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December 31, 2001

Barbara Z. Sweeney
Office of the Corporate Secretary
National Association of Securities Dealers, Inc.
1735 K Street, NW
Washington, D.C. 20006-1500

Re: NASD Notice to Members 01-65 – Comment on Proposed Rules and Policies For Expungement of Central Registration Depository ("CRD") Information

Dear Ms. Sweeney:

The Securities Industry Association ("SIA")[1] welcomes the opportunity to comment on NASD Notice to Members 01-65 ("Notice"), which seeks input from interested parties on NASD Regulation's ("NASDR") proposed rules, policies, and procedures for handling requests to expunge erroneous and/or unfounded customer dispute information from NASDR's Central Registration Depository ("CRD").

I. Introduction

As noted in the Notice, several constituencies and interests will be affected by any significant change to the CRD reporting system. Regulatory agencies and self-regulatory organizations clearly have a strong interest in maintaining a CRD system that is accurate, current, and comprehensive in light of their important public responsibilities. Member firms also utilize the CRD system in hiring and supervising registered representatives, and so too rely upon the integrity of the information contained therein. Similarly, private investors look to the public disclosure component of the CRD when making decisions to

[1] The Securities Industry Association brings together the shared interests of nearly 700 securities firms to accomplish common goals. SIA member firms (including investment banks, broker-dealers, and mutual fund companies) are active in all U.S. and foreign markets and in all phases of corporate and public finance. The U.S. securities industry manages the accounts of nearly 80 million investors directly and indirectly through corporate, thrift, and pension plans, and generates $358 billion of revenue. Securities firms employ approximately 760,000 individuals in the United States. (More information about SIA is available on its home page: http://www.sia.com.)

do business with a particular registered representative or firm.[2] Finally, registered representatives themselves have a keen interest in insuring that the CRD system reports truthful and well-founded customer dispute information. Accordingly, investors, regulators, registered persons, and firms all have a stake in ensuring that the CRD system is scrupulously fair, correct and current. For the reasons discussed below, SIA believes that the changes contemplated in the Notice do not achieve that objective.

Like NASDR, SIA shares the view that expungement is an "extraordinary" remedy, as it is the only means of purging factually incorrect information from a registered person's permanent record. We must not forget, however, that the CRD system itself is equally extraordinary and has no analog in any other professional or commercial field.[3] In contrast to other licensing disclosure systems, the contents of the CRD system are public, readily accessible and sweep in *unproven and unscreened* allegations for all to see.[4] Nor is there any limitations period after which unfounded accusations are automatically removed from the CRD system. Any allegation of a sales practice violation – irrespective of how old, frivolous, or facially incorrect – is captured by the CRD system and will remain there until the allegation is expunged.[5] As such, the CRD system is unquestionably unique, and it is this uniqueness that must inform any plan to alter the expungement remedy. SIA, therefore, echoes and applauds the concern expressed by NASDR that "compelling issues involving personal privacy and fundamental fairness" require "a fair process" for the removal of erroneous CRD information.

SIA also recognizes that not every expungement request may be appropriate. We too favor implementation of reasonable procedures that safeguard against the "misuse" of the expungement remedy by those who would intentionally seek to circumvent their reporting obligations. Such procedures could encompass NASDR-issued guidance to arbitrators on assessing expungement requests, as well as inclusion of such guidance in arbitrator training curriculum.

SIA cannot support, however, the expungement procedures enumerated in the Notice, as we believe them to be unduly burdensome, inefficient, and palpably unfair. Indeed, we find the proposed measures to be so cumbersome and costly that, we fear, the remedy essentially will fall into nonuse. In the end, CRD records will be fraught with inaccuracies and potentially misleading information that disserve investors, regulators,

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[2] Much of the information reported on the CRD system is made publicly available, either by NASDR though the Public Disclosure Program ("PDP") or by the SEC or individual state securities administrators.

[3] It is our understanding that neither doctors, lawyers, nor any other body of professionals are subject to a national system of public disclosure that reports even the flimsiest unproven allegation.

[4] Question 23I(l) of the Uniform Application for Securities Industry Registration and Transfer ("Form U-4") requires that registered representatives report any arbitration matter in which he or she is named as a respondent if the claim alleges a sales practice violation. It also requires reporting of all customer complaints, with narrow exception, which allege sales practice misconduct.

[5] Though limited categories of reportable items, such as stale customer complaints, ultimately "drop off" the PDP only, even this type of information is subject to public disclosure by the state securities regulators unless expunged from the CRD system.

member firms and registered personnel alike. Meanwhile, those registered persons unjustly or mistakenly accused of professional impropriety face substantial damage to reputation and business. Thus, while we appreciate NASDR's efforts to address these complex issues, any process that creates procedural impediments to the expeditious and inexpensive correction of a falsity is no solution and must be rejected.

As detailed below, SIA has several concerns with the proposed procedures. SIA's chief objections concern the mandatory court confirmation requirement, as well as NASDR's compulsory participation as a party in all expungement proceedings. Such mandates are an unwarranted, resource-inefficient appendix to what is intended to be a streamlined process. Moreover, they significantly diminish arbitrator power and undermine the credibility of the arbitration process generally. We also question both the appropriateness and utility of any process that permits NASDR and state regulators to second-guess the propriety of expungement decisions rendered by arbitrators. SIA also opposes the sharp curtailment of the availability of expungement in the vast majority of cases that are resolved through settlement rather than through a contested hearing. Finally, we find the proposed criteria for determining whether expungement is warranted to be too narrow.

II. Court Confirmation Undermines the Credibility of Arbitrators and the Arbitration Process

Among the most problematic features of the proposed procedures is that an expungement order contained within an arbitration award will be rendered meaningless unless confirmed by a court. Such confirmation proceedings, however, are both expensive and time consuming.[6] Having to bear that additional cost is especially vexing in cases involving expungement awards, because an arbitration panel has already determined that the underlying allegations were unfounded.

Much more troubling is the dangerous and unmistakable message that a mandatory external confirmation requirement sends – that is, arbitration panels cannot be trusted to apply the expungement remedy judiciously absent court oversight. Such a rule is ill conceived and runs directly counter to the expansive authority granted to arbitrators.

It is well settled that Federal Arbitration Act ("FAA") bestows upon arbitrators great latitude to fashion remedies and awards as they deem appropriate. 9 U.S.C. §§ 5, 9. It is not surprising, therefore, that federal courts consistently recognize arbitrators as "private judges," with no less freedom than a court of law. Such plenary power resounds

[6] As of January 1999, there has been an NASDR imposed "moratorium" on obeying expungement provisions in arbitration awards unless and until such awards are confirmed by court order. *See* NASDR Notice to Members 99-09. Though we understand that the moratorium was the product of extensive negotiations between NASDR and the North American Securities Administrators Association ("NASAA"), NASDR has always held that "obtaining a court order can *be time-consuming and expensive*" and "information that can be proven to be factually incorrect *should be* expunged from the CRD system without a court order." SEC Release No 34-42402; SR-NASD-99-45. (Emphasis added).

throughout the NASD Dispute Resolution Code of Arbitration Procedure (the "Code") as well. Specifically, the Code empowers NASD Dispute Resolution arbitrators to adjudicate all liability issues in a particular case and "award *any relief* that would be available in court under the law."[7] This includes compensatory and punitive damages, attorneys' fees,[8] and arbitration costs.[9] Arbitration panels also may make disciplinary referrals in instances of serious regulatory violations.

Moreover, once rendered, arbitration awards are considered by the NASD to be final adjudications, in full force and effect.[10] As such, awards must be paid in full within thirty days unless a motion to vacate is made in the appropriate court.[11] Failure to make prompt payment may result in suspension proceedings against the member firm or associated person. Notably, the Code does not obligate prevailing parties to seek court confirmation as a prerequisite to other arbitrator ordered relief. Yet, since January 1999, and as proposed in Notice, this is precisely the predicament in which falsely or inaccurately accused registered persons find themselves. Having finally been exonerated of any wrongdoing by a duly constituted arbitration panel, such individuals must still obtain court confirmation to remove the damaging information from their permanent public record.

Surely, if arbitrators can be trusted to reach binding decisions, award millions of dollars in compensatory and punitive damages, and make disciplinary referrals, they can be trusted to evaluate and grant expungement relief without need for court oversight.

In addition to court review, NASDR also proposes that anyone seeking to enforce an expungement award name NASDR as a party to the proceeding so (i) NASDR may undertake its own independent analysis of the propriety of the expungement relief ordered by the arbitrators, and (ii) state securities regulators are afforded the opportunity to object to such relief. Such a process, we believe, promises to open a Pandora's box of unintended consequences, not the least of which is the further and more substantial erosion of an arbitration process. By according to both itself and the state securities regulators the authority to review, object to, and seek to set aside part of an arbitration award, NASDR disserves an arbitration process that is intended to quickly, fairly, and inexpensively resolve securities disputes.[12]

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[7] Rule 10214.
[8] Rule 10215.
[9] Rules 10205 (c) and 10332(c).
[10] Rule 10330(b) reads: "Unless the applicable law directs otherwise, all awards rendered pursuant to this Code shall be deemed final and not subject to review or appeal."
[11] Rule 10330(h).
[12] The Notice states that NASDR and NASAA "jointly administer the CRD system" and that CRD "policy" is "established with NASAA and the SEC." SIA understands that the CRD system is the product of a private agreement between NASAA and NASDR. We also understand that the current proposal arises out of NASAA's reported assertion that the CRD system constitutes an official state "record" that cannot be altered by expungement. NASAA, however, has failed to proffer any meaningful authority in support of this "state-record" claim. Certainly, before we proceed down this dangerous path and substantially diminish the important role of arbitrators and the arbitration process generally, there should be a more convincing case than that which has been presented so far.

III. Proposed Rule is Unduly Burdensome, Costly, and Resource Inefficient

If adopted, the proposed court confirmation procedures will result in undue costs and delays in obtaining expungement relief. Confirmation proceedings will become expensive, adversarial retrials of issues already decided by arbitration panels. Parties will be forced to file longer and more substantial briefs, courts will require more extensive documentation of arbitration hearing records, oral arguments will not be uncommon, and appeals may well follow. Firms, especially smaller firms, having already incurred the expense of defending the registered employee in the original arbitration claim, may balk at committing additional resources necessary to get the expungement award confirmed in an adversarial court proceeding. Consequently, a registered representative would be placed in the undesirable position of having to choose between spending significant personal resources to pursue the confirmation, or living with a blemish on his or her CRD record that an arbitration panel has already ordered removed.

Nor will these additional costs be borne by member firms and their associated persons alone. Both NASDR and the state regulators will have to allocate substantial financial and administrative resources to ensure a uniform mechanism for the systematic reviews of expungement awards. Once named in a proceeding, NASDR also will have to contend with widely varying state procedural rules governing entering appearances, filing responsive pleadings and motion practice. This undoubtedly will necessitate local counsel, adding further to the mushrooming expense of what is intended to be a quick and efficient dispute resolution process. Interestingly, there is no discussion anywhere in the Notice of how NASDR or state regulators intend to staff and fund this component of the proposed procedures. SIA respectfully suggests that investor protection would be far better served by allocating state and NASDR resources for purposes other than participation in redundant state court proceedings.

Indeed, SIA believes the proposal to be ill-timed since it will place undue burdens on registered representatives and firms at a time of dramatic budget cuts. Now more than ever, it is imperative that unfairly or inaccurately accused registered persons be permitted to quickly and inexpensively expunge patently false allegations of professional misconduct from their permanent public record – especially, in instances of factual impossibility and clear error. SIA finds it particularly puzzling that NASDR would propose such resource-inefficient procedures in light of its current Rule Modernization Initiative.[13] As detailed above, interjecting additional layers of duplicative judicial and regulatory review depletes valuable administrative and economic resources from all segments of the securities industry while providing nominal benefit.[14] If for no other

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[13] NASD has recently appointed an Economic Advisory Board ("EAB") to assist the NASD in maximizing the benefit of its regulation while minimizing costs to both NASD and the industry. The EAB's mission is to create a process that subjects existing and prospective NASDR rules to a rigorous economic analysis that yields more efficient rulemaking.

reason, this alone requires rejection of the proposal. We therefore urge the NASDR to delete the proposed confirmation process and restore awards containing expungement provisions to the rightful status of every other arbitration award.

IV. NASDR Should Not Restrict the Availability of Expungement by Stipulated Award in Settled Cases

The issue of expungement relief by stipulated awards in settled cases is undoubtedly the thorniest problem posed by the Notice. SIA shares the NASDR's concerns over the potential "inappropriate use" of expungement in cases resolved through consent or mutual agreement. We too agree that culpable respondents should not be able to "buy" clean CRD records through the payment of large settlements.

To severely limit the availability of expungement in settled cases to only those involving "factual impossibility" or "clear error," however, is unnecessarily restrictive and may have an unintended chilling effect on the settlement process. Under the proposed criteria, NASDR would not expunge customer arbitration information in cases settled without an evidentiary hearing, unless first deemed to involve factual impossibility or clear error. Accordingly, a registered representative settling a case prior to hearing could not obtain expungement relief based upon the "without legal merit" or "defamatory" categories, as would otherwise be available after a formal hearing. In excluding these latter two criteria, NASDR reasons "it is unlikely that claimant's counsel would agree to such findings as part of the settlement."

The fact is, parties settle cases – including meritless cases – for many reasons, not the least of which is a desire to avoid the considerable time, effort and expense that litigation invariably entails. For example, a claimant, after document production, may better understand the facts in dispute (*i.e.*, the alleged unauthorized sales were actually proper margin liquidations) and consent to dismiss the claims against a particular claimant for little or no consideration. Such a scenario, however, would fall outside the scope of the proposed criteria for settled claims and not qualify for expungement relief, though entirely appropriate. Consequently, the unjustly named respondent would be forced to either forgo the expungement relief, or defend claims that otherwise would settle but for the unavailability of expungement.

Equally troubling with this aspect of the proposed rule is that it creates an inherent conflict of interest between the member firms and their registered representatives. Today, member firms routinely provide legal representation to their associated persons in customer dispute claims to reduce costs, as well as for ease of administration. Under the proposed regime, firms may be reluctant to represent multiple respondents knowing that, if the case settles, the unjustly named respondent may be foreclosed from obtaining expungement. Similarly, registered representatives may become obligated to retain

[14] SIA further believes that the proposal would not withstand the SEC's scrutiny under the cost/benefit standard established in Section 3(f) of the Securities Exchange Act of 1934.

separate counsel solely to preserve their expungement remedy, once again incurring needless expense.

A more reasonable solution is to require arbitrator review of *all* settled matters seeking expungement relief, using the same analysis applicable to weighing expungement requests in contested hearings. Arbitrators could be specifically directed to review all stipulated facts to determine the propriety of expungement relief. In no event should the full availability of the expungement remedy be contingent upon whether the parties reach a mutually agreeable resolution in advance of a full hearing. Rather, improperly named respondents should be able to settle cases and present the settlement terms to a single arbitrator or panel for evaluation and approval. If necessary, the arbitrator(s) may require a "mini-hearing" on the expungement issue, at which time the arbitrator(s) may request additional documentation, affidavits of witnesses, or other evidence that will assist in the determination of whether expungement is warranted under the circumstances.

At a minimum, NASDR should give effect to expungement relief contained within a stipulated award in any matter settled for nominal or no consideration. Such an approach, we believe, sufficiently resolves the concerns of NASDR without unduly burdening member firms and their registered representatives. It also addresses the difficulties presented by the customary pleading practice of many claimants' counsel.[15] Experience shows that claimants and their counsel routinely file complaints and/or claims with a garden variety of alleged wrongful acts, including fraud, misappropriation, and churning, without prior sufficient facts to substantiate either (i) the specific claims alleged or (ii) the culpability of the individual respondents named in the complaint. In addition, claimants will often list as respondents supervisors, managers, and compliance officers, as well as senior executives, even though there are no supervisory issues in dispute. Surely, if upon exchange of information or discovery it becomes evident that a particular respondent was unjustly named in a proceeding, then that respondent should be permitted – and indeed, encouraged – to pursue the fairest settlement possible, which may include a stipulated award containing an expungement relief.

V. The Proposed Expungement Criteria Are Too Narrow

NASDR specifically solicits comments on the proposed expungement criteria. As stated above, SIA strongly believes that the issue of whether expungement is warranted in a particular case is a matter best decided by the arbitrators selected to adjudicate that case. SIA also concurs that appropriate guidelines should be promulgated to assist arbitrators in weighing expungement requests and that a thorough discussion of those standards and their application should be included in the arbitrator training curriculum. We do not believe, however, that expungement should be predicated on specific factual

[15] In addition to preserving the expungement remedy, NASD Dispute Resolution should consider implementing better control measures to promote more responsible pleading by claimants and their counsel. One suggestion is to require claimants and their counsel to certify to a good faith basis for naming each of the respondents in the claim.

findings, particularly since arbitrators are not required to articulate the basis for other portions of the award. SIA, therefore, urges the NASDR to reconsider this aspect of the proposal. Should NASDR nevertheless decide that specific criteria are required, we recommend that NASDR give serious consideration to our specific comments below.

Factual Impossibility and Clear Error

SIA believes that the "factual impossibility" and "clear error" category is too narrow and should be expanded to address instances in which a respondent had no involvement with the account activity or transaction at issue (e.g. legal department personnel who responded to an initial customer complaint). In addition, we recommend that there be a category for claims against individuals who merely performed ministerial acts, made no recommendations, or were not personally responsible for the customer's losses (*e.g.*, the sales assistant who simply processed an unsolicited order). Finally, absent supervisory issues, we believe that NASDR should permit expungement of claims against CEOs, high level executives or managers who had no direct dealing with the customer or supervisory responsibility over the registered representative involved with the account or transaction at issue.

Without Legal Merit

SIA believes that the "without *legal* merit" category is also too narrow and should be clarified to include situations where the claim against *the particular individual named* is without merit. There are many claims that may have merit against the firm as a whole or against other associated persons but not with respect to a particular named respondent. This category should also cover situations where the arbitrators have found that the *facts* did not support the claims. For example, allegations were reported that an associated person stole funds from a joint account but the facts established at the hearing prove that the claimant merely was unaware of her joint tenant's withdrawals. Another example would be naming as a respondent a member of a financial advisory team when the facts prove that the associated person never dealt with the claimant. In order to encompass claims that are without factual support, SIA suggests renaming the category from "without legal merit" to "*the claim against a particular respondent is without merit.*"

Defamatory In Nature

SIA also is of the view that the "defamatory in nature" category should be expanded to permit a finding of "false or defamatory in nature." This will give the arbitrators another reasonable basis for ordering expungement. Allegations found to be false should not be permitted to remain on someone's CRD record.

VI. Conclusion

The Committee appreciates the opportunity to provide comments on the proposed expungement procedures. Although we commend NASDR for their efforts to address this complex issue, we believe the proposed procedures are fraught with difficulties that do not adequately balance the legitimate concerns of all impacted constituencies.

While it is clear that the integrity of the CRD system must be protected and that respondents should not be able to expunge valid claims of professional misconduct, it is equally plain that wrongly accused respondents must have unfettered access to the only remedy that can remove the blight of a false claim from a very public and unique record. The solution to the apparent tension between these interests does not lie in erecting barricades to the availability of expungement relief in the form of narrow and overly stringent limitations. Nor does it lie in imposing an onerous confirmation process that improperly invites review of arbitration awards by NASDR staff, state regulatory agencies, and the courts. Rather, the answer may be found in promulgating fair guidelines for expungement, training arbitrators on the meaning and proper application of those guidelines, and then trusting arbitration panels to continue to do what they have done so well for many years – render fair, impartial, and *final* decisions.

We hope this letter has been helpful and look forward to working with NASDR to craft a workable solution that meets the important goals of the proposed procedures. If we can provide any further information or clarification of points made in this letter, please contact me or Amal Aly, Associate General Counsel, at (212) 618-0568.

Sincerely,

Stuart J. Kaswell
Senior Vice President
and General Counsel

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