Financial Industry Regulatory Authority

June 11, 2008

Nancy M. Morris
Secretary
U. S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

Re: File No. SR-FINRA-2008-010 – Proposed Rule Change to Adopt Rule 12805 of the Code of Arbitration Procedure for Customer Disputes and Rule 13805 of the Code of Arbitration Procedure for Industry Disputes to Establish New Procedures for Arbitrators to Follow When Considering Requests for Expungement Relief; Response to Comments

Dear Ms. Morris:

The Financial Industry Regulatory Authority, Inc. ("FINRA") hereby responds to the comment letters received by the Securities and Exchange Commission ("SEC") with respect to the above rule filing. In this rule filing, FINRA is proposing to adopt Rule 12805 of the Code of Arbitration Procedure for Customer Disputes ("Customer Code") and Rule 13805 of the Code of Arbitration Procedure for Industry Disputes ("Industry Code") (collectively, the "Codes") to establish new procedures that arbitrators must follow when considering requests for expungement relief under Rule 2130.[1]

Specifically, the proposal requires arbitrators considering an expungement request to:

- hold a recorded hearing session by telephone or in person;
- provide a brief written explanation of the reasons for ordering expungement;
- in cases involving a settlement, review the settlement documents to examine the amount paid to any party and any other terms and conditions of the settlement; and
- assess forum fees for hearing sessions held solely for the purpose of considering expungement against the parties requesting the relief.

[1] *See* Securities Exchange Act Rel. No. 57572 (March 27, 2008), 73 FR 18308 (April 3, 2008) (File No. SR-FINRA-2008-010, Notice of Filing of Proposed Rule Change to Establish New Procedures that Arbitrators Must Follow when Considering Expungement).

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The SEC received 11 letters.[2] Six commenters support the proposal[3] and five oppose it.[4]

One commenter contends that the proposal may enable a party requesting expungement to use expungement findings against a customer in a subsequent proceeding based on the doctrine of collateral estoppel.[5] The commenter requests that the rule proposal be modified to ensure that such findings cannot be used collaterally outside the expungement process. FINRA does not believe that it is appropriate to revise the proposal in such a manner because (1) FINRA does not have the authority to dictate how parties may use an arbitral finding after the arbitration has concluded; (2) other forums, particularly state and federal courts, are not bound to accept FINRA's determination with respect to the collateral use of arbitral findings even if it made recommendations in this area; and (3) expungement findings should be treated in the same manner as any other arbitral findings.

Three commenters expressed concern that if customer claimants do not participate in the expungement hearing, arbitrators will hear only the requesting party's position.[6] In response, FINRA notes that under the rule proposal customers will continue to have the opportunity to attend and participate in expungement hearings.[7] The panel, however,

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2 Comment letters were submitted by Seth E. Lipner, Professor of Law, Bernard M. Baruch College, CUNY, and Member Deutsch Lipner, dated April 8, 2008 ("Lipner letter"); Steven B. Caruso, Maddox Hargett Caruso, P.C., dated April 8, 2008 ("Caruso letter"); Jill Gross, Director, Pace University, Investor Rights Clinic, and Teresa Milano, dated April 15, 2008 ("Gross and Milano letter"); Raghavan Sathianathan, dated April 17, 2008 ("Sathianathan letter"); William A. Jacobson, Associate Clinical Professor, Director, Cornell Securities Law Clinic, Cornell Law School, and Arthur A. Andersen III, dated April 23, 2008 ("Jacobson and Andersen letter"); Barbara Black, Charles Hartsock Professor of Law, director of Corporate Law Center, University of Cincinnati dated April 24, 2008 ("Black letter"); Karen Tyler, President, North American Securities Administrators Association, North Dakota Securities Commissioner, dated April 24, 2008 ("NASAA letter"); Scott R. Shewan, Born, Pape Shewan, LLP, dated April 24, 2008 ("Shewan letter"); Barry D. Estell, dated May 7, 2008 ("Estell letter"), Brian N. Smiley, Smiley Bishop Porter LLP, dated May 8, 2008 ("Smiley letter"); and Laurence S. Schultz, President, Public Investors Arbitration Bar Association, dated May 16, 2008 ("PIABA letter").

3 *See* Caruso, Gross and Milano, NASAA, Shewan, Smiley and PIABA letters. While supporting the proposal, four of these commenters (NASAA, Shewan, Smiley and PIABA) recommend additional changes or revisions that are outside the scope of the rule filing as they pertain to other FINRA rules.

4 *See* Lipner, Sathianathan, Jacobson and Andersen, Black, and Estell letters.

5 *See* Jacobson and Andersen letter.

6 *See* NASAA, Jacobson and Andersen, and Estell letters.

7 Even if a customer does not wish to attend or participate in a hearing (either in person or telephonically), the customer still may submit a written statement to the panel regarding the issue of expungement.

does not have the authority to compel customers to participate in the hearing process. In such instances, the arbitrators would conduct a hearing and the party requesting expungement would be required to present evidence to support an award in his or her favor. Arbitrators are trained to conduct ex parte hearings. In addition, FINRA will take several measures to ensure that arbitrators are prepared to perform the critical fact finding required by the rule proposal, whether or not a customer is present at the hearing.[8]

Several commenters raised issues that are outside the scope of the rule filing.[9] A number of commenters expressed various opinions on the expungement process under NASD Rule 2130[10] and on the reporting requirements under the uniform registration forms. One commenter alleged broker-dealer misuse of Forms U4 and U5. One commenter suggests that the proposed rule would change existing policy or practice surrounding the accessibility to or confidentiality of hearing transcripts.[11] Since these issues are outside the scope of the rule proposal, FINRA will not address them herein.

In conclusion, FINRA believes that the proposed rule change contains appropriate new procedures that arbitrators must follow when considering requests for expungement relief under NASD Rule 2130, and should be approved. The new procedures will add transparency and procedural safeguards designed to ensure that the extraordinary relief of expungement is granted only under appropriate circumstances, which should, in turn, enhance the integrity of the information in the CRD system.

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8 To help prepare arbitrators for the new rule requirements, FINRA plans to (1) notify all arbitrators of the changes; (2) update its expungement training program to reflect the changes encompassed by the rule proposal and encourage all of its arbitrators to take the training; (3) publish an article in *The Neutral Corner* explaining the new rule; and (4) conduct a call-in workshop during which staff will discuss the rule changes and allow arbitrators and mediators to ask questions about the rules.

9 *See* Jacobson and Andersen, Sathianathan, Shewan, Estell, Lipner, Black, PIABA, and NASAA letters.

10 *See* Securities Exchange Act Rel. No. 48933 (December 16, 2003), 68 FR 74667 (December 24, 2003), (File No. SR-NASD 2002-168, 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).

11 Currently, FINRA does not provide hearing transcripts to non-parties unless required to do so under subpoena or pursuant to a formal regulatory access request. This policy would not change under the rule proposal.

Thank you for the opportunity to respond to the comment letters. If you have any questions, please contact me by telephone at (212) 858-4481 or by email at margo.hassan@finra.org.

Very truly yours,

Margo A. Hassan
Counsel