ For example, rigid posture or relaxed facial expressions may indicate that a witness is lying in their testimony.¹⁷ Similarly, lying witnesses are more likely to “move their hands less, speak with higher pitched voices, and . . . through foot and leg movements.”¹⁸ Appearances in person and by videoconference allow arbitrators to directly observe these cues. Appearance by telephone, however, does not.

FINRA's decision to allow only in-person or videoconference appearances would also reflect the principle that expungement is an extraordinary remedy.¹⁹ FINRA demands that arbitrators only recommend expungement under limited circumstances and when arbitrators are certain that the underlying complaint has “no meaningful investor protection or regulatory value.”²⁰ The physical appearance of an associated person—in person or by videoconference—allows the arbitration panel to reach this high level of certainty. That is, the panel can garner relevant information from an individual by questioning that person while also observing both the verbal and non-verbal cues that signal the credibility of their responses.

Alongside the benefits to arbitrators of more easily observing a person's credibility, any limitation of appearances to only in person or videoconference carries minimal, if any, costs. FINRA currently offers 71 hearing venues.²¹ Likewise, all four of FINRA's main regional

¹⁵ James P. Timony, *Demeanor Credibility*, 49 CATH. U. L. REV. 903, 915 (stating that “[v]ideo technology allows a witness to testify without being physically present in court, while still giving the fact-finder the advantage of observing the witness's demeanor,” while telephonic appearances do not.).

¹⁶ Steven I. Friedland, *On Common Sense and the Evaluation of Witness Credibility*, 40 CASE W. RES. L. REV. 165, 185–86 (1989).

¹⁷ *Id.*

¹⁸ *Id.*

¹⁹ See FINRA Rule 2080(b)(2), *supra* note 1; see also *Notice to Arbitrators and Parties on Expanded Expungement Guidance*, FINRA, <http://www.finra.org/arbitration-and-mediation/notice-arbitrators-and-parties-expanded-expungement-guidance> (last visited Jan. 28, 2018).

²⁰ See *Notice to Arbitrators and Parties on Expanded Expungement Guidance*, *supra* note 19.

²¹ *Dispute Resolution Regional Offices and Hearing Locations*, FINRA, <https://www.finra.org/arbitration-and-mediation/dispute-resolution-regional-offices-and-hearing-locations> (last visited Jan 31, 2018) (“including at least one in each state of the United States, one in San Juan, Puerto Rico, and one in London, UK.”).

offices offer videoconferencing capabilities.²² And in circumstances where an expungement hearing is not held at one of FINRA's physical offices, several companies offer videoconferencing solutions compatible with FINRA's videoconferencing system.²³ This accessibility makes any travel costs unnecessary, while also giving the arbitration panel a clear chance to observe the demeanor of any person seeking expungement.

Request for Comment No. 11. *The proposal would clarify for arbitrators that the standard for granting the permanent removal of customer dispute information from CRD is a finding that at least one of the Rule 2080(b)(1) factors applies and that customer dispute information has "no investor protection or regulatory value." Are there specific factors that arbitrators should consider when making a finding that the customer dispute information has "no investor protection or regulatory value"?*

FINRA should provide arbitrators with clear guidance documents that practically explain the factors in Rule 2080(b)(1) as well as the level of certainty required by arbitrators to find that customer dispute information has "no investor protection or regulatory value." The discussion below outlines how these guidance documents should explain the meaning of terms such as "clearly erroneous," "not involved," "factually impossible," or "false." In crafting this guidance, FINRA should explain the level of certainty required for expungement by reference to the standards that our judicial system already recognizes.

An arbitration decision in 2013 shows the importance of guidance documents that explain the expungement standard by reference to those already in public courts.²⁴ In that decision, an arbitrator explained the burdens he *believed* were required by the Rule 2080(b)(1) factors of "clearly erroneous" and "false."²⁵ The arbitrator described "clearly erroneous" as being closest to a "clear and convincing evidence" standard used commonly within civil courts.²⁶ Similarly, the arbitrator clarified "false" to mean that "[w]hen an allegation is supported by some reasonable proof, even short of 'preponderance,' it cannot be said to be 'false.'"²⁷ The arbitrator did not rely on any FINRA guidance, however, to create these standards of review. Instead, the arbitrator merely explained the vagueness of the current expungement standards and stated "until FINRA substantially clarifies Rule 2080, requests for expungement will multiply, resulting in many expungements FINRA never intended."²⁸

This decision explains how arbitrators need to rely on an established legal standard to evaluate expungement requests. Vague terms such as "false" or "factually impossible" are simply impractical without context.

²² *Videoconferencing Available in FINRA Regional Offices*, FINRA, <https://www.finra.org/arbitration-and-mediation/videoconferencing-available-finra-regional-offices> (last visited Jan. 28, 2018).

²³ *Id.* ("Other companies may also provide off-site videoconferencing compatible with FINRA's.").

²⁴ *Gilliam v. SagePoint Fin., Inc.*, FINRA No. 12-03717, 2013 WL 3963949 (2013) (Meyer, Arb.).

²⁵ *Id.* at *2 (2013).

²⁶ *Id.*

²⁷ *Id.* (emphasis added).

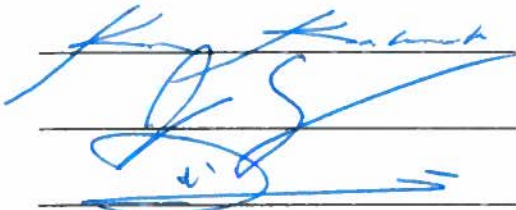
²⁸ *Id.* at *4.

Request for Comment No. 12. *In a simplified arbitration case, if a customer requests a hearing, should the single arbitrator be permitted to decide an expungement request, if a request is filed?*

FINRA should not allow the single arbitrator in a simplified arbitration case to decide an expungement request. As stated throughout this comment, expungement must be treated as an extraordinary remedy. A unanimous decision by three arbitrators provides a better assurance that the public's interest in knowing about complaints will be protected.

Respectfully Submitted,

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