

Notice to Members

JUNE 2004

SUGGESTED ROUTING

Legal & Compliance
Registered Representatives
Senior Management

KEY TOPICS

Affidavits
Arbitration
Central Registration Depository System (CRD® or CRD system)
Customer Dispute Information
Dispute Resolution
Expungement
Rule 2110
Rule 2130

GUIDANCE

Expungement

Members' Use of Affidavits in Connection with Stipulated Awards and Settlements to Obtain Expungement of Customer Dispute Information under Rule 2130

Executive Summary

On December 16, 2003, the Securities and Exchange Commission (SEC) approved Rule 2130 governing the expungement of customer dispute information from the Central Registration Depository System (CRD® or the CRD system).¹ As described in further detail below, Rule 2130 applies to any request made to a court of competent jurisdiction to expunge customer dispute information from the CRD system that has its basis in an arbitration or civil lawsuit filed on or after April 12, 2004.²

This *Notice* addresses members' obligations under Rule 2130 regarding the use of affidavits in connection with settlements that are incorporated into stipulated awards to obtain expungement of customer dispute information from the CRD system under Rule 2130. For a more detailed discussion of Rule 2130's requirements, members and other interested parties should review *Notice to Members (NTM) 04-16* (March 2004) (Expungement). NASD also has published questions and answers about Rule 2130 on its Web site at www.nasd.com.

Questions/Further Information

Questions concerning this *Notice* may be directed to Richard E. Pullano, Associate Vice President/Chief Counsel, Registration and Disclosure, at (240) 386-4821; Jean I. Feeney, Vice President and Chief Counsel, NASD Dispute Resolution, at (202) 728-6959; or Shirley H. Weiss, Associate General Counsel, Office of General Counsel, Regulatory Policy and Oversight, at (202) 728-8844.

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Background

Rule 2130 reflects NASD's commitment to maintaining a CRD system that provides public investors and regulators access to accurate information about firms and brokers and maintains the integrity of the arbitration process. Rule 2130 recognizes the interests of: (1) NASD, the states, and other regulators in retaining broad access to customer dispute information to fulfill their regulatory responsibilities and investor protection obligations; (2) the brokerage community and others in a fair process that recognizes their stake in protecting their reputations and permits expungement from the CRD system when appropriate; and (3) investors in having access to accurate and meaningful information about firms and brokers with which they conduct, or may conduct, business.³ All of these groups have a common interest in a CRD system that contains accurate and meaningful information.

Rule 2130 protects the ability of all CRD users to obtain meaningful data about members and registered persons by permitting customer dispute information to be expunged from the CRD system only when arbitrators and a court have affirmatively found that: (1) the information, claim, or allegation 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.

Stipulated Awards and Settlements

NASD has recently become aware of instances in which claimants and respondents appear to be settling customer claims for monetary compensation to the claimant in return (at least in part) for a customer affidavit that absolves one or more of the respondents of responsibility for any alleged wrongdoing.⁴ These affidavits, attested to in connection with settlements that often are incorporated into stipulated awards, appear to be inconsistent on their face with the initial claim and terms of the settlement.

NASD cautions its members and their associated persons that when they submit affidavits in which the content is the product of a bargained-for consideration as opposed to the truth, members and/or their associated persons subject themselves to a panoply of applicable sanctions, including possible disciplinary action for violation of NASD Rules, including Rule 2110, and other penalties, including possible criminal sanctions.⁵

NASD is taking the following actions in response to this issue. First, arbitrators will be receiving training that alerts them to this concern. As further described in *NtM 04-16*, with respect to cases filed on or after April 12, 2004, arbitrators must make affirmative findings based on one (or more) of the standards in Rule 2130 in order for NASD to waive participation in the court confirmation process. The training required of arbitrators who consider expungement relief will make clear that arbitrators are expected to consider whether a financial settlement indicates some culpability on the part of the respondent, thereby precluding them from making an affirmative finding that one or more of the standards for expungement in Rule 2130 have been met. The training also will advise arbitrators to consider the original claim, any other evidence presented, and the settlement terms in assessing the credibility of a supporting affidavit.

Second, when advised by the parties of a request for court confirmation of an arbitration award containing expungement relief, NASD will require the party requesting a waiver under Rule 2130 to provide, in addition to the arbitration award, a copy of the claim and all settlement documents and affidavits. Under Rule 2130, parties are required to name NASD and serve NASD with all appropriate documents. Upon request, NASD may waive the parties' obligation to name NASD as a party. NASD will not, however, waive its participation in the court confirmation proceeding unless and until NASD staff has reviewed all appropriate documents and determined that the expungement relief is based on one or more of the standards in Rule 2130. Thus, parties will be required to submit these documents notwithstanding any confidentiality provision in the settlement documents. NASD staff will review these documents to determine if granting a waiver is appropriate under the specific circumstances of the case. If NASD decides not to waive the requirement to be named as a party in the court confirmation process, the party seeking expungement would then name NASD as a party, NASD would appear in court to oppose the expungement, and the court would decide whether or not to order expungement.

Third, as stated above, NASD believes that abusing NASD's dispute resolution system by negotiating settlements with customers in return for exculpatory affidavits that the member or associated person knows or should know are false or misleading contravenes Rule 2110, which requires members and their associated persons, in the conduct of their business, to observe high standards of commercial honor and just and equitable principles of trade.⁶ Accordingly, members and associated persons who engage in this conduct may be subject to disciplinary action by NASD's Department of Enforcement.

Endnotes

- 1 SEC Order Granting Approval of Proposed Rule Change and Amendment No. 1, Thereto, and Notice of Filing and Order Granting Accelerated Approval to Amendment No. 2, Thereto, Relating to Proposed NASD Rule 2130 Concerning the Expungement of Customer Dispute Information From the Central Registration Depository System, 68 Fed. Reg. 74667 (Dec. 24, 2003) Exchange Act Release No. 48933 (File No. SR-NASD-2000-168 (Dec. 16, 2003), 68 Fed. Reg. 74667 (Dec. 24, 2003).
- 2 All requests to expunge customer dispute information from the CRD system arising from arbitrations or civil lawsuits filed before April 12, 2004, including any settlements arising therefrom, will continue to be subject to the terms of the moratorium in effect as of January 19, 1999, as discussed in *Notice to Members 99-09* (February 1999).
- 3 Although public investors do not have access to the CRD system, the information in that system is available to investors through NASD BrokerCheck and individual state disclosure programs.
- 4 Because these cases were filed before April 12, 2004, they are not subject to the requirements of Rule 2130, including the notice requirements contained therein. As further discussed in *NtM 04-16*, under Rule 2130, members and associated persons seeking a court order to expunge information must name NASD as an additional party and serve NASD with all appropriate documents unless NASD waives that requirement.
- 5 NASD further cautions that individuals not subject to NASD jurisdiction who submit false affidavits also are subject to significant sanctions from the arbitration panel or court, law enforcement agencies, state bar association or other attorney disciplinary bodies (in the case of attorneys), or others.
- 6 As a general matter, in connection with settling arbitration claims and/or other complaints, members may not engage in any conduct that impedes the ability of NASD or any other securities industry regulator to investigate potential violations of NASD rules or the securities laws. Such conduct would include the use of impermissible confidentiality provisions in settlement agreements, the imposition of a requirement that customers withdraw complaints to NASD or other securities regulators as a condition to settlement, and procuring, as a condition to settlement, affidavits or other statements from customers that falsely or misleadingly repudiate or otherwise contradict prior claims or complaints made by such customers. Members are advised to review *Notice to Members 04-44* for further discussion of these issues.

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