

July 18, 2014

Kevin O'Neill
Deputy Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

**Re: File No. SR-FINRA-2014-020 (Prohibited Conditions Relating to
Expungement of Customer Dispute Information) – Response to Comments**

Dear Mr. O'Neill:

This letter responds to comments submitted to the Securities and Exchange Commission (“SEC” or “Commission”) regarding the above-referenced rule filing, a proposed rule change to adopt FINRA Rule 2081. The proposed rule change would prohibit member firms and associated persons from conditioning or seeking to condition settlement of a dispute with a customer on, or to otherwise compensate the customer for, the customer’s agreement to consent to, or not to oppose, the firm’s or associated person’s request to expunge such customer dispute information from the Central Registration Depository (“CRD®”).¹ The Commission received 15 comments in response to the proposal.²

¹ See Securities Exchange Act Release No. 71959 (April 17, 2014), 79 FR 22734 (April 23, 2014).

² See Letters from Steven B. Caruso, Maddox Hargett Caruso, P.C., dated April 21, 2014 (“Caruso”); Nicole G. Iannarone, Assistant Clinical Professor, Tim Guilmette, Student Intern, and Nataliya Obikhod, Student Intern, Georgia State University College of Law, dated May 1, 2014 (“Georgia State”); Ryan K. Bakhtiari, Aidikoff, Uhl and Bakhtiari, dated May 5, 2014 (“Bakhtiari”); Richard P. Ryder, dated May 5, 2014 (“Ryder”); Barry D. Estell, dated May 7, 2014 (“Estell”); Leonard Steiner, Steiner & Libo, PC, dated May 7, 2014 (“Steiner”); Philip M. Aidikoff, Aidikoff, Uhl and Bakhtiari, dated May 1, 2014 (“Aidikoff”); George H. Friedman, George H. Friedman Consulting, LLC, dated May 13, 2014 (“Friedman”); Jason Doss, President, Public Investors Arbitration Bar Association, dated May 13, 2014 (“PIABA”); David T. Bellaire, Executive Vice President and General Counsel, Financial Services Institute, dated May 14, 2014 (“FSI”); Andrea Seidt, Ohio Securities Commissioner and President, North American Securities Administrators Association, dated May 14, 2014 (“NASAA”); Jill Gross, Director, Elissa Germaine, Supervising Attorney, and Michelle Robinson, Student Intern, John Jay Legal Services, Inc., Pace University School of Law, dated May 14, 2014

A. General Support

The majority of commenters supported the proposal³ stating, among other things, that it is a step in the right direction,⁴ that it will help protect the integrity of the CRD system, and that it will increase disclosure of material information to investors.⁵ One commenter, Estell, while not expressly supporting or opposing the proposal, stated that expungement should not be allowed under any circumstances. Another commenter, Jacobowitz, also neither expressly supported nor opposed the proposal. Instead, Jacobowitz provided the results of his review of expungement requests in awards issued in the first nine months of 2013, and awards issued in the six months following the October 2013 publication of FINRA's expanded guidance to arbitrators ("Arbitrator Guidance").⁶

Some commenters who supported the proposal also expressed concerns, or requested clarification, regarding the application of the proposal. These comments and FINRA's responses to the comments are discussed in more detail below.

1. Rule's Enforceability

NASAA stated that the proposal does not indicate how FINRA would enforce the rule or what consequences firms and associated persons would face for failing to comply

("Pace"); Kevin M. Carroll, Managing Director and Associate General Counsel, Securities Industry and Financial Markets Association Small Firms Committee, dated May 14, 2014 ("SIFMA"); Ronald M. Amato, Amato Law Firm, LLC, dated May 15, 2014 ("Amato"); and Harry A. Jacobowitz, Database Manager, Securities Arbitration Commentator, Inc. ("SAC"), dated May 16, 2014 ("Jacobowitz").

³ See, e.g., Aidikoff, Amato, Bakhtiari, Caruso, Friedman, FSI, Georgia State, NASAA, Pace, PIABA, Ryder, SIFMA, and Steiner.

⁴ See, e.g., Amato, Georgia State, and Pace.

⁵ See, e.g., Amato, Bakhtiari, Caruso, and SIFMA.

⁶ See Notice to Arbitrators and Parties on Expanded Expungement Guidance, available at: <http://www.finra.org/arbitrationandmediation/arbitration/specialprocedures/expungement/>. Based on his review, Jacobowitz, a Database Manager at SAC, opined that arbitrators are treating expungement requests "more skeptically" since the publication of the Arbitrator Guidance.

with the rule. In particular, NASAA stated that it is concerned that firms or associated persons may “skirt the rule and include such conditions in cover letters or emails that remain unseen by arbitrators.” NASAA stated that it is also concerned that firms or their associated persons may enter into unrecorded oral agreements with customers that are never reviewed.

As FINRA stated in the rule filing, the proposal’s prohibition would apply to both written and oral agreements. In addition, the proposal would apply to agreements entered into during the course of settlement negotiations, as well as to any agreements entered into separate from such negotiations. Thus, the proposal would prohibit member firms and associated persons from conditioning or seeking to condition settlement of a dispute with a customer on the customer’s agreement to consent to, or not to oppose, a request for expungement relief, regardless of when or in what form such condition arises. In addition, FINRA notes that its Arbitrator Guidance encourages arbitrators to inquire whether a party conditioned settlement on an agreement not to oppose a request for expungement relief in determining whether to recommend expungement relief in settled arbitration claims.⁷ Moreover, after the Commission approves the proposal, FINRA would update the Arbitrator Guidance to incorporate the criteria of the new rule to help ensure that arbitrators are aware of the prohibition in the rule and to further emphasize the importance of arbitrators inquiring whether a party conditioned settlement on an agreement that the customer not oppose a request for expungement relief.

In response to NASAA’s concerns regarding the enforcement mechanisms that would apply for failing to comply with proposed Rule 2081, FINRA notes that a violation of the rule would subject member firms and their associated persons to a panoply of applicable sanctions, including possible disciplinary action for violation of FINRA Rules, including Rule 2010, and other penalties.⁸

2. Requests for Clarification

NASAA raised concerns that the proposed rule does not clearly define what it means to “condition settlement” on an agreement not to oppose settlement and requested that FINRA issue additional guidance clarifying to what extent, if any, agreements not to oppose expungement can remain terms in settlement agreements. As stated above, the

⁷ See Arbitrator Guidance, *supra* note 6 (stating that “Arbitrators should inquire and fully consider whether a party conditioned a settlement of the arbitration upon agreement not to oppose the request for expungement in cases in which the investor does not participate in the expungement hearing or the requesting party states that an investor has indicated that he or she will not oppose the expungement request”).

⁸ See FINRA Rule 8310.

proposed rule would prohibit member firms and associated persons from conditioning or seeking to condition settlement of a dispute with a customer, whether orally or in writing, on the customer's agreement to consent to, or not to oppose, the firm's or associated person's request to expunge such customer dispute information from the CRD system. Thus, the proposed rule would prohibit any such agreements from being terms in settlement agreements.

Another commenter, Ryder, stated that the proposed rule is over-broad in that a respondent in arbitration "should be able openly and legitimately to ask a claimant, in the course of the settlement process, to stipulate to the issue of expungement relief being withheld from the anticipated settlement for the purpose of further proceedings." Ryder stated that the right "to condition the settlement on the claimant's agreement to ask the arbitrators to consider the question of expungement relief" must be preserved. In addition, Ryder stated that respondents should "have the right to ask the settling claimant whether s/he intends to be present at the expungement proceedings" and "whether an attending claimant intends to oppose the relief or join in favor"

In its comment letter, SIFMA stated that member firms may choose, in appropriate cases, and at their discretion, to include recitals in settlement agreements to the effect that: (1) Respondent intends to seek expungement relief; (2) Such expungement request was not a condition of the settlement agreement; (3) Respondent has not paid any consideration related to the expungement request; and (4) Claimant may participate in the hearing on expungement if he/she so chooses. SIFMA requested FINRA's views and feedback on these recitals.

The proposed rule is intended to prevent the parties to a settlement agreement from "bargaining for" expungement relief as a condition to settlement. The proposal would not prohibit a respondent from including the recitals that SIFMA suggests as they would reinforce the concept that parties cannot offer or receive any consideration for expungement relief as a condition to settlement. As to Ryder's comments, the proposed rule would not prevent parties from clarifying in the settlement agreement that expungement is not addressed in the agreement. Further, it would not preclude a respondent from inquiring whether any party intends to support or oppose a request for expungement relief. Nevertheless, FINRA would consider any actions by a member firm to influence another party to a settlement agreement for purposes of obtaining expungement relief, whether expressly or otherwise, to be a potential violation of the proposed rule.

Finally, FINRA notes that, after Commission approval of the proposed rule, it would issue guidance, as needed, to clarify the rule's applicability to particular facts and circumstances as questions arise.

B. Requests for Additional Action

Some commenters who supported the proposal also expressed concerns regarding the expungement process more generally and encouraged FINRA and the SEC to take additional steps to help ensure that information is not improperly removed from CRD. For example, PIABA stated that FINRA's arbitrator training must be mandatory, and should be completed before an arbitrator considers any pending request for expungement. FSI stated that it is important that FINRA continue to provide extensive arbitrator training and clear guidance with respect to the expungement process and the appropriate analysis required when determining whether to recommend expungement.

FINRA notes that since the adoption of FINRA Rule 2080 in 2004, FINRA has required all arbitrators to take a training course on expungement, or be removed from the arbitrator pool. FINRA updated the arbitrator training materials in 2008 to incorporate the additional requirements of Rules 12805 and 13805 and required all arbitrators to complete an additional refresher training regarding these updated rules.

In February 2014, FINRA completely revised its arbitrator training on expungement, which is now available on FINRA's website at no charge to arbitrators.⁹ The mandatory training for new arbitrators emphasizes the importance of maintaining the integrity of the information in the CRD system and, in turn, BrokerCheck®, and the arbitrator's critical role in helping to ensure that the information available through those systems is accurate and meaningful. The revised training also addresses some of the suggestions made by PIABA in its October 2013 study about the materials arbitrators should review when considering expungement requests.¹⁰ In addition to requiring new arbitrators to take the revised training, FINRA has also encouraged all arbitrators to take the revised training before conducting any expungement hearings.

In addition to the updated expungement training, FINRA created a companion online Neutral Workshop on expungement¹¹ and published an article, focusing on the

⁹ See FINRA, Arbitration and Mediation, "Required Basic Arbitrator Training," available at: <http://www.finra.org/ArbitrationAndMediation/Arbitrators/Training/RequiredBasicArbitratorTraining/index.htm>. The downloadable PDF version is available on the Written Materials page of the Arbitrator Training section.

¹⁰ See PIABA Study: Stockbroker Arbitration Slates Wiped Clean 9 Out Of 10 Times When "Expungement" Sought In Settled Cases, available at: <http://piaba.org/system/files/pdfs/PIABA%20Expungement%20Study.pdf>.

¹¹ The audio file is available on FINRA's website at: <http://www.finra.org/ArbitrationAndMediation/Arbitrators/CaseGuidanceResources/DisputeResolutionAudioFiles/index.htm>.

topic of expungement, in *The Neutral Corner*,¹² a FINRA publication distributed to arbitrators and published on FINRA's website.

As noted above, after the Commission approves the proposal, FINRA would update its current expungement training to incorporate the criteria of the new rule, and the training would remain mandatory for new arbitrators and available to all arbitrators at no charge on the website. Further, FINRA would publish an article in *The Neutral Corner* explaining the requirements of the new rule and FINRA's expectations for compliance with it, and would encourage all arbitrators to take expungement training before conducting an expungement hearing. Finally, FINRA would continue to monitor the effectiveness of the training and other resource materials on expungement it has provided to the arbitrators and make any additions or changes as necessary.

With respect to other comments and suggestions regarding the expungement process more generally, PIABA recommended that FINRA ensure that arbitrators have made the appropriate inquiry of brokers during expungement hearings at which customers do not appear. Steiner suggested that FINRA require hearing panels to solicit, by letter or subpoena, testimony from the claimant. In addition, PIABA recommended that FINRA (and state securities regulators) play a more active role in arbitrators' rulings on motions for expungement relief. NASAA suggested that FINRA partner with it and move toward the adoption of additional substantive expungement rules, improve notice to regulators regarding expungement by implementing a pre-notice requirement, consider identifying categories of claims that are ineligible for expungement, and consider the creation of expungement-only arbitration or regulatory panels.

FINRA notes that it is continuously looking at ways to improve the expungement process and appreciates commenters' suggestions in this regard. Since these comments are outside the scope of the rule filing, however, FINRA will not address them herein.

C. Requirements for Expungement Relief

In its comment letter, SIFMA stated that, in the proposal, FINRA raises what could be viewed as a new and significantly expanded requirement for expungement relief. Specifically, SIFMA references language in the proposal relating to expungement of customer dispute information being appropriate when it "has no meaningful investor protection or regulatory value." SIFMA stated that "FINRA and our industry have long-relied upon . . . the three bases set forth in FINRA Rule 2080 as appropriate and sufficient grounds for granting expungement relief."

¹² See *The Neutral Corner*, "A Closer Look at Expungement: Asking the Right Questions," Jisook Lee, Volume 4-2013, available at: <http://www.finra.org/web/groups/arbitrationmediation/@arbmed/@arbtors/documents/arbmed/p410646.pdf>.

FINRA Rule 2080 provides that firms and associated persons seeking expungement of customer dispute information from the CRD system must obtain a court order that either directs expungement or confirms an arbitration award containing expungement relief. The Rule requires that firms and associated persons seeking such a court order or confirmation name FINRA as a party. Upon request, FINRA may waive the obligation to name it as a party if FINRA determines that the expungement relief is based on an affirmative judicial or arbitral finding that: (1) the claim, allegation or information is factually impossible or clearly erroneous; (2) the registered person was not involved in the alleged investment-related sales practice violation, forgery, theft, misappropriation or conversion of funds; or (3) the claim, allegation or information is false.

Expungement is extraordinary relief that should be granted in limited circumstances, only after a determination by an independent adjudicator that the matter in question meets one of the criteria in FINRA Rule 2080. FINRA's references to such relief being appropriate when the information to be expunged "has no meaningful investor protection or regulatory value" is not a new requirement. In developing the Arbitrator Guidance, and, in particular, the use of the "no meaningful investor protection or regulatory value" language, FINRA used language and interpretation from the proposal to adopt Rule 2130 (now FINRA Rule 2080) governing the expungement of customer dispute information from the CRD system.¹³ In its Response to Comments on the proposal to adopt Rule 2130, FINRA supported its goal of maintaining the integrity and accuracy of its CRD system by stating that it "recognize[d] that expungement of a CRD record under any condition is an extraordinary remedy and should only be used when the expunged information has no meaningful regulatory value."¹⁴ The Approval Order reinforced this concept by stating that adopting explicit criteria for expungement – the grounds listed in Rule 2080(b)(1)(A)-(C) – would strengthen the expungement process by ensuring that only information that is not valuable to regulators and investors is expunged from the system.¹⁵

Further, this reference is not intended to expand the criteria in Rule 2080. Rather, it is to emphasize the investor protection and regulatory concerns relating to expungement

¹³ See Exchange Act Release No. 48933 (Dec. 16, 2003), 68 FR 74667 (Dec. 7, 2003) (SEC Order Approving SR-NASD-2002-168).

¹⁴ See SR-NASD-2002-168, Amendment No. 2 to Proposed Rule 2130 Governing Expungement of Customer Dispute Information from the Central Registration Depository and Response to Comments, letter to Jonathan G. Katz, Secretary, SEC, from Shirley H. Weiss, Associate General Counsel, NASD.

¹⁵ See *supra*, note 13 at 74672.

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of customer dispute information from the CRD system. Thus, for example, if an arbitrator finds that a customer's claim and allegations of sales practice violations are meritorious and justify an award to a customer, such customer dispute information is likely to be valuable to regulators, the investing public, and to other securities firms that may be potential employers of the associated person who is the subject of the claim and allegations and, therefore, such information should be remain in the CRD system and available through BrokerCheck.

FINRA believes that the foregoing, along with the discussion in the rule filing, responds to the issues raised by the commenters. If you have any questions, please contact me at 202-728-8104.

Sincerely,



Victoria L. Crane
Associate General Counsel