**Mignon McLemore**
Associate General Counsel
Office of General Counsel

Direct: (202) 728-8151
Fax: (202) 728-8264

November 10, 2022

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

**RE: File No. SR-FINRA-2022-024 (Proposed Rule Change to Amend the Codes of Arbitration Procedure to Modify the Current Process relating to the Expungement of Customer Dispute Information) – Response to Comments and Amendment No. 1**

Dear Ms. Countryman:

This letter is being submitted by the Financial Industry Regulatory Authority, Inc. ("FINRA") in response to comments received by the Securities and Exchange Commission ("SEC" or "Commission") regarding the above-referenced rule filing. The proposed rule change would amend 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 ("Proposal") from the Central Registration Depository (CRD®) system.[1]

Specifically, the Proposal would amend the Codes to impose requirements on expungement requests (a) filed by an associated person during an investment-related, customer-initiated arbitration ("customer arbitration"), or filed by a party to the customer arbitration on behalf of an associated person ("on-behalf-of request"), or (b) filed by an associated person separate from a customer arbitration ("straight-in request"). Specifically, the proposed rule change would: (1) require that a straight-in request be decided by a three-person panel that is randomly selected from a roster of experienced public arbitrators with enhanced expungement training; (2) prohibit parties to a straight-in request from agreeing to fewer than three arbitrators to consider their expungement requests, striking any of the selected arbitrators, stipulating to an arbitrator's removal or stipulating to the use of pre-selected arbitrators; (3) provide notification to state securities regulators of all expungement requests and a mechanism for state securities regulators to attend and participate in expungement hearings in straight-in requests; (4) impose strict time limits on the filing of straight-in requests; (5) codify and update the best practices in the Notice to Arbitrators and

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

Parties on Expanded Expungement Guidance applicable to all expungement hearings, including amendments to establish additional requirements for expungement hearings, to facilitate customer attendance and participation in expungement hearings and to codify the panel's[2] ability to request any evidence relevant to the expungement request;[3] (6) require the unanimous agreement of the panel to issue an award containing expungement relief; and (7) establish procedural requirements for filing expungement requests, including for on-behalf-of requests. The Proposal would also amend the Customer Code to specify procedures for requesting expungement of customer dispute information during simplified arbitrations.

The Commission published the Proposal for public comment in the Federal Register on August 15, 2022 and received 45 comments in response.[4] Twelve commenters, including PIABA, PIABA Foundation and NASAA, expressed general support for the Proposal.[5] These commenters also expressed concerns with certain aspects of the Proposal and suggested modifications. SIFMA, AdvisorLaw, Hennion, several financial advisors and one securities attorney opposed the Proposal.[6] A number of other commenters expressed concerns with aspects of the Proposal and suggested modifications.[7] The remaining comments were outside the scope of the Proposal.[8]

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

## I. Overview

### A. Initiatives and Rules Addressing Expungement of Customer Dispute Information

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2 Under the Codes, the term "panel" means the arbitration panel, whether it consists of one or more arbitrators. See FINRA Rules 12100(u) and 13100(s). Unless otherwise specified, FINRA uses the term "panel" to mean either a panel or single arbitrator.

3 See FINRA Dispute Resolution Services, Notice to Arbitrators and Parties on Expanded Expungement Guidance ("Guidance"), https://www.finra.org/arbitration-and-mediation/notice-arbitrators-and-parties-expanded-expungement-guidance (last updated September 2017).

4 See Attachment A for the list of commenters.

5 Cambridge, Caruso, Cornell, D. Robbins, Edwards, Evans, FSI, Miami, NASAA, PIABA, PIABA Foundation and St. John's.

6 AdvisorLaw, Altizer, Austin, Barber, Beckner, Grebenik, Greer, Hennion, Holland, KK Financial, Maher, Mitchell, Neal, O'Bannon, O'Connell, SIFMA, Snider, Sonnier, Staudinger, T. Robbins and Tobin.

7 Ambrosio, Anderson, Dawson, Ferguson, Howe, Lunin-Pack, Mcmahon, Supernault and Webber.

8 Anonymous, Karis and Rycraft.

Over the course of many years, FINRA has undertaken a number of initiatives and adopted a number of rules[9] governing the use of the arbitration forum administered by FINRA Dispute Resolution Services ("DRS") to seek expungement of customer dispute information. Some of these enhancements include but are not limited to: (1) publishing the Guidance;[10] (2) forming the FINRA Dispute Resolution Task Force;[11] (3) publishing Regulatory Notice 17-42;[12] and (4) implementing minimum fees for requests for expungement of customer dispute information.[13]

In the past two years, FINRA has increased its efforts in this space by filing with the SEC a rule filing to make several significant enhancements to the current expungement process by establishing special arbitration procedures for expungement requests ("2020 Rule Filing"). In May 2021, FINRA temporarily withdrew the 2020 Rule Filing after discussions with SEC staff so that FINRA could further consider whether modifications to the filing were appropriate.[14] In

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9 A chronology of the steps FINRA has taken to strengthen the expungement framework is available at https://www.finra.org/rules-guidance/key-topics/expungement.

10 See Guidance, supra note 3. The Guidance has been amended three times since its initial publication.

11 The FINRA Dispute Resolution Task Force ("Task Force") was composed of individuals, from the public and industry sectors, who represented a broad range of interests in securities dispute resolution. The Task Force noted that the majority of issues that arise in the expungement process are those involving settled cases that do not go to final resolution, and unanimously recommended, in its final report, the creation of a special arbitration panel consisting of experienced arbitrators from the chairperson roster who have received enhanced training on expungement to decide expungement requests in settled customer arbitrations. See FINRA Dispute Resolution Task Force, Final Report and Recommendations of the FINRA Dispute Resolution Task Force (January 15, 2019), https://www.finra.org/sites/default/files/DR_task_report_status_011519.pdf.

12 Regulatory Notice 17-42 (December 2017) ("Notice"), https://www.finra.org/rules-guidance/notices/17-42.

13 FINRA amended 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 a straight-in request. As a result of the amendments, parties requesting expungement can no longer avoid the fees intended for such requests under the Codes or automatically qualify for a single arbitrator. The amendments also apply a minimum process fee and member surcharge to straight-in requests, as well as a minimum hearing session fee to expungement-only hearings. See Securities Exchange Act Release No. 88945 (May 26, 2020), 85 FR 33212 (June 1, 2020) (Order Approving File No. SR-FINRA-2020-005) ("Minimum Fees for Expungement"); see also Regulatory Notice 20-25 (July 2020) (announcing a September 14, 2020 effective date), https://www.finra.org/rules-guidance/notices/20-25.

14 See FINRA Statement on Temporary Withdrawal of Specialized Arbitrator Roster Rule Filing (May 28, 2021) ("2020 Rule Filing Withdrawal"), https://www.finra.org/media-

April 2022, FINRA published its Discussion Paper, which provides background and data regarding expungement of customer dispute information and explores potential alternatives to the current expungement process.[15] FINRA indicated its intent to "pursue a two-track approach to improving the expungement process," which included "adopting the substantial improvements to the current expungement process that can be readily achieved with the Proposal." FINRA filed the Proposal with the SEC on July 29, 2022, noting that the proposed amendments "are responsive to the concerns that have been identified with the current expungement process and would help protect the integrity of the CRD by making substantial improvements to the current expungement process."[16]

B. Statistical Support for Expungement

Several commenters cited to statistics provided by FINRA to support their assertions that expungement is already an extraordinary remedy under the current process and, therefore, there is no need for the Proposal.[17] For example, Hennion contended that the statistics used by FINRA "in support of the [proposed] amendments reflect that expungements are rarely sought" and suggested that the "shortened time frame presents a skewed time frame" to analyze the statistics as it includes market events, such as "interest rate disruptions and pandemic related volatility."

FINRA disagrees. Its rules specify a narrow set of circumstances in which expungement of customer dispute information from the CRD system is appropriate. An arbitrator considering an expungement request must make a finding that the information to be expunged is factually impossible, clearly erroneous or false or that the associated person was not involved in the alleged misconduct.[18] When these standards were approved by the SEC, it was contemplated that expungement would be an extraordinary remedy that would be allowed only in these limited circumstances.[19]

However, from January 2016 to December 2021,[20] in customer arbitrations in which the customer dispute was resolved after a hearing on the merits, associated persons obtained awards

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center/newsreleases/2021/finra-statement-temporary-withdrawal-specialized-arbitrator-roster.

15 Discussion Paper on Expungement of Customer Dispute Information (April 2022) ("Discussion Paper"), https://www.finra.org/sites/default/files/2022-04/Expungement_Discussion_Paper.pdf.

16 See Proposal, 87 FR 50170, 50171.

17 See AdvisorLaw, Hennion and Staudinger.

18 See FINRA Rules 2080, 12805 and 13805.

19 See Securities Exchange Act Release No. 58886 (October 30, 2008), 73 FR 66086 (November 6, 2008) (Order Approving File No. SR-FINRA-2008-010).

20 This sample period corresponds with the new DRS procedures, called the Expungement Tracker, which began in January 2016. The Expungement Tracker encourages parties requesting expungement to provide certain information, such as the CRD occurrence number, so that the forum is able to process expungement requests efficiently. See

containing expungement relief for 42 percent of the expungement requests; in customer arbitrations in which the customer dispute was resolved without a hearing on the merits (e.g., the customer dispute was settled), associated persons obtained awards containing expungement relief for 68 percent of the expungement requests; in straight-in requests, associated persons obtained awards containing expungement relief for 84 percent of the expungement requests. FINRA believes that this data, and the other data presented in the Proposal, supports the conclusion that the current expungement process would benefit from the proposed amendments.

C. Impact of Costs on Expungement Requests

Several commenters also raised concerns about the costs related to filing a request for expungement.[21] These commenters suggested that the fees for representation in addition to the DRS arbitration forum fees will cause expungement to be even further "out of reach."[22] Hennion stated that "when the amendments were originally contemplated by" the National Arbitration and Mediation Committee, a FINRA Board of Governors' ("FINRA Board") advisory committee, "the [C]ommittee did not include a representative from a small retail firm (upon belief)." Further, Hennion suggested that the Proposal "will result in the further dismantling of small retail operations" as the costs to request expungement could either dissuade new employees, particularly younger associated persons, from joining the industry or result in the removal of associated persons who lack the knowledge or funds to request expungement.

When a customer, associated person or member firm files an arbitration claim, DRS assesses a filing fee, which is based on the claim amount or if there is no amount in dispute, the fee for non-monetary claims.[23] An associated person who files a request for expungement without a monetary claim will be assessed the non-monetary filing fee.[24] As with other non-monetary claims, FINRA incurs costs to process expungement requests; these fees help cover

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Arbitration & Mediation, Changes to Expungement Requests, https://www.finra.org/arbitration-mediation/changes-expungement-requests. FINRA notes that these criteria have been integrated into the Proposal and would become mandatory if the Proposal is approved. See proposed Rules 12805(a)(1)(C)(ii)c. and 13805(a)(3)(C).

21 See Hennion, Maher, T. Robbins and Webber.

22 See Hennion; see also Tobin (suggesting that expungement should be expanded to make it more accessible to small broker-dealer firms) and Mitchell (opining that requesting expungement involves an "exorbitant cost").

23 An expungement request is a non-monetary or not specified claim ("non-monetary claim"). The fees applicable to non-monetary claims are higher than those applicable to small monetary claims. See FINRA Rules 12900(a) and 13900(a).

24 If the associated person or other party requesting expungement adds a monetary claim to the expungement request, the filing fee will be the non-monetary filing fee or the applicable filing fee provided in the Codes, whichever is greater. See FINRA Rules 12900(a)(3) and 13900(a)(3). See also Minimum Fees for Expungement, supra note 13.

some of the DRS arbitration forum's expenses.[25] FINRA recognizes that the fees involved to initiate an arbitration claim can be a financial hardship for some forum users. In instances in which DRS's fees may be challenging to pay due to financial hardship, the Director[26] has the authority to defer payment of all or part of an associated person's filing fee on a showing of financial hardship.[27]

With regard to comments about the potential impact of the Proposal on small firms, FINRA notes that the process of seeking approval from the FINRA Board to file a proposal with the SEC involves review of the proposal by and input from not only the FINRA Board, but also Board advisory committees, including the Small Firm Advisory Committee.[28] FINRA believes that the Proposal balances the interests of securities regulators and securities firms in having accurate and relevant information to fulfill their regulatory responsibilities; the interests of investors in having access to accurate and meaningful information about individuals with whom they may entrust their money; the interests of prospective employers in having accurate information for use in making hiring decisions; and the interests of the brokerage community in having a fair process to address inaccurate customer dispute information.

D. Alternatives to Current Expungement Process

Although PIABA, PIABA Foundation and NASAA expressed support for the Proposal, they continue to believe that expungement determinations should be removed from the DRS arbitration forum and instead, should be resolved in a regulatory setting. FINRA believes it is important to pursue a two-track approach to improving the expungement process. In the near term, FINRA believes the integrity of the information in the CRD system should be protected by adopting the substantial improvements to the current expungement process that can be readily achieved with the Proposal. Concurrent with FINRA's work on these near-term enhancements, FINRA will continue its longstanding efforts with NASAA and other interested parties to

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25 The Codes require that the panel assess all DRS arbitration forum fees for hearing sessions in which the sole topic is the determination of the appropriateness of expungement against the parties requesting expungement relief. See FINRA Rule 12805(d) and 13805(d). This requirement would remain the same under the Proposal. See proposed Rules 12805(c)(9) and 13805(c)(10).

26 The term "Director" means the Director of FINRA Dispute Resolution Services. Unless the Code provides that the Director may not delegate a specific function, the term includes FINRA staff to whom the Director has delegated authority. See FINRA Rules 12100 (m) and 13100(m).

27 See FINRA Rules 12900(a)(1) and 13900(a)(1). Information on how to request an arbitration fee waiver is available at https://www.finra.org/arbitration-mediation/arbitration-fee-waivers. In addition, in the award, the panel may order a party to reimburse another party for all or part of any filing fee paid. See FINRA Rules 12900(d) and 13900(d).

28 See About FINRA, Governance, Advisory Committees at https://www.finra.org/about/governance/advisory-committees.

consider a redesign of the current expungement process.[29] FINRA looks forward to pursuing solutions to further *enhance the* expungement process and welcomes any information these interested parties can provide to more fully inform a holistic view of the issues around expungement throughout the financial services industry.

## II. State Attendance and Participation in Straight-In Requests

The Proposal would provide a mechanism for an authorized representative of state securities regulators ("authorized representative") to provide the state securities regulators' position or positions on an expungement request in writing or by attending and participating in the expungement hearing in person or by video conference.[30] NASAA, PIABA Foundation, PIABA, Miami, St John's and Cornell supported this provision of the Proposal. NASAA, for example, stated that it "appreciates any opportunity to appear to advocate for the preservation of public records." PIABA "applaud[ed]" FINRA because "for the first time state regulators will be able to play a significant and active role in this regulatory determination, which aligns with the important regulatory function of the CRD system."[31] PIABA Foundation noted that it had previously proposed that FINRA "create and embed an investor protection advocate into the expungement arbitration process," and that allowing state securities regulators or their authorized representative to participate in straight-in requests "creates the framework and mechanism for the [a]dvocate role envisioned by the PIABA Foundation."

### A. Potential Limitations on State Attendance and Participation

While NASAA supported this provision of the Proposal, it also stated that "state participation in [expungement] proceedings would be limited by resources and state-specific procedural hurdles that could inhibit the ability to appear," and thus believes its "limited utility must be recognized." The Proposal provides that the Director would notify the state securities regulators, in the manner determined by the Director in collaboration with state securities regulators, within 15 days of receiving an expungement request[32] and provide access to relevant

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29 See 2020 Rule Filing Withdrawal, supra note 14 and accompanying text.

30 See proposed Rule 13805(c)(6)(A).

31 See also PIABA Foundation ("applaud[ing]" FINRA for "proposing to allow state securities regulators or their authorized representatives to participate in straight-in expungement arbitrations" because they "are an important stakeholder with a vested interest to protect the integrity of the CRD database and to ensure that expungements are treated as an extraordinary remedy") and St. John's and Miami (supporting the opportunity for state securities regulators to participate in expungement hearings which will help address the problem of unopposed expungement hearings).

32 See proposed Rules 12800(f)(1), 12805(b) and 13805(b)(2)(A). NASAA expressed appreciation for the earlier notice of expungement requests and "look[s] forward to working with FINRA to implement a technological solution to make the expungement notification process to NASAA and states as efficient as possible." Miami suggested that FINRA consider notifying state securities regulators about separate, expungement-only hearings following a simplified arbitration. FINRA reminds the commenters that such notice will be provided under proposed Rule 12800(f)(1).

documents to help state securities regulators determine whether to attend and participate in the expungement hearing.[33] FINRA recognizes that in person attendance and participation by an authorized representative may be limited given state resource constraints; thus, the Proposal provides low-cost options to help facilitate state participation. Specifically, the Proposal would permit the authorized representative to attend and participate via video conference or submit a state's position in writing.[34]

B. State Participation Should be Extended to Expungement Requests in Customer Cases

Edwards expressed concern that the Proposal "improperly limits state securities regulator participation only to 'straight-in' expungement requests." Edwards stated that "[t]he authorized representatives of state securities regulators should be able to participate in any expungement hearing," including those held during customer cases. In contrast, Neal suggested that FINRA should not permit state securities regulators to participate in straight-in requests, as such participation "only increases the expense of filing" an expungement request.

As FINRA explained in the Proposal, the purpose of allowing an authorized representative to attend and participate in straight-in requests would be to provide meaningful opposition to the expungement request, which might otherwise be unopposed, and thus help create a more complete factual record for the panel to rely upon to decide the expungement request.[35] The Proposal would not allow an authorized representative to attend or participate in a customer arbitration where expungement has been requested. FINRA believes such attendance or participation could substantially disrupt the customer's case and would be less impactful, as the panel from the customer arbitration hears the customer's evidence on the merits.

As FINRA also explained in the Proposal, NASAA and state securities regulators have a shared interest with FINRA in protecting the integrity of the information contained in the CRD system, as it is a crucial tool in their registration and oversight responsibilities.[36] According to NASAA, "[s]tate securities regulators are often legally obligated to maintain the information in the CRD system as a state record. The Uniform Securities Acts, which form the basis of most state securities statutes, generally provide that securities regulators must retain all information filed as part of a registration application or as an amendment to the information filed as part of

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33 But see Hennion (suggesting that FINRA provide notification to state regulators regarding expungement requests "at the time when they have the ability to become involved – at the state court confirmation level"). FINRA notes that an associated person seeking to confirm an arbitration award containing expungement relief must name FINRA as an additional party unless this requirement is waived by FINRA. See FINRA Rule 2080. Currently, upon receipt of a complaint naming FINRA or a request for a waiver from the requirement to name FINRA as an additional party, FINRA will notify NASAA of the complaint or waiver request. NASAA, in turn, will notify the appropriate state securities regulator.

34 See proposed Rule 13805(c)(6)(A).

35 See Proposal, 87 FR 50170, 50186.

36 See id.

the application."[37] Thus, NASAA has indicated that expungement of customer dispute information potentially implicates the public records obligations of state governments.[38] FINRA believes, therefore, that developing a process for state securities regulators to participate in straight-in requests is critical to protecting the integrity of the information in the CRD system. In addition, FINRA believes the concern about state participation increasing costs to file an expungement request may be overstated, as FINRA has indicated that the authorized representative would not be a party to the request, and thus, would not be permitted to take actions that could delay the proceeding or add to the parties' costs.[39]

## III. Customer Attendance and Participation

NASAA, Cornell and St. John's indicated their support for the elements of the Proposal that would encourage customers to attend and participate in an expungement hearing. St. John's and Cornell expressed support for the mandatory notification requirement that would inform customers of an expungement hearing. Cornell supported the proposed notification requirement because it would result in "[a] shorter time gap" between the customer arbitration and the expungement hearing, and thus, "make it more likely that customers participate in the expungement hearing," while Miami stated that the notification requirement would minimize the chance that an associated person's "expungement request goes completely unopposed."

AdvisorLaw expressed concern that "allowing non-parties to participate in arbitration proceedings without the non-parties submitting to the [DRS arbitration] forum's jurisdiction" could create an incentive for non-parties to commit perjury without fear of being held accountable. FINRA notes that current FINRA rules and the proposed rules would help address this concern. As discussed in more detail below, the arbitrators who would decide straight-in requests[40] would have the experience, qualifications and training necessary to conduct a fair and impartial expungement hearing in accordance with the proposed rules.[41] FINRA believes this corps of arbitrators would have the experience necessary to assess the credibility of those attending and participating in the hearing, as well as any documentary information. In addition, the Proposal would give an associated person requesting expungement the opportunity to cross-examine a non-party customer if the person chooses to testify or any witness called by the

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37 Brief of Amicus Curiae North American Securities Administrators Association, Inc. in Support of the Division of Securities and Retail Franchising, at 6-7, https://www.nasaa.org/wp-content/uploads/2021/06/Brief-of-Amicus-Curiae-NASAA-in-Support-of-the-Div-of-Securities-and-Retail-Franchising-06.23.21.pdf.

38 Id.

39 As a non-party, an authorized representative would not be entitled to seek discovery from the parties through the DRS arbitration forum, file motions or seek to postpone a hearing.

40 All straight-in requests would be required to be decided by a three-person panel, randomly selected from a roster of experienced public arbitrators with enhanced expungement training and with no significant ties to the industry ("Special Arbitrator Roster").

41 See proposed Rule 13806(b).

customer or authorized representative.[42] FINRA believes these mechanisms should be sufficient to ensure that a non-party's testimony or documentary information presented is appropriately scrutinized.

NASAA expressed support for "those parts of the [Proposal] designed to facilitate attendance and participation," and suggested amending the Proposal to clarify that "customers would have the opportunity and ability to participate in *all aspects of the hearing*."[43] FINRA intended for the Proposal to provide that customers would have the opportunity and ability to participate in all aspects of the hearing. Accordingly, FINRA has determined to amend proposed Rules 12805(c)(3)(A) and 13805(c)(3)(A) to state that all customers whose customer arbitrations, civil litigations or customer complaints are a subject of the expungement request are entitled to attend and participate in *all aspects of* the prehearing conferences and the expungement hearing.

NASAA also recommended amending the Proposal to provide that FINRA "will 'deliver' the relevant documents to customers upon request," rather than providing customers with "access." FINRA believes that the current process for ensuring that customers receive documents is sufficient. FINRA provides customers with access to documents through the DRS Party Portal ("Portal"), which is used for arbitration and mediation case participants.[44] Once registered on the Portal, a customer may, among other things, view documents and submit documents to FINRA.[45] For those customers who are unable to access the Portal, DRS would provide paper documents upon request.

## IV. No Evidentiary Weight Given to Non-Participation of a Customer or Authorized Representative

The Proposal would prohibit the panel from considering a decision of a customer or an authorized representative not to attend or participate in the expungement hearing in a straight-in request as material to the determination of whether expungement is appropriate.[46]

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42 See proposed Rules 12805(c)(5)(B) and 13805(c)(5)(B). In addition, FINRA Rules 12104 and 13104 outline the procedures for submitting a referral during or at the conclusion of an arbitration proceeding. If an arbitrator refers a matter or conduct for investigation, the Director will assess the arbitrator referral and determine whether to forward the referral to FINRA's National Cause and Financial Crimes Detection Program (NCFC). NCFC coordinates with other FINRA departments to pursue matters under FINRA's jurisdiction and may also make an appropriate external referral (e.g., to the local District Attorney's office, SEC, Federal Bureau of Investigation, bar association or any other applicable agency) for further investigation. See also Volume 1 – 2017 of The Neutral Corner, FINRA Arbitration and Arbitrator Disciplinary Referrals.

43 Emphasis added.

44 See Proposal, 87 FR 50170, 50185 n.175.

45 See FINRA Dispute Resolution Services, DR Portal, https://www.finra.org/arbitration-mediation/dr-portal.

46 See proposed Rules 12805(c)(8)(C) and 13805(c)(9)(C).

NASAA agreed with the position that a "decision by a customer or [authorized] representative not to participate in an expungement hearing should not be given any evidentiary weight."[47] Therefore, NASAA suggested amending the Proposal "to state clearly that arbitrators must give no weight to such decisions." FINRA agrees that a customer's or an authorized representative's decision not to attend or participate should not be given any evidentiary weight by the panel when making the expungement determination, and that the Proposal could be strengthened to clarify this position. Accordingly, FINRA is proposing to amend proposed Rules 12805(c)(8)(C) and 13805(c)(9)(C) to state that a panel shall not give any evidentiary weight to a decision by a customer or an authorized representative not to attend or participate in an expungement hearing when making a determination of whether expungement is appropriate.

## V. Unanimous Decision to Issue an Award Containing Expungement Relief

The Proposal would require that arbitrators agree unanimously to issue an award containing expungement relief.[48] NASAA, PIABA, St. John's and Cornell supported requiring arbitrators to agree unanimously to issue an award containing expungement relief. In addition, PIABA "commend[ed]" FINRA, and noted further that "[r]equiring unanimous decisions properly reflects the heightened burden and importance for [expungement] proceedings." St. John's and Cornell also supported the requirement of a unanimous decision for all expungement requests, with Cornell noting that "it would further safeguard the integrity of the information maintained in the CRD system." In contrast, SIFMA recommended that "the unanimity requirement be stricken from the Proposal, and that the standard for expungement should remain majority decision." FSI suggested that the "decision on whether to grant expungement need only be a majority decision."[49]

As FINRA explained in the Proposal, requiring a unanimous decision of the arbitrators would help protect the integrity of the information in the CRD system and help ensure that the expungement process operates as intended—as a remedy that is appropriate only in limited circumstances in accordance with the narrow standards in FINRA rules. Accordingly, FINRA has determined to retain this requirement in the Proposal.

## VI. Required Finding to Issue an Award Containing Expungement Relief

The Proposal would amend FINRA Rules 12805 and 13805 to provide that "in order to issue an award containing expungement relief," a panel must unanimously find "that one or more of the grounds for expungement enumerated in the proposed rule has been established: (1) the claim, allegation or information is factually impossible or clearly erroneous; (2) the associated person was not involved in the alleged investment-related sales practice violation, forgery, theft,

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47 Emphasis added. See Proposal, 87 FR 50170, 50185.

48 See proposed Rules 12805(c)(8)(A) and 13805(c)(9)(A).

49 FSI suggested that a unanimous decision is not necessary because "the requirement of the written rationale will encourage unanimity of the decision without mandating it." See also infra Section VIII. (Written Rationale Requirement).

misappropriation or conversion of funds; or (3) the claim, allegation or information is false."[50] The Proposal would revise the current language in FINRA Rules 12805 and 13805 by replacing the current reference to the FINRA Rule 2080 grounds for expungement with an explicit list of the three grounds specified in FINRA Rule 2080(b)(1).[51] As stated in the Proposal, FINRA believes this change would help further protect the integrity of the information in the CRD system[52]—it would reinforce that expungement of customer dispute information from the CRD system is appropriate only in limited circumstances by specifying in the Codes the narrow grounds that arbitrators must find in issuing an award containing expungement relief. In addition, to help ensure that there is no confusion as to which standards the arbitrators must apply, the Proposal would direct that the panel shall not issue, and the Director shall not serve, an award containing expungement relief based on any other grounds.[53]

SIFMA stated that the current grounds upon which arbitrators may grant expungement under FINRA Rules 12805 and 13805 "include both Rule 2080(b)(1) and (b)(2) grounds." In addition, SIFMA stated that "FINRA arbitrators (and courts) today remain free to grant expungement on equitable grounds, including without limitation the grounds listed in Rule 2080(b)(2)." Thus, SIFMA stated that the Proposal should be amended to allow arbitrators to grant expungement on these grounds.

FINRA disagrees with the commenter. FINRA believes that the change would help address any concern that arbitrators in the DRS arbitration forum may apply the incorrect standard when issuing an award containing expungement relief. As discussed below, FINRA Rules 12805 and 13805, their rulemaking history and related guidance establish that arbitrators in the forum are limited to the grounds enumerated in FINRA Rule 2080(b)(1)(A)-(C) when awarding expungement.[54] Moreover, FINRA believes that allowing arbitrators in the forum to

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50 Proposal, 87 FR 50170, 50184.

51 See proposed Rules 12805(c)(8)(A)(ii) and 13805(c)(9)(A)(ii).

52 Proposal, 87 FR 50170, 50184.

53 Id.

54 FINRA Rule 2080(b) requires members or associated persons to name FINRA as an additional party when they petition a court of competent jurisdiction for expungement relief or seek judicial confirmation of an arbitration award containing expungement relief, unless FINRA waives this requirement. Under FINRA Rule 2080(b)(1), FINRA may waive the requirement that it be named if "FINRA determines that the expungement relief is based on" one of three enumerated "affirmative arbitral or judicial 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

issue awards containing expungement relief by applying an "equitable" standard, as SIFMA suggests, would not sufficiently protect the integrity of the information in the CRD system.[55]

When the SEC approved FINRA Rule 2080 (formerly NASD Rule 2130), it was contemplated that arbitrators in the forum should award expungement only if they found one of the three grounds in FINRA Rule 2080(b)(1)(A)-(C).[56] Later, when FINRA proposed FINRA Rules 12805 and 13805, it specified that the new "procedures [were] designed to . . . ensure that expungement occurs only when the arbitrators find and document one of the narrow grounds specified in Rule [2080]."[57] The only grounds specified for arbitrators in FINRA Rule 2080 are the three narrow grounds in paragraph (b)(1). The SEC's approval of FINRA Rules 12805 and 13805 demonstrates its expectation that a panel would be required to "indicate in the arbitration

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

FINRA Rule 2080(b)(2), in contrast, does not identify any specific affirmative findings that an arbitrator can make to support awarding expungement. Instead, FINRA Rule 2080(b)(2) authorizes FINRA "in its sole discretion and under extraordinary circumstances" to determine whether to waive the obligation to name it as an additional party "[i]f the expungement relief is based on judicial or arbitral findings other than those described [in FINRA Rule 2080(b)(1)]."

55 Unlike arbitrators considering expungement requests, courts are not bound by FINRA rules related to expungement of customer dispute information. While arbitrators considering expungement requests have received training regarding the importance of expungement, judges may or may not have knowledge about the missions of FINRA or the state securities regulators, the securities markets and the important purposes of the CRD system.

56 See Securities Exchange Act Release No. 48933 (December 16, 2003), 68 FR 74667 (December 24, 2003) (Order Approving File No. SR-NASD-2002-168) (Proposed Rule Change to Adopt [FINRA Rule 2080]) ("Approval Order") (discussing, throughout the Approval Order, the "three proposed standards" in FINRA Rule [2080]; how arbitrators will know of the standards for expungement relief under proposed rule [2080] "because they will have received appropriate training" and "members and associated persons will know that arbitrators will only grant expungement relief based on those standards; how "all parties and arbitrators will be aware of the standards under which expungement relief should be granted;" and that the SEC was satisfied that the "requirement that an 'affirmative' determination be made by an arbitrator will provide sufficient regulatory protection."); Notice to Members 04-16 (March 2004) (announcing approval of FINRA Rule [2080], describing how it will protect information in the CRD system by permitting expungement of customer dispute information "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").

57 Securities Exchange Act Release No. 57572 (March 27, 2008), 73 FR 18308 (April 3, 2008) (Notice of Filing of File No. SR-FINRA-2008-010) (emphasis added).

award which of the grounds for expungement in Rule [2080](b)(1)(A)–(C) serves as the basis for the expungement order."[58] The SEC's approval order also describes FINRA's response to comments as stating "that the proposal requires arbitrators to evaluate fully whether the party requesting expungement either in arbitration or in connection with a settlement agreement has met the criteria promulgated under Rule [2080](b)(1)(A)–(C)."[59] In finding that the proposed rule change was consistent with the requirements of the Securities Exchange Act of 1934,[60] the SEC described how the additional procedures "should help ensure that investors and regulators have access to all relevant data in the CRD."[61] Contrary to SIFMA's assertion, in approving FINRA Rules 12805 and 13805, the SEC explicitly approved the FINRA Rule 2080(b)(1) limitation, which was then incorporated throughout FINRA's published guidance.[62]

In addition, the plain language of current FINRA Rules 12805 and 13805 is consistent with the SEC's explicit approval of the FINRA Rule 2080(b)(1) limitation. Notably, current FINRA Rules 12805 and 13805 describe what "the panel must" do in order to grant expungement of customer dispute information. A key distinction between paragraphs (b)(1) and (b)(2) in FINRA Rule 2080 is that the latter does not describe any grounds upon which arbitrators may grant expungement in the forum; rather, it describes a more general standard for FINRA to consider in making its own regulatory determination in extraordinary circumstances when the court or arbitrator makes findings "other than those described in [2080](b)(1)]."

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58 Securities Exchange Act Release No. 58886 (October 30, 2008), 73 FR 66086, 66087 (November 6, 2008) (Order Approving File No. SR-FINRA-2008-010).

59 73 FR 66086, 66089.

60 15 U.S.C. 78s(b)(1).

61 73 FR 66086, 66089.

62 The requirement that the panel indicate in the arbitration award which of the grounds for expungement in FINRA Rule 2080(b)(1)(A)–(C) serves as the basis for the expungement order has been incorporated throughout FINRA's published guidance to arbitrators and the public regarding expungement. See Regulatory Notice 08-79 (December 2008) (stating that "[t]he arbitration panel must indicate which of the grounds for expungement under Rule [2080](b)(1)(A)–(C) serve as the basis for their expungement order"); FINRA Dispute Resolution Services Arbitrators Guide, at 74, https://www.finra.org/sites/default/files/arbitrators-ref-guide.pdf (explaining that FINRA "Rule 2080 establishes procedures to ensure that expungement occurs only when the arbitrators find and document one of its narrow grounds: [listing the three grounds in FINRA Rule 2080(b)(1)(A)-(C)]"); FINRA Dispute Resolution Services, Notice to Arbitrators and Parties on Expanded Expungement Guidance, https://www.finra.org/arbitration-and-mediation/notice-arbitrators-and-parties-expanded-expungement-guidance (last updated Sept. 2017) (describing how FINRA Rules 12805 and 13805 are "intended to ensure that expungement occurs only when the arbitrators find and document one of the narrow grounds specified in Rule 2080: [listing the three grounds in FINRA Rule 2080(b)(1)(A)-(C)]"). DRS's Basic Arbitrator Training Program also explains that expungement may occur only after the arbitrators find and document one of these three grounds.

Accordingly, the language in current FINRA Rules 12805 and 13805 requiring the panel to "[i]ndicate in the arbitration award which of the Rule 2080 grounds for expungement serve(s) as the basis for its expungement order" is properly understood as referring only to the grounds listed in paragraph (b)(1). Those are, after all, the only specific grounds listed in FINRA Rule 2080 that a panel could affirmatively find in making an expungement determination.

In support of its position, SIFMA also stated that there are "many" cases where expungement would be fair and appropriate, but would not qualify for expungement if the grounds were limited to the FINRA Rule 2080(b)(1) grounds. SIFMA posed three hypothetical scenarios in which a customer has made a written complaint but it is implied that the associated person has not committed an actual violation.

As a threshold matter, FINRA notes that a firm is not required to report every customer complaint it receives about an associated person to the CRD system. Rather, Forms U4 and U5 require that certain investment-related, consumer-initiated complaints be reported which allege an associated person's involvement in sales practice violations, forgery, theft, misappropriation, conversion of funds or securities.[63] Thus, customer complaints—including the customer complaints described in SIFMA's three hypotheticals—are reportable to the CRD system only if they meet the specified criteria for reporting on Forms U4 or U5.[64]

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63 See Form U4 (Uniform Application for Securities Industry Registration or Transfer) (05/2009), Question 14I, https://www.finra.org/sites/default/files/form-u4.pdf; Rev. Form U5 (Uniform Termination Notice for Securities Industry Registration) (05/2009), Question 7E, https://www.finra.org/sites/default/files/form-u5.pdf. FINRA notes that for purposes of Forms U4 and U5, "sales practice violations" are defined as "includ[ing] any conduct directed at or involving a customer which would constitute a violation of: any rules for which a person could be disciplined by any self-regulatory organization; any provision of the Securities Exchange Act of 1934; or any state statute prohibiting fraudulent conduct in connection with the offer, sale or purchase of a security or in connection with the rendering of investment advice." See Form U4 and U5 Interpretive Questions and Answers, https://www.finra.org/sites/default/files/Interpretive-Guidance-final-03.05.15.pdf.

64 For example, one of SIFMA's hypotheticals describes a scenario in which an associated person places a temporary hold on a senior investor's account consistent with the safe harbor in FINRA Rule 2165 (Financial Exploitation of Specified Adults), but the customer, or perhaps the person seeking to exploit her, files a written complaint alleging that the associated person intentionally withheld the investor's funds. FINRA Rule 2165, however, permits the member firm, not the associated person, to place a temporary hold pursuant to the rule. In addition, FINRA has previously discussed that any complaint related to FINRA Rule 2165 would be reportable only if it met the specified criteria for reporting in Forms U4 or U5 or FINRA Rule 4530, and that a retrospective review of FINRA Rule 2165 did not identify any reported customer complaints related to placing a temporary hold pursuant to FINRA Rule 2165. See also Securities Exchange Act Release No. 92225 (June 22, 2021), 86 FR 34084, 34088 (Notice of Filing of File No. SR-FINRA-2021-016).

If a customer complaint meets the criteria for reporting and the associated person then wants to seek to remove the information from the CRD system, the associated person may request expungement through the DRS arbitration forum by asserting one of the three narrow grounds for seeking expungement or by petitioning a court of competent jurisdiction for expungement. The associated person may also comment on the complaint on Form U4, or by submitting a Broker Comment Request Form to FINRA.[65]

Irrespective of the detailed response and rulemaking history described above, SIFMA is incorrect in suggesting that FINRA has not justified the proposed amendment. As described above, FINRA stated in the Proposal that the amendment would further protect the integrity of the information in the CRD system.[66] SIFMA is also incorrect in suggesting that the Proposal does not constitute soliciting comment on the proposed rule change or that FINRA did not previously solicit comment on it. The Proposal clearly articulates the amendment and the basis for it, and FINRA previously sought comment in Regulatory Notice 17-42 (describing how "a three-person panel of arbitrators must unanimously agree that expungement is appropriate under Rule 2080(b)(1)").[67]

As discussed above, to obtain an arbitration award containing expungement relief, the Proposal would require a panel, after conducting an expungement hearing in accordance with the requirements of the Proposal, to find unanimously 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. Protecting the integrity of the information in the CRD system is essential to FINRA's mission of investor protection. These three narrow grounds fairly address the circumstances in which an associated person would appropriately seek expungement of customer dispute information in the DRS arbitration forum.[68]

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65 Associated persons who are registered with a firm may provide a comment on Form U4 regarding a customer complaint, arbitration or civil litigation that has been reported to their CRD record. An individual who is no longer registered, but for whom a BrokerCheck report is available, may submit a request to add a Broker Comment that provides an update or adds context to information disclosed through BrokerCheck, including a customer complaint, arbitration or civil litigation. See https://www.finra.org/registration-exams-ce/individuals/guidelines-broker-comments-brokercheck.

66 See Proposal, 87 FR 50170, 50184.

67 See Notice, supra note 12. FINRA also notes that SIFMA acknowledged, but did not disagree with, the FINRA Rule 2080(b)(1) limitation in its comment letter addressing the Notice. See letter from Kevin M. Carroll, Managing Director and Associate General Counsel, SIFMA, to Marcia E. Asquith, Office of the Corporate Secretary, FINRA, dated February 5, 2018, at 6, https://www.finra.org/sites/default/files/17-42_Sifma_comment.pdf.

68 See Regulatory Notice 08-79 (December 2008).

As stated in this letter and in the Proposal, FINRA, NASAA and state securities regulators have a shared interest in protecting the integrity of the information contained in the CRD system, as it is a crucial tool in their registration and oversight responsibilities.[69] Thus, the removal of information from the CRD system should be based on specific standards, such as those enumerated in FINRA Rule 2080(b)(1) and now proposed to be listed explicitly in proposed Rules 12805 and 13805.

## VII. Other Standards to Decide Expungement

NASAA recommended that "decisions to expunge records should only be reached when the evidence presented in support of expungement meets a clear and convincing standard of proof," because it believes "[s]uch an evidentiary standard would be consistent with the extraordinary nature of expungement." NASAA also suggested adding a presumption against expungement into the Codes. PIABA suggested that FINRA require that arbitration panels "must find the underlying customer dispute information has 'no investor protection or regulatory value' in order to recommend expungement."

As discussed above and in the Proposal, to further clarify the limited circumstances under which arbitrators must decide expungement requests, the Proposal would expressly list in the Codes the narrow grounds in FINRA Rule 2080(b)(1) for deciding these requests.[70] FINRA believes that the incorporation of these grounds into the Codes and the requirement for a unanimous decision by experienced public arbitrators with enhanced expungement training would achieve the goal of balancing the competing interests in the expungement process of providing a fair process and protecting the integrity of the information in the CRD system. Thus, FINRA declines to amend the Proposal as suggested by the commenters.

## VIII. Written Rationale Requirement

Currently, a panel considering a request for expungement relief is required to provide a "brief" written explanation of the reasons for its finding that one or more of the grounds for expungement applies to the facts of the case.[71] The Proposal would remove the word "brief" such that the panel would be required to provide enough detail in the award to explain its rationale for awarding expungement relief.[72]

NASAA supported "requiring arbitrators to explain their rationale for granting expungement relief," and urged FINRA to also require arbitrators "to provide a fulsome explanation of how a request meets expungement's extraordinary standard, including an explanation of how the arbitrators determined that the requesting party's uncontested assertions accurately reflected the truth of the matter."

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69 See Proposal, 87 FR 50170, 50186.

70 See proposed Rules 12805(c)(8)(A)(i) and 13805(c)(9)(A)(i).

71 See FINRA Rules 12805(c) and 13805(c).

72 See proposed Rules 12805(c)(8)(B) and 13805(c)(9)(B).

As explained in the Proposal, the panel's explanation must not be solely a recitation of one of the grounds for awarding expungement relief or language provided in the expungement request. Further, the Proposal would require the panel to identify any specific documentary, testimonial or other evidence on which the panel relied in awarding expungement relief.[73] In addition, FINRA would specify in its enhanced expungement training for arbitrators the importance of explaining their rationale for awarding expungement relief. Thus, at this time, FINRA declines to amend the Proposal as suggested.

## IX. Limitations On Expungement Requests

The Proposal would add strict time limits to when an associated person may file a straight-in request. Specifically, the Proposal would 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) three years of the date the customer complaint was initially reported in the CRD system and there was no customer arbitration or civil litigation associated with the customer dispute information.[74] PIABA, NASAA, Cambridge, Cornell, St. John's and Miami supported this change. More specifically, NASAA was "pleased to see that straight-in requests would be time limited and those not in compliance with this requirement would be denied the [DRS] arbitration forum."[75] In addition, Cambridge stated that "including the proposed time limits for filing expungement requests will increase the efficacy of the expungement process." Cornell and St. John's also supported stricter time limits on filing straight-in requests, with Cornell noting that "a shorter time gap [between the conclusion of the customer arbitration or the initial reporting of a complaint] could also increase the probability that the customer attends and participates in the hearing."

### A. Need for Time Limits on Straight-in Requests

Several commenters expressed concerns that the proposed time limits for straight-in requests were either too restrictive or not strict enough. AdvisorLaw stated that "the amount of time that passes after allegations are cast has absolutely nothing to do with whether the allegations" have met one of the FINRA Rule 2080 grounds for expungement.[76] PIABA stated that it favored the shorter one-year limitation period for all expungement requests that FINRA had originally proposed in Regulatory Notice 17-42, instead of the proposed two- and three-year time limits.[77] Hennion recommended "a six-year period of eligibility with expansion for good cause" as an alternate time limit for filing an expungement request, to provide associated persons

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73 See Proposal, 87 FR 50170, 50184.

74 See proposed Rule 13805(a)(2)(A)(iv)-(v).

75 The Proposal would provide the Director with express authority to decline the use of the DRS arbitration forum, if, for example, an expungement request is ineligible under the proposed time limitations. See proposed Rules 12203(b) and 13203(b).

76 AdvisorLaw suggested that "[a]n appropriate and just remedy would consist of removing all [customer dispute information from CRD] that never rose to the level of a hearing on the merits, after the possibility of a hearing on the merits expires."

77 See Notice, supra note 12.

who "may not have been meaningfully involved in the underlying arbitration" an opportunity to file an expungement request.[78]

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.[79] As described in the Proposal's economic impact analysis, the majority of the straight-in requests filed between January 2016 and December 2021 would not have been permitted under the proposed time limits.[80]

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.[81] 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.[82]

The three-year time period to seek expungement of customer complaints would allow firms to complete their investigation of the customer complaint and close it in the CRD system; associated persons to develop a sense of whether the complaint may evolve into an arbitration or civil litigation; and associated persons to determine whether to proceed with a request to expunge the complaint.[83]

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78 See also Barber (suggesting that no time limits be placed on expungement of customer dispute information) and Neal (opposing the three-year time limit on complaints because it would "increase the expense of filing for expungement"). See supra Section I.C. (Impact of Costs on Expungement Requests).

79 See also Miami ("requiring the associated person to file an expungement request closer in time to the alleged misconduct mitigates the risk of spoliation of evidence and increases the likelihood that the firm would still possess relevant documents and evidence") and Cambridge (suggesting that the proposed time limits will "decrease the cost to member firms" because "[w]hen expungement requests are filed four or five or even ten years after the event giving rise to the request, responding to discovery requests and producing relevant information becomes much more difficult and time consuming"). Cambridge also noted that "[w]ith passing time, documentary evidence may not be as easily accessible and the people with knowledge of the matter may no longer be associated with the member firm."

80 See Proposal, 87 FR 50170, 50194.

81 See Proposal, 87 FR 50170, 50181.

82 See id.

83 See id.

B. Prevent Bundling of Unrelated Expungement Requests

PIABA suggested that FINRA "prohibit associated persons from making 'straight-in' expungement requests for multiple, unrelated matters by denying the [DRS arbitration] forum for such requests." Miami recommended that the Proposal "require that expungement requests in a consolidated claim be related in some way" and that there be "a nexus between the requested hearing location" and the location of the allegation at issue. Miami suggested that the bundling of multiple, unrelated expungement requests brought before "expungement-friendly arbitrator pools increase the incidence of granted expungement requests."

As FINRA explains in the Proposal, the proposed time limits may curtail the common practice of bundling unrelated and aged expungement requests in one straight-in request, because complaints initially reported outside of the three-year window would be barred.[84] FINRA also notes that the requirement under the Proposal that an associated person must file a straight-in request against the member firm at which the person was associated at the time the customer dispute arose would help ensure that there is a connection between the respondent firm and the subject matter of the straight-in request.[85] In addition, the ability for a customer to attend and participate in an expungement hearing by telephone or by video conference should help address concerns about there being a connection between the hearing location and the allegation at issue.[86] The Proposal would not impact existing FINRA rules that allow an associated person to bundle multiple expungement requests in one straight-in request if the claims are eligible for arbitration and share common questions of law or fact, among other things.[87]

In response to Miami's concern about expungement requests being brought before "expungement-friendly arbitrator pools," FINRA notes that the Proposal includes several requirements to minimize the potential for influence in the arbitrator selection process for straight-in requests. For example, the Proposal would require FINRA's list selection algorithm

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84 See id.; see also Cornell (stating that the Proposal would "promote timely filings of expungement requests and might prevent associated persons from bundling multiple unrelated expungement requests into a single straight-in request").

85 See proposed Rule 13805(a)(1). If the requisite connection is not present, the Director would be authorized to deny the use of the DRS arbitration forum for the request. See proposed Rule 13203(b).

86 Specifically, customers whose customer arbitrations, civil litigations, or customer complaints are a subject of the expungement request would be able to attend and participate in the expungement hearing by telephone, in person or by video conference. See proposed Rules 12805(c)(3)(B) and 13805(c)(3)(B).

87 FINRA rules provide, in relevant part, that one or more parties may join multiple claims together in the same arbitration if the claims contain common questions of law or fact and: (a) the claims assert any right to relief jointly and severally; or (b) the claims arise out of the same transaction or occurrence, or series of transactions or occurrences. See FINRA Rules 12312(a), 12313(a), 13312(a) and 13313(a).

to randomly select a three-person panel from the Special Arbitrator Roster.[88] The parties would not be able to agree to fewer than three arbitrators. In addition, the parties would not be permitted to strike any arbitrators selected by the list selection algorithm or stipulate to their removal. The parties also would not be permitted to stipulate to the use of pre-selected arbitrators (i.e., arbitrators that the parties find on their own to use in their cases).[89] These requirements would help ensure that arbitrators on the Special Arbitrator Roster have the qualifications and training to decide straight-in requests and that the arbitrators conducting the expungement hearings are impartial and experienced in managing and conducting arbitration hearings in the DRS arbitration forum.

## X. Expungement Requests During Simplified Customer Arbitrations

The Proposal would codify an associated person's ability to request expungement when named as a respondent in a simplified arbitration (customer arbitrations involving $50,000 or less), and for other parties to request expungement on behalf of an unnamed person in these arbitrations. The Proposal would also establish procedures for requesting and considering expungement requests in simplified arbitrations that are consistent with the expedited nature of these proceedings.[90] If, for example, the customer opts not to have a hearing or chooses an Option Two special proceeding, the arbitrator would decide the customer's dispute first and issue an award.[91] After the customer's dispute is decided, the arbitrator must hold a separate expungement-only hearing to consider and decide the expungement request and issue a separate, subsequent award.[92]

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88 See infra Section XI.B.1. (Straight-In Requests Under the Industry Code and the Special Arbitrator Roster - Eligibility Requirements for Special Arbitrator Roster) and accompanying discussion.

FINRA recently updated the Codes to make technical, non-substantive changes to remove references to the Neutral List Selection System from those rules describing arbitrator list selection and instead refer to the "list selection algorithm." See Securities Exchange Act Release No. 95871 (September 22, 2022), 87 FR 58854 (September 28, 2022) (Notice of Filing and Immediate Effectiveness of File No. SR-FINRA-2022-026). FINRA would amend proposed Rules 13806(b)(1), (b)(3) and (b)(4) to make conforming changes.

89 See Proposal, 87 FR 50170, 50180.

90 See proposed Rules 12800(d) and (e). Under the proposed rule change, an associated person would not be permitted to request expungement in a simplified arbitration administered under the Industry Code. See FINRA Rule 13800. All expungement requests under the Industry Code must be filed in accordance with proposed Rule 13805.

91 See proposed Rule 12800(e)(1)(A).

92 See id. The arbitrator must conduct the expungement hearing pursuant to proposed Rule 12805(c). The expungement award must meet the requirements of proposed Rule 12805(c)(8), and the DRS arbitration forum fees would be assessed pursuant to proposed Rule 12805(c)(9).

Cornell, St. John's and Miami, three securities arbitration clinics whose cases are filed and decided under the simplified arbitration rules, expressed support for the proposed changes to the simplified process. In particular, they favored the proposed bifurcation of the customer's case from the expungement hearing. Cornell noted that it "strongly support[ed]" the proposed rule change "to bifurcate the expungement request in simplified cases." Cornell continued that "a bifurcated hearing will allow for a just resolution of the request because the arbitrator will have all of the facts and special insights necessary to decide whether to recommend a request for expungement, while ensuring that the resolution of the investor's claim is not delayed." However, Cornell and Miami also suggested some modifications to the proposed changes to the simplified arbitration rules.

A. Suggested Changes to the Simplified Process

Cornell requested that the Proposal be amended to provide that, during a simplified arbitration where the parties agree to have a specific arbitrator, the 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." FINRA stated in the Proposal that arbitrators deciding expungement requests in simplified arbitrations would be experienced public arbitrators who would be required to evidence successful completion of, and agreement with, the enhanced expungement training provided by DRS prior to considering and deciding the expungement request.[93] Where the parties agree to have a specific arbitrator and expungement is requested in the simplified case, the arbitrator would be required to complete the enhanced expungement training provided to the arbitrators on the Special Arbitrator Roster prior to considering the expungement request.[94]

Miami expressed support for the requirement for automatic notification of state securities regulators regarding expungement requests but suggested that FINRA consider notifying state securities regulators about separate, expungement-only hearings following a simplified arbitration. Miami added that allowing state regulators to participate in separate, expungement-only hearings would "increase the likelihood that the customer's interests are adequately represented without interfering with a claimant's presentation of their case-in-chief or raising concerns about confidentiality."

At this time, FINRA is not proposing to allow state securities regulator participation in separate expungement-only hearings in simplified arbitrations because, unlike in straight-in requests, these expungement hearings would occur after the arbitrator has heard the merits of the customer's case in an adversarial process. In addition, given that the expungement-only hearing would likely be scheduled shortly after the customer's dispute is decided or closes, FINRA believes that it could potentially increase the likelihood of customer attendance and participation. Thus, FINRA does not believe that it is necessary for state securities regulators to also attend and participate in expungement-only hearings in simplified arbitrations

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93 See Proposal, 87 FR 50170, 50187.

94 See id.

B. Permitting a Named Associated Person to Request Expungement in a Simplified Arbitration

Miami expressed concern that the Proposal does not require a named associated person to request expungement in a simplified arbitration. Miami suggested that this procedure, "which only applies in simplified cases, makes an unnecessary distinction between simplified and non-simplified proceedings." As FINRA explains in the Proposal, due to the expedited nature of simplified arbitrations, associated persons should have the option to file an expungement as a straight-in request under the Industry Code.[95] In simplified arbitrations, there may be less discovery, and the customer can dictate the extent of the evidence presented to the arbitrator.[96] For example, the customer may choose to have the arbitration decided on the papers. Because there may be less information available for the arbitrator to evaluate an expungement request during a simplified arbitration—even when the simplified arbitration results in an award—FINRA believes it is appropriate for the associated person to retain the ability to choose to file the request as a straight-in request under the Industry Code, provided the request is not barred.[97] As noted in the Proposal, however, if the Commission approves the proposed rule change, FINRA will continue to monitor expungement requests and decisions in simplified arbitrations to determine if additional changes are warranted.[98]

C. Create a Simplified Process for Expungement Requests

Hennion suggested that a simplified process for expungement should be created with similar fees and an "on the papers" option before a single arbitrator for customer complaints and customer arbitrations under $50,000. As discussed in this letter and in the Proposal, the proposed rule change is intended to help protect the integrity of the information in the CRD system by addressing concerns with the current expungement process, particularly straight-in requests, and ensuring that the expungement process works as intended—with specially trained and experienced arbitrators issuing awards containing expungement relief only in limited circumstances in accordance with the narrow standards in FINRA rules. FINRA also believes an important part of ensuring the expungement process works as intended is for arbitrators to hold recorded expungement hearings during which they can hear testimony and assess the credibility of the associated person requesting expungement and any witnesses. Thus, FINRA declines to amend the Proposal as suggested.

## XI. Straight-In Requests Under the Industry Code and the Special Arbitrator Roster

A. Straight-In Requests

Under the Proposal, all arbitration requests to expunge customer dispute information that are not associated with a customer arbitration would be required to be filed as a straight-in

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95 See id.

96 See id.

97 See id.

98 See id. at 50188.

request under proposed Rule 13805.[99] In addition, an associated person would be permitted to request expungement of customer dispute information associated with a customer arbitration under proposed Rule 13805 if: (1) the associated person is named in the arbitration or is the subject of an on-behalf-of request and the customer arbitration closes other than by award or by award without a hearing; or (2) the associated person is the subject of a customer arbitration, but is neither named in the arbitration nor the subject of an on-behalf-of request, and the customer arbitration closes for any reason. If an associated person requests expungement under proposed Rule 13805, a three-person panel randomly selected from the Special Arbitrator Roster in accordance with proposed Rule 13806 would decide the expungement request.[100] PIABA and St. John's expressly supported this approach, with PIABA stating in particular that "fil[ing] a new 'straight-in' expungement request after the arbitration case [closes other than by award or by award without a hearing] is a better alternative."

SIFMA, however, opposed the change, suggesting that the same panel should be allowed to decide the expungement request regardless of how the customer's arbitration closes "for efficiency and other purposes." As FINRA notes in the Proposal, the proposed approach reflects the importance of protecting the integrity of information in the CRD system. When the customer arbitration closes other than by award or by award without a hearing, the panel selected by the parties in the customer arbitration may not have heard the presentation of the evidence on the merits of the case and, therefore, may not bring to bear any special insights in determining whether to issue an award containing expungement relief. In addition, customers or their representatives have little incentive to attend and participate in an expungement hearing once their case has settled. Requiring that an associated person file the expungement request as a straight-in request under the Industry Code to be heard and decided by a three-person panel that is randomly selected from the Special Arbitrator Roster would strengthen the expungement framework. As discussed in more detail below, while keeping in mind the importance of protecting the integrity of information in the CRD system, this corps of experienced and specially trained arbitrators would follow the procedures set forth in proposed Rule 13805 to determine whether they unanimously agree that one or more three narrow grounds exist in order to issue an award containing expungement relief.[101]

B. Special Arbitrator Roster

Under the Proposal, to be eligible for the Special Arbitrator Roster, an arbitrator must: (1) be a public arbitrator who is eligible for the chairperson roster;[102] (2) have evidenced successful

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99 See proposed Rules 12805(a)(1)(A) and 13805(a)(1).

100 See Proposal, 87 FR 50170, 50178.

101 See id. at 50177–78.

102 Arbitrators are eligible for the chairperson roster if they have completed chairperson training provided by FINRA and: have a law degree and are a member of a bar of at least one jurisdiction and have served as an arbitrator through award on at least one arbitration administered by a self-regulatory organization in which hearings were held; or have served as an arbitrator through award on at least three arbitrations administered by a self-

completion of, and agreement with, enhanced expungement training provided by FINRA; and (3) served as an arbitrator through award on at least four customer arbitrations administered by FINRA or by another SRO in which a hearing was held.

Cambridge, Cornell, PIABA and St. John's supported creating the Special Arbitrator Roster and the arbitrator selection criteria. Cornell stated that it supports these "measures to mitigate the impact of an unopposed expungement request," and suggested that such measures "will give the associated persons fewer causes for removal that are related to arbitrator bias."

1. Eligibility Requirements for the Special Arbitrator Roster

Several other commenters raised concerns regarding the proposed eligibility requirements. PIABA Foundation suggested that the most experienced arbitrators should not be on the Special Arbitrator Roster as they have exhibited bias in favor of granting expungements in the past. In addition, PIABA Foundation suggested that FINRA "specifically recruit current and former state and federal regulators to serve as arbitrators on the Special Arbitrator Roster." FSI and Hennion suggested that FINRA expand the pool of arbitrators who could be eligible to serve on the Special Arbitrator Roster. Instead of limiting the roster to public, chair-qualified arbitrators, FSI and Hennion urged FINRA to consider including arbitrators with industry experience. Further, PIABA Foundation questioned whether the proposed enhanced expungement training would be effective. Hennion suggested that arbitrators would be required to pay for the training.

FINRA believes the eligibility requirements would help ensure that arbitrators on the Special Arbitrator Roster have the qualifications and training to decide straight-in requests and that the persons conducting the expungement hearings are impartial and experienced in managing and conducting arbitration hearings in the DRS arbitration forum. In particular, the expansion of the Expungement Training module for arbitrators seeking to qualify for the Special Arbitrator Roster would allow FINRA to further emphasize that expungement should be awarded in limited circumstances and only if the arbitrators unanimously find that the information to be expunged meets one of the three narrow grounds specified in FINRA rules. FINRA does not currently charge arbitrators to take any arbitrator training courses, and that would continue to be the case with the enhanced expungement training.

In addition, FINRA believes that having experienced public arbitrators, without significant ties to the financial industry, deciding straight-in requests would help achieve the goal of balancing the competing interests in the expungement process of providing a fair process and ensuring that information about associated persons that is available to investors is accurate. Among other requirements, public arbitrators are not employed by the securities industry; do not devote 20 percent or more of their professional work to the securities industry or to parties in disputes concerning investment accounts or transactions or employment relationships within the

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regulatory organization in which hearings were held. See FINRA Rules 12400(c) and 13400(c).

financial industry; and do not have immediate family members or co-workers who do so.[103] In contrast, non-public arbitrators include persons who are associated with or represent the financial industry.[104]

Also, if customers and state securities regulators decline to attend and participate in straight-in requests, having three experienced public arbitrators with enhanced expungement training available to ask questions, request evidence and to serve generally as factfinders in the absence of customer or state input, would help ensure that a complete factual record is created to support the panel's decision. Accordingly, FINRA declines to amend the Proposal as suggested.

2. Composition of a Panel

The Proposal would require the list selection algorithm to select randomly three public chairpersons from the Special Arbitrator Roster to decide a straight-in request.[105] The parties would not be permitted to strike any arbitrators on the list, stipulate to the use of pre-selected arbitrators, stipulate to their removal or agree to fewer than three arbitrators. The parties would be permitted to challenge an arbitrator for cause, and if the arbitrator is removed, the list selection algorithm would select a replacement arbitrator from the Special Arbitrator Roster.

PIABA called the selection criteria changes "critically important, [because] they remove actual or apparent repeat-player incentives to decide expungement cases." Cambridge also suggested that "eliminating the current arbitrator ranking process will increase efficiency and decrease costs for all parties to the expungement matter, since the parties will no longer need to spend hours researching and ranking arbitrators to find the individuals most experienced at handling these issues." Moreover, Cornell stated that the list selection criteria would "address the concerns with arbitrator-shopping, [because] not allowing the striking of arbitrators will prevent associated persons and member firms from working collectively to select a panel more likely to recommend expungement." AdvisorLaw and Hennion expressed concerns, however, about removing the ability of an associated person who requests expungement to strike and rank arbitrators. AdvisorLaw noted that striking and ranking is a process that is "enjoyed by all other participants in FINRA arbitration proceedings."

As FINRA explains in the Proposal, the current process for selecting arbitrators—striking and combining ranked lists—would not be appropriate to use to select arbitrators to decide straight-in requests.[106] In arbitrations outside of the expungement context, the parties are typically adverse, which means that during arbitrator selection, each side may rank arbitrators on the lists whom they believe may be favorable to their case. The adversarial nature of the proceedings serves to minimize the impact of each party's influence in arbitrator selection. In contrast, a straight-in request filed by an associated person against a member firm with which

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103 See FINRA Rules 12100(aa) and 13100(x).

104 See FINRA Rules 12100(t) and 13100(r).

105 See proposed Rule 13806(b)(1); see also supra note 102 and accompanying text.

106 See Proposal, 87 FR 50170, 50180.

they are or were associated is less likely to be adversarial in nature. Thus, the Proposal would prevent associated persons and member firms from collaboratively seeking to influence the outcome of the expungement request through arbitrator selection.[107]

FINRA recognizes that the proposed arbitrator selection process for straight-in requests would limit the associated person and member firm's input on arbitrator selection for reasons that may be unrelated to whether the arbitrator would potentially be sympathetic to the expungement request, such as their perception of the arbitrator's competence or efficiency. However, FINRA believes that the higher standards that the arbitrators must meet to serve on the Special Arbitrator Roster should mitigate the impact of the absence of party input on the selection of arbitrators. In addition, associated persons and member firms would still be permitted to challenge any arbitrator for cause.[108]

## XII. Requests For Expungement Under the Customer Code

PIABA, NASAA, Cambridge, St. John's, Miami and Cornell expressly supported requiring a named associated person to seek expungement of customer dispute information associated with the customer's statement of claim during the customer arbitration, and if the associated person does not do so, requiring the associated person to forfeit the opportunity to seek expungement of the same customer dispute information in any subsequent proceeding. NASAA's support was based on the concern that "expungement hearings are largely one-sided" and NASAA's belief that "requiring [associated persons] to make their request to arbitrators that have had the opportunity to hear the customer's side of the story" would address this concern. Cambridge noted that the change would promote efficiency because the requirement "reduces the need for additional hearings, filing fees, attorney fees and other arbitration costs concerning the same parties and the same evidence." In addition, Cornell noted that this requirement would curtail arbitrator shopping, where associated persons "remove an expungement request after the panel becomes aware of evidence that could result in the denial of the expungement request." Cornell also supported the proposed rule change "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."

### A. Limiting Chairpersons for Customer Arbitrations with Expungement Requests to the Special Arbitrator Roster

D. Robbins suggested that FINRA amend the Proposal to require that, in customer arbitrations where a request for expungement is filed, "the list of proposed [c]hairpersons sent to the parties should only contain [arbitrators] from the Special Arbitrator Roster." FINRA believes that in arbitrations outside of the expungement context, the parties are typically adverse, which means that during arbitrator selection, each side may rank arbitrators on the lists whom they believe may be favorable to their case. The adversarial nature of the proceedings serves to minimize the impact of each party's influence in arbitrator selection. Further, in these contested

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107 See id.

108 See id.

cases, the panel will benefit from input from all of the parties involved, have access to and thus the ability to review all pleadings, hear testimony and assess the credibility of the parties and witnesses. This means that a decision on the expungement request should be based on a complete record from the contested customer arbitration if the arbitration goes to award. Thus, FINRA declines to amend the Proposal as suggested.

B. Finding of Liability in Customer Arbitration

St. John's suggested that associated persons "be prohibited from seeking expungement if there has been a finding of liability in the underlying [(i.e., customer)] arbitration." Arbitration awards are final and binding unless vacated based on the limited grounds set forth in applicable state or federal statutes. Thus, if an associated person is found liable in a customer arbitration, FINRA considers the associated person legally bound by the award and the Director will decline the use of the FINRA arbitration forum if the associated person then requests expungement of customer dispute information that is associated with the customer arbitration in which the associated person was found liable. FINRA considers such expungement requests a collateral attack on the binding arbitration award. A collateral attack is not contemplated under FINRA rules and is contrary to FINRA's Codes of Arbitration Procedure.[109] The only avenue for challenging a prior adverse arbitration award is to file a timely motion with an appropriate court to vacate, modify or correct the award. Accordingly, FINRA has determined to amend the Proposal to provide that an associated person shall not file a claim requesting expungement of customer dispute information from the CRD system if the customer dispute information is associated with a customer arbitration or civil litigation in which a panel or court of competent jurisdiction previously found the associated person liable.[110]

C. Prohibiting Expungement Requests from Being Withdrawn

Under the Proposal, if an associated person withdraws or does not pursue an expungement request after it is filed, the panel would be required to deny the expungement request with prejudice.[111] This requirement would foreclose the ability of associated persons to withdraw expungement requests to avoid having their requests decided by a panel that they believe does not favor their request, and then seek to re-file the request with the hope of obtaining a potentially more favorable decision from a different panel. Miami expressly supported this change, saying that by "explicitly prohibiting the named associated person from withdrawing a request for expungement during arbitration and refiling it as a straight-in request, associated persons can no longer have 'two bites of the apple' in deciding who hears their expungement requests." AdvisorLaw and Hennion, however, suggested that associated persons should be able to voluntarily withdraw expungement requests without prejudice.

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109 See FINRA Rules 12904(b) and 13904(b).

110 See proposed Rule 13805(a)(2)(A)(iv).

111 See proposed Rule 13805(a)(4).

FINRA disagrees that associated persons should have the opportunity to withdraw and re-file expungement requests. FINRA is concerned that "arbitrator shopping" and repeated attempts to seek expungement of the same customer dispute information are inconsistent with the arbitration process and threaten the integrity of the information in the CRD system.[112] Among the requests to expunge customer dispute information in arbitration from January 2016 through December 2021, FINRA identified 282 disclosures that were the subject of a previously withdrawn or denied requests to expunge.[113] To limit arbitrator shopping and multiple attempts at expunging the same customer dispute information, the Proposal would require that once an expungement request is filed by the associated person, the panel must decide the expungement request. This prohibition on withdrawing and refiling would apply to requests filed in simplified arbitrations[114] and during a customer arbitration,[115] and to straight-in requests.[116]

D. Unnamed Persons

1. Intervention in a Customer Arbitration by an Unnamed Person

Under the Proposal, a party to a customer arbitration may file an on-behalf-of request for an unnamed person that seeks to expunge customer dispute information associated with the customer's statement of claim, provided the request is eligible for arbitration under proposed Rule 12805.[117] A party to the customer arbitration would be able to choose to file an on-behalf-of request – it would not be mandatory.[118] AdvisorLaw expressed concern that the Proposal "prohibit[s] the 'unnamed person' from intervening" in a customer case.

FINRA believes that if the associated person is neither a party to the arbitration nor the subject of an on-behalf-of request by another party to the arbitration, the associated person should not be able to intervene in the customer's arbitration to request expungement. In these circumstances, the associated person's conduct is unlikely to be fully addressed by the parties during the customer arbitration, and FINRA does not believe that the customer should have the presentation of their case interrupted or delayed by an associated person's intervention to request expungement. Accordingly, under the Proposal, unnamed persons would be prohibited from intervening in a customer arbitration and requesting expungement.[119] Instead, the unnamed person would be able to file the request as a new claim against the member firm at which the person was associated at the time the customer dispute arose under proposed Rule 13805,

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112 See Discussion Paper, supra note 15.

113 See id.

114 See proposed Rules 12800(d)(1)(C) and 12800(d)(2)(C).

115 See proposed Rules 12805(a)(1)(D)(i) and (a)(2)(E)(i).

116 See proposed Rule 13805(a)(4).

117 See proposed Rule 12805(a)(2)(B).

118 See proposed Rule 12805(a)(2)(A).

119 See Proposal, 87 FR 50170, 50178.

provided the request is not barred, and a panel from the Special Arbitrator Roster would decide the request.[120]

2. Alternatives to an Unnamed Person Filing a Straight-In Request

FSI and Barber suggested that FINRA provide alternatives for unnamed persons to seek expungement relief, other than filing a straight-in request, when they may not be aware of a customer arbitration or had no input in the resolution of customer's case (e.g., whether the case should be settled).

FINRA's existing rules help ensure that associated persons are aware of arbitration disclosures on their Forms U4 and U5.[121] In addition, if a party to the customer arbitration is unwilling to file an on-behalf-of request or if a party files an on-behalf-of request and the arbitration settles, the Proposal would allow the associated person to seek expungement by filing a request to expunge the same customer dispute information as a straight-in request.

## XIII. Panel Requests for Additional Documents or Evidence

NASAA expressed support for codifying the ability of the panel to request from the associated person, the party requesting expungement on behalf of an unnamed person and the member firm at which the person was associated at the time the customer dispute arose, as applicable, any documentary, testimonial or other evidence that the panel deems relevant to the expungement request.[122] NASAA suggested that FINRA amend the Proposal to "consider the failure to produce requested documents to be grounds for denial of the expungement request with prejudice."

FINRA rules provide arbitrators with authority to determine whether sanctions should be imposed for failure to comply with any provision of the Code, or any order of a panel or single arbitrator authorized to act on behalf of the panel. Specifically, under FINRA Rule 12212(a), a panel may assess monetary penalties payable to one or more parties; preclude a party from presenting evidence; make an adverse inference against a party; assess postponement and forum fees; and assess attorneys' fees, costs and expenses.[123] The panel may also dismiss a claim,

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120 See id.

121 See, e.g., FINRA Rule 1010(c)(2)(A)-(B) and FINRA By-Laws, Article V, Sections 3(a) and 3(b).

122 See proposed Rules 12805(c)(6) and 13805(c)(7). The Guidance also suggests that arbitrators should ask the associated person seeking expungement or the party seeking expungement on an associated person's behalf to provide a current copy of the BrokerCheck report for the person whose record would be expunged, paying particular attention to the "Disclosure Events" section of the report. See Guidance, supra note 3. FINRA continues to encourage arbitrators to request a current copy of the associated person's BrokerCheck report.

123 See also FINRA Rule 13212(a).

defense or arbitration with prejudice as a sanction for material and intentional failure to comply with an order of the panel if prior warnings or sanctions have proven ineffective.[124]

Further, a member or an associated person could be subject to disciplinary action for failure to produce requested documents.[125] In addition, under the Interpretive Material of the Codes, it may be deemed conduct inconsistent with just and equitable principles of trade and a violation of FINRA Rule 2010 for a member or a person associated with a member to fail to appear or to produce any document in his possession or control as directed pursuant to provisions of the Code.[126] For these reasons, FINRA has determined not to modify the Proposal as suggested.

## XIV. Forum Fees

The Proposal would incorporate the current requirements into FINRA Rules 12805(d) and 13805(d) that address how DRS arbitration forum fees are assessed in expungement hearings. Specifically, the panel must assess against the parties requesting expungement all DRS arbitration forum fees for each hearing session in which the sole topic is the determination of the appropriateness of expungement.[127]

SIFMA 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. 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.[128] 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.[129] Accordingly, amendments to the expungement fees are not warranted.

FSI stated that, where firms have already paid the fee in a customer arbitration, an associated person seeking expungement in a straight-in request (particularly, where an unnamed person is not made aware of the customer arbitration, where the customer and firm settle or the customer arbitration is dismissed) should not be required to pay another full fee for a straight-in expungement request. As discussed above, the party who files an expungement request is

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124 See FINRA IM-12000(c), FINRA Rule 12212(c), FINRA IM-13000(c) and FINRA Rule 13212(c).

125 See FINRA Rules 12212(b) and 13212(b).

126 See FINRA IM-12000(c) and IM-13000(c).

127 See proposed Rules 12805(c)(9) and 13805(c)(10); see also Proposal, 87 FR 50170, 50185.

128 See FINRA Rules 12901(a)(3), 12903(c), 13901(c) and 13903(c).

129 See also Minimum Fees for Expungement, supra note 13.

assessed the non-monetary filing fee.[130] As FINRA explained in the Proposal, if the associated person, or the requesting party in the case of an on-behalf-of request, files a straight-in request after having previously paid the filing fee to request expungement of the same customer dispute information during a customer arbitration that settles or is dismissed, FINRA would not assess a second filing fee when the associated person files the straight-in request.[131]

## XV. Amend FINRA Rule 2080 Grounds for Expungement

NASAA and Caruso suggested that the Proposal should amend FINRA Rule 2080. NASAA expressed concern that "the fundamental flaws with FINRA Rule 2080 will continue to exist even if this Proposal is adopted," because the Proposal is not narrowing the grounds for expungement nor ensuring that expungement is intended to serve as an extraordinary remedy granted solely in extremely limited circumstances. Caruso recommended amending FINRA Rule 2080(b)(1) to add another ground to serve as a basis for the panel to award expungement relief.[132]

FINRA Rule 2080 is not part of the Codes, and FINRA is not proposing amendments to FINRA Rule 2080 at this time. However, as discussed above, the Proposal would revise the current language in FINRA Rules 12805 and 13805 to list explicitly the three narrow grounds in FINRA Rule 2080(b)(1) as the exclusive grounds for awarding expungement in the DRS arbitration forum.

In addition, FINRA anticipates that as it moves forward with its ongoing dialog with interested parties to improve and develop an alternative to the current expungement process, proposed changes to FINRA Rule 2080 will be included within that discussion.[133]

## XVI. Additional Comments

### A. Aggregate Effect of the Proposal and FINRA Rule 4111 on Member Firms

Hennion expressed concern about the effect the Proposal, if approved, and FINRA Rule 4111, combined, would have on member firms.[134] Hennion commented, with respect to FINRA Rule 4111, that "the regulatory presumption is that a complaint is valid and it is automatically counted against a Firm on an annual basis for the next five (5) years." Hennion added that

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130 See supra Section I.C. (Impact of Costs on Expungement Requests).

131 See Proposal, 87 FR 50170, 50179 n.95.

132 Caruso suggested amending the Proposal to provide that "the Claimant did not sustain its burden of proof to support the claim, allegation or information that has been presented."

133 See Discussion Paper, supra note 15 (exploring potential alternatives to the current expungement process, including potential changes to FINRA Rule 2080).

134 But see FSI (commenting that "various financial industry regulators would benefit from coordination to permanently ban bad actors from having access to investors" and that "[t]his proposal appears to be an important step forward in such coordination").

"[u]pon hitting a certain threshold [in FINRA Rule 4111], the Firm's ability to continue into business may be called into question and the representative may in fact be 'culled' from the firm to save itself." Hennion summarized that "maintaining customer complaints on a representative's license . . . may further accelerate the removal of firms and individuals from the marketplace."

FINRA believes that Hennion greatly overstated the potential FINRA Rule 4111 impacts of a registered person's customer complaint disclosure.[135] FINRA Rule 4111 establishes a multi-step, annual process through which FINRA will determine whether a member firm raises investor protection concerns substantial enough to require that it be designated as a "Restricted Firm" and subject to additional obligations. Each year's process begins with a calculation of which firms meet the "Preliminary Criteria for Identification," which are numeric thresholds based on firm-level and individual-level disclosure events (that occurred within a lookback period) to identify member firms with a significantly higher level of risk-related disclosures as compared to similarly sized peers.[136] The criteria includes—among numerous other events—certain arbitration awards, civil judgments, and settlements at or above $15,000 that are reportable on the registered person's Uniform Registration Forms.[137] Meeting the Preliminary Criteria for Identification does not mean, however, that the firm is a Restricted Firm.[138] Rather, a firm that meets the criteria, and that remains subject to the FINRA Rule 4111 process after an initial evaluation by the Department of Member Supervision, has several ways to affect outcomes during subsequent steps in the process, including a one-time staff-reduction opportunity and a consultation.[139] A member firm is not a Restricted Firm unless and until it is designated as such in a decision of the Department of Member Supervision.[140]

FINRA Rule 4111 is expected to directly impact a relatively small number of member firms and registered persons and—contrary to Hennion's suggestion—is not designed nor intended to "remove firms and individuals from the marketplace." At the time FINRA proposed FINRA Rule 4111, it explained that 1.3-2.0 percent of all member firms would have met the Preliminary Criteria for Identification during a review period, had the criteria been in place at the time and that the number was decreasing over time.[141] FINRA also explained that the anticipated

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135 If by "customer complaint" and "complaint," Hennion is referring to *pending* customer complaints, the FINRA Rule 4111 annual calculation does not count *pending* customer complaints. See FINRA Rules 4111(i)(4)(B) and (i)(4)(E).

136 See Regulatory Notice 21-34 (September 2021); see FINRA Rules 4111(b) and 4111(i)(9).

137 See FINRA Rule 4111(i)(4)(A)(i) and (ii); see also FINRA Rule 4111(i)(4)(D).

138 See FINRA Rule 4111 FAQ 1.1, https://www.finra.org/rules-guidance/key-topics/protecting-investors-from-misconduct/faq.

139 See Regulatory Notice 21-34; see also FINRA Rules 4111(c) and (d).

140 See FINRA Rule 4111(e).

141 See Securities Exchange Act Release No. 90527 (November 27, 2020), 85 FR 78540, 78553 (December 4, 2020) (Notice of Filing of File No. SR-FINRA-2020-041).

economic impacts of FINRA Rule 4111 on firms hiring and registered persons seeking employment would likely be limited to a small proportion of firms and registered persons, adding that "the vast majority of member firms, approximately 98 percent, would likely be able to employ most of the individuals seeking employment in the industry—including ones who have some disclosures—without coming close to meeting the Preliminary Criteria for Identification."[142] Moreover, FINRA Rule 4111 is intended to provide incentives for firms with a significant history of misconduct to change behavior, not put firms in jeopardy.[143] As an example, when the Department of Member Supervision determines a maximum Restricted Deposit Requirement to impose on a Restricted Firm pursuant to FINRA Rule 4111, the amount must, among other things, "not significantly undermine the continued financial stability and operational capability of the firm as an ongoing enterprise over the next 12 months."[144]

B. Expungement of Forms U4 and U5 Termination Information

Cambridge, Howe, Sonnier and Karis suggested that FINRA develop standards and rules similar to FINRA Rules 2080 and 12805 to address expungement of employment-related termination information reported to the CRD system through Forms U4 and U5. Cambridge also recommended that FINRA "include training on [expungement of] U5 [termination information] in the enhanced [expungement] training that would be required in order to be included on the Special Arbitrator Roster," and further recommended "that arbitrators from the Special Arbitration Roster be appointed in U5 expungement cases." Moreover, Cambridge suggested that FINRA adopt "a safe harbor provision protecting firms from defamation awards [as part of] the expungement framework."

FINRA recognizes that expungement requests involving employment-related information, particularly the circumstances surrounding the termination of an associated person's employment, present a unique set of challenges in the forum.[145] However, the focus of the

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142 See id. FINRA acknowledged that registered persons with a significant number of disciplinary or other disclosure events on their records may find it difficult to retain employment, or get employed by new firms (particularly where those firms and their registered persons already have disciplinary records), and that firms meeting the Preliminary Criteria for Identification or close to meeting the criteria may find it difficult to hire registered persons with disclosure events. Id.

143 See id. at 78558.

144 See FINRA Rule 4111(i)(15)(A).

145 The requirements of FINRA Rule 2080 and the procedural requirements under FINRA Rules 12805 and 13805 do not apply to intra-industry expungement requests unless the information to be expunged involves customer dispute information. However, as FINRA explains in its Arbitrator's Guide and in a The Neutral Corner article, associated persons may request expungement of the reason for termination reported on their CRD records by a former employer. See FINRA DRS Arbitrator's Guide, https://www.finra.org/sites/default/files/arbitrators-ref-guide.pdf; see also The Neutral Corner, Volume 2 (2010),

Proposal is to amend the current process relating to expungement of customer dispute information. Thus, FINRA declines to expand the Proposal as suggested by the commenters.

C. Data Reported on Uniform Registration Forms

Several commenters[146] expressed concerns with some of the specific events that must be disclosed on the Uniform Registration Forms.[147] FINRA acknowledges the commenters' concerns. However, the Proposal is focused on the expungement of customer dispute information from the CRD system not on what must be disclosed on the Uniform Registration Forms. In addition, FINRA notes that Forms U4 and U5 were developed by FINRA, NASAA and state securities regulators. Any amendments to these Forms would require collaboration with, and agreement among FINRA, NASAA and state securities regulators before being filed with the SEC for approval.

**Conclusion**

FINRA is committed to strengthening the current expungement process so that it works as intended—as a remedy that is appropriate only in limited circumstances and in accordance with the narrow standards in FINRA rules. FINRA believes the Proposal will help achieve this goal. Protecting the integrity and accuracy of the information in the CRD system is essential to FINRA's mission of investor protection.

If the SEC approves the Proposal, and as FINRA gains experience with the expungement process as revised by the Proposal, FINRA will continue to evaluate whether there are other ways to further strengthen the current expungement process. In addition, FINRA intends to provide information on its website regarding expungement requests.[148] FINRA also welcomes continued engagement with interested parties on expungement, including on potential alternative frameworks to the current expungement process.

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FINRA believes that the foregoing responds to the material issues raised by the commenters on the Proposal. If you have any questions, please contact me on 202-728-8151, email: Mignon.McLemore@finra.org.

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https://www.finra.org/sites/default/files/Publication/p121538.pdf. In addition, associated persons may comment on customer complaints on Forms U4 and U5, and through BrokerCheck. See supra note 65.

146 Barber, Grebenik, Howe, O'Bannon, T. Robbins and Webber.

147 The uniform registration forms are Form BD (Uniform Application for Broker-Dealer Registration), Form BDW (Uniform Request for Broker-Dealer Withdrawal), Form BR (Uniform Branch Office Registration Form), Form U4, Form U5 and Form U6 (Uniform Disciplinary Action Reporting Form).

148 Caruso, Miami and NASAA.

Sincerely,

/s/ Mignon McLemore

Mignon McLemore
Associate General Counsel
Office of General Counsel

**Attachment A: Alphabetical List of Commenters to File No. SR-FINRA-2022-024**

1. Charles Altizer, ("Altizer") (August 30, 2022)

2. Louis Ambrosio, ("Ambrosio") (August 30, 2022)

3. Ross Anderson, ("Anderson") (August 30, 2022)

4 Anonymous, PlanMember Sec, ("Anonymous") (August 30, 2022)

5. Michael P. Austin, CFP, ("Austin") (October 11, 2022)

6. Josh Barber, ("Barber") (August 24, 2022)

7. Ronald Beckner, Raymond James Financial Services, ("Beckner") (October 12, 2022)

8 Celiza Brangança & Jason R. Doss, The PIABA Foundation, Inc., ("PIABA Foundation") (September 6, 2022)

9. Jennifer W. Burke, Hennion & Walsh, Inc., ("Hennion") (September 6, 2022)

10. Kevin M. Carroll, The Securities Industry and Financial Markets Association, ("SIFMA") (September 2, 2022)

11. Steven B. Caruso ("Caruso") (August 18, 2022)

12. Frederick J. Dawson, Raymond James Financial Services, ("Dawson") (August 30, 2022)

13. Michael S. Edmiston, Public Investors Advocate Bar Association, ("PIABA") (September 6, 2022)

14. Benjamin P. Edwards, University of Nevada, Las Vegas, William S. Boyd School of Law, ("Edwards") (September 6, 2022)

15. Scott Eichhorn, Melanie S. Cherdack, Hillary R. Gabriele & Michael A. Newell, University of Miami, School of Law, ("Miami") (September 6, 2022)

16. Randall Evans, ("Evans") (October 8, 2022);

17. Jen Ferguson, Symphony Financial Team, ("Symphony") (August 30, 2022)

18. Samantha Giuglianotti, Anastasia Greer, Daniel Khaldarov & Christine Lazaro, St. John's University School of Law, ("St. John's") (September 6, 2022)

19. Tosh Grebenik, ("Grebenik") (August 30, 2022)

20. D. Lee Greer, Lee Greer Wealth Management, ("Greer") (October 13, 2022)

21. David Holland, ("Holland") (August 30, 2022)

22. Trish Howe, Howe Financial Advisory, LLC, ("Howe") (August 30, 2022)

23. William A. Jacobson, Evangeline Charles & Louis Akra, Cornell University Law School, ("Cornell") (September 6, 2022)

24. Gregory J. Karis, ("Karis") (August 16, 2022)

25. Dochtor D. Kennedy, AdvisorLaw, LLC, ("AdvisorLaw") (August 24, 2022)

26. KK Financial Solutions, ("KK Financial") (August 17, 2022)

27. Melanie Senter Lubin, North American Securities Administrators Association, Inc. ("NASAA") (September 6, 2022)

28. Jesse Lunin-Pack, ("Lunin-Pack") (August 30, 2022)

29. James Maher, Maher Financial, ("Maher") (August 23, 2022)

30. Edward J. Mcmahon, ("Mcmahon") (August 31, 2022)

31. Seth A. Miller, Cambridge Investment Research, Inc., ("Cambridge") (September 6, 2022)

32. Richard Mitchell, ("Mitchell") (August 30, 2022)

33. Michael Neal, M.A. NEAL Financial Services, ("Neal") (August 31, 2022)

34. John O'Bannon, Diversified Financial Group, ("O'Bannon") (October 11, 2022)

35. Douglas W. O'Connell, ("O'Connell") (August 23, 2022)

36. David E. Robbins, Kaufmann Gildin & Robbins LLP, ("D. Robbins") (August 20, 2022)

37. Thomas Robbins, ("T. Robbins") (August 16, 2022)

38. Lee Rycraft, ("Rycraft") (August 16, 2022)

39. Monte Snider, ("Snider") (August 24, 2022)

40. Scott Sonnier, ("Sonnier") (August 30, 2022)

41. Victoria Staudinger, ("Staudinger") (August 16, 2022)

42. Bruce E. Supernault, ("Supernault") (August 31, 2022)

43. Justine Tobin, Tobin Company Securities LLC, ("Tobin") (August 16, 2022)

44. Robin M. Traxler, Financial Services Institute, ("FSI") (September 6, 2022)

45. Meredith A. Webber, ("Webber") (August 31, 2022)