



May 21, 2012

By Email (pubcom@finra.org)

Marcia E. Asquith
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506

Re: FINRA Regulatory Notice 12-18, Request for Comment on Proposed New *In Re*
Expungement Procedures for Persons Not Named in a Customer-Initiated Arbitration

Dear Ms. Asquith:

The Securities Industry and Financial Markets Association (“SIFMA”)¹ appreciates the opportunity to furnish this letter in response to FINRA Regulatory Notice 12-18 (“Notice 12-18”). Notice 12-18 seeks comments on proposed new rules that would establish a procedure to permit persons who are not parties to a customer arbitration, but who are the “subject of” alleged sales practice violations that are required to be reported to the Central Registration Depository (“CRD”), to obtain expungement relief through an *In re* proceeding at the conclusion of the underlying customer arbitration.

Subject to our comments below, SIFMA supports FINRA’s proposed rules establishing a process to file and prosecute *In re* expungement applications. SIFMA shares FINRA’s stated understanding in Notice 12-18 that such rules are necessary to “provide unnamed persons with a remedy to seek redress concerning allegations that could impact their livelihoods,” while at the same time balancing that need against FINRA’s desire to “ensure the integrity of the CRD records on which the investing public relies.”²

Registered persons in the securities industry are subject to comprehensive reporting and disclosure requirements that are unlike those in virtually all other professions. These reporting and disclosure requirements have been the subject of detailed rulemaking at the federal, state and SRO levels as regulators and the industry have worked towards the development of a reporting and disclosure regime designed to provide the public with relevant information to aid in their

¹ SIFMA brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA’s mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (“GFMA”). For more information, visit www.sifma.org.

² FINRA Regulatory Notice 12-18, p. 1 (April 2012).

selection of financial firms and representatives. Throughout the development of these disclosure requirements, and while recognizing the positive goal of promoting informed investor decision-making, SIFMA has cautioned against disclosure requirements that do not advance the goal of providing relevant information and, worse, risk the dissemination of unfounded negative information that can have an adverse impact on a registered person's business and reputation.³

FINRA's current expungement rules offer a registered person an opportunity, through a neutral fact-finding process, to have information "arising from disputes with customers" removed from his or her CRD record (i) that is factually impossible or clearly erroneous; (ii) where the registered person was not involved in the alleged investment-related sales practice violation, forgery theft, misappropriation or conversion of funds; or (iii) where the claim, allegation or information is false.⁴ This process, developed following the January 1999 NASD moratorium requiring arbitrator-ordered expungements to be confirmed by a court of competent jurisdiction, was implemented in April 2004 through the enactment of NASD Rule 2130 (now FINRA Rule 2080). NASD Notice to Members 04-16 stated that the expungement rules were designed to take into account three "competing" interests, including (i) the interests of the states and NASD to have broad access to customer dispute information to fulfill their regulatory responsibilities, (ii) the interests of investors in "having access to accurate and meaningful information about brokers with whom they conduct, or may conduct, business," and (iii) "the interests of 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."⁵

With these prefatory comments in mind, SIFMA offers the following comments:

FINRA Should Establish an Equivalent Procedure for the Expungement of Unfounded Claims in Written Customer Complaints and Civil Litigation

SIFMA appreciates FINRA's recognition that procedural impediments to the pursuit of expungement claims by "unnamed persons" in customer arbitrations may render relief practically unavailable to persons with valid grounds for expungement. However, while the *In re* process as proposed provides a remedy for "unnamed persons" in customer arbitrations, SIFMA strongly believes that the rationale for implementing an *In re* process for customer arbitrations applies with equal force to other "disputes with customers" involving written customer complaints and civil litigation. False or misleading allegations that can harm a registered person's business or reputation may appear in either the body of a filed arbitration claim or in a written customer complaint to a firm. A fair and efficient expungement remedy should be available to all registered persons that are the subject of unfounded claims, in whatever form they take.

³ Most recently, SIFMA has provided FINRA with comments on ways to facilitate and increase investor use of the BrokerCheck system. See, SIFMA Letter to Marcia Asquith Commenting on Regulatory Notice 12-10, April 5, 2012, available at <http://www.sifma.org/issues/item.aspx?id=8589938247>.

⁴ FINRA Rule 2080(b)(1)(A)-(C). These findings may be obtained from either a FINRA arbitration panel or a court of competent jurisdiction.

⁵ NASD Notice to Members 04-16, p. 2 (April 2004).

Major amendments to the disclosure requirements of Forms U4 and U5 became effective in May 2009. At that time, the Forms were amended to require reporting when a registered person, who was not named as a respondent in a pending arbitration, was nonetheless the “subject of an *investment-related*, consumer-initiated arbitration claim or civil litigation” that alleged that the registered person was “*involved in one or more sales practice violations.... [or] forgery, theft, misappropriation or conversion of funds or securities.*”⁶

At the time the amendments to the Uniform Forms went into effect, FINRA noted that the new disclosure questions regarding the requirement to disclose an unnamed representative’s alleged involvement in sales practice violations⁷ was designed to “reflect the language of the corresponding questions regarding alleged sales practice violations of persons identified in consumer complaints.”⁸ In particular, FINRA advised firms and their associated persons that, “As a result of these amendments, as of May 18, 2009, alleged sales practice violations made by a customer against persons identified in the body of a civil litigation complaint or arbitration claim will be treated the same way that customer complaints are treated in the Forms.”⁹

Allegations of sales practice violations in written customer complaints are required to be reported under Questions 14I(3) and 7E(3). Firms are not permitted to decline to report such complaints if their investigation disproves the allegations – rather, firms must base their reporting determinations on the allegations as made by the customer. The Disclosure Reporting Page for each reported written customer complaint requires detailed descriptions of the allegations, which are subsequently publicly disclosed through BrokerCheck. If the written complaint is reviewed and denied by the firm, following the July 2010 revisions to the BrokerCheck disclosure rule¹⁰ those allegations remain publicly disclosed through BrokerCheck until ten years after a registered person leaves the securities industry. Similarly, disclosures related to “unnamed persons” that are the “subject of” sales practice allegations in arbitration claims are displayed through BrokerCheck with nearly identical detail and prominence as those disclosures for written customer complaints.

SIFMA believes that the continued disclosure of denied or unfounded written customer complaints serves no regulatory purpose, provides no material information to investors, and, in fact, carries the very real risk of misleading potential customers and investors. Moreover, the current practice of disclosing through BrokerCheck all such complaints, as opposed to the prior practice of those complaints being archived as “historic complaints” and not disclosed after three years, extends the potential negative reputational impact and business impact over a registered person’s entire career.

⁶ Question 14I(4), (5) of Form U4 and 7E(4) and (5) of Form U5. Italicized terms are in the original and denote defined terms in the Uniform Forms. These disclosure questions contain other criteria to assess reportability (e.g., whether the claim for compensatory damages is equal to or exceeds \$5,000) that are not particularly relevant to the comments presented herein.

⁷ For convenience, the term “sales practice violations” will include allegations of “forgery, theft, misappropriation or conversion of funds or securities.”

⁸ FINRA Regulatory Notice 09-23 at p. 4 (May 2009).

⁹ *Id.* at p. 5 (emphasis added).

¹⁰ FINRA Rule 8312.

Presently, the procedural impediments to the expungement of erroneous or unfounded written customer complaints are equally, if not more vexing than those identified for “unnamed persons” in arbitration filings as described in Notice 12-18. The current options for “unnamed persons” to seek expungement of “subject of” allegations are to:

- Ask their current or former firm that is a party to the arbitration to request expungement on their behalf;
- Seek to intervene in the arbitration filed by the customer; or
- Initiate a new arbitration case in which the unnamed person requests expungement relief and names the customer or firm as the respondent.¹¹

These options, according to FINRA, “do not always adequately address a number of issues that can arise in connection with expungement requests.”¹² FINRA finds the current process falls short in that (1) it is not fair for an unnamed person to have to rely on their current or former firm to raise an expungement claim on their behalf; (2) the customer’s arbitration case should not be delayed or disrupted to “address an issue that may have no bearing on the outcome of the customer’s relief requests” and it may be “impractical” for the unnamed party to intervene in an arbitration as it could expose the person to liability; and finally (3) “if the unnamed person files a new arbitration case to expunge these allegations, FINRA believes that neither the firm nor the customer should be required to incur the additional expense of participating as a respondent in a new case.”¹³

There is no principled reason why the flaws identified in the current process for obtaining expungement relief for “unnamed persons” do not apply equally to relief sought for persons who are the subject of unfounded and denied written customer complaints. As FINRA confirms, the rationale behind the amendments to the Forms U4 and U5 was to treat claims related to “unnamed persons” in “the same way” as written customer complaints.¹⁴ Similarly, there is no justification for enacting a new procedure to afford relief to one class of aggrieved registered persons while leaving another subject to the prior, and admittedly flawed, process.

Reportable disclosure events for individuals may also arise in connection with civil litigation that, due to being settled or for jurisdictional reasons,¹⁵ does not result in arbitration. Unfounded allegations against “unnamed persons” made in such circumstances should also be subject to an equivalent remedy to that proposed for arbitrations.

SIFMA believes that, utilizing a framework that is substantially similar to that proposed in Notice 12-18 (subject to our further comments below), an effective procedure to permit the initiation and determination of expungement claims related to written customer complaints can

¹¹ Regulatory Notice 12-18 at p. 3.

¹² Id.

¹³ Id.

¹⁴ Regulatory Notice 09-23, supra, fn. 8.

¹⁵ A claim may be “*investment-related*” according to the Uniform Forms and still not involve a broker-dealer subject to the FINRA dispute resolution system. For example, civil litigation involving a registered person that involves banking or real estate may be reportable under the Uniform Forms but would not necessarily be adjudicable through FINRA Dispute Resolution.

be developed.¹⁶ SIFMA welcomes the opportunity to work with FINRA to develop such analogous procedures as part of the current amendments to the expungement rules.

The Proposed *In re* Procedures Should be Available Retroactively

The proposed *In re* procedures implicitly recognize the substantial impediments to obtaining expungement relief. Regulatory Notice 12-18 does not indicate that the proposed procedure would be available to address claims related to disclosures made where the underlying arbitration has been closed.

Because disclosures for “unnamed persons” are treated the same as written customer complaints, unfounded allegations that are not expunged remain disclosed on a registered person’s BrokerCheck report for as long as they are registered, and for ten years thereafter. Therefore, unless the *In re* procedures are applied retroactively to disclosures where FINRA concedes procedural and other impediments to prosecuting expungement claims existed, scores of registered persons who may otherwise be entitled to relief will have no remedy.

SIFMA recognizes that the proposed *In re* process places limits on the time within which expungement proceedings must be filed. Those time limits, we agree, are necessary to expeditiously resolve possible expungement claims following the closing of an arbitration. In order to ameliorate potential concerns about claims remaining open to possible filings indefinitely, SIFMA suggests that the retroactive application of the rule could “sunset” after an appropriate period of time sufficient to give registered persons adequate notice of an opportunity to file *In re* expungement claims. For these claims, excepting the provisions of the proposed rule related to notice issues, the initiation, discovery and hearing procedures could remain substantially the same.

This proposed retroactive application of the *In re* procedures will prevent what would otherwise be the unfair result of leaving a subset of registered persons without a means of removing false or misleading information from their public disclosures.

Technical/Procedural Comments Regarding the Proposed *In re* Procedure

Privacy/Confidentiality Issues

The proposed *In re* procedures require FINRA to automatically send a copy of the statement of claim to the registered representative in every case where there is a Form U4 Question 14I(4) or Form U5 Question 7E(4) filing.¹⁷ However, in some cases, a statement of claim may contain confidential customer or firm information that is not related to the allegations against the “unnamed person.” Thus, the automatic delivery of a statement of claim should be modified to provide that (i) FINRA or, in the alternative, the named firm shall redact statement of claims to be delivered to the registered person such that (a) only customer information directly related to

¹⁶ FINRA has rejected earlier SIFMA suggestions that it establish a process outside the arbitration system modeled after FINRA’s National Adjudicatory Council to review information reported through BrokerCheck for accuracy. SIFMA suggested such a process in its May 13, 2010 letter commenting on proposed changes to Rule 8312 (BrokerCheck Disclosure), available at <http://www.sifma.org/issues/item.aspx?id=900>. Most recently, in our comment to Regulatory Notice 12-10, we reiterated the need to take steps to ensure that information disclosed through BrokerCheck is done so fairly and accurately. See n.3, *supra*.

¹⁷ Proposed FINRA Rule 13807(b).

the alleged sales practice violations involving the unnamed person will be disclosed and (b) all personally-identifiable customer information (such as social security number and account numbers) is removed to the extent not relevant, and (ii) delivery of an un-redacted statement of claim not occur until after the registered person files a Notice of Intent to File, with appropriate confidentiality provisions as discussed herein, pursuant to proposed Rule 13807(c).

To further ensure the confidentiality of materials provided pursuant to the proposed *In re* procedure, SIFMA recommends that the proposed Notice of Intent to File an *In re* Expungement Claim (“Notice of Intent”)¹⁸ be modified to include in numbered paragraph 2 that the party filing the notice agrees to maintain the confidentiality of all pleadings, including the statement of claim, in addition to other documents that they may receive in connection with their application for relief. SIFMA also recommends that FINRA advise recipients of arbitration records that the failure of a registered person to comply with the confidentiality provisions of the Notice of Intent could subject that person to a claim for damages by any aggrieved party and/or FINRA disciplinary action.

Time Limits

The proposed *In re* procedure provides that notice to a registered person following a Question 14I(4) or 7E(4) filing will be made by overnight mail and that the 180-day time limit for filing a Notice of Intent begins on the date FINRA sends the notice. The proposed rules also provide that the subsequent notice of an arbitration case closing is not required to be sent similarly by overnight mail even though the time limit for action (filing an *In re* statement of claim) is shorter (60 days).¹⁹ SIFMA believes that the delivery methods for both forms of notice should be uniform.

In addition, SIFMA requests that FINRA provide appropriate guidance, through additional Regulatory Notices or published Q&As, as to how time limits will be adjusted or modified under various scenarios. For example, if an arbitration is resolved prior to the expiration of the 180-day period within which a Notice of Intent must be filed, what impact, if any, does that have on applicable filing requirements?

SIFMA believes that additional clarity on timing questions such as these will promote the effective implementation of the new *In re* procedure.

Discovery

Proposed Rule 13807(f) requires FINRA to send a copy of the “pleadings (including any exhibits) submitted in the underlying customer arbitration within 10 days from the date the unnamed person files an expungement claim.” SIFMA proposes that, in any final rule or enacting release, FINRA confirm that in the context of proposed Rule 13807(f), the term “pleadings” shall have the meaning set forth in Rule 13100(s), and that FINRA state explicitly that the exhibits subject to delivery under Rule 13807 are limited to those appended to the

¹⁸ Regulatory Notice 12-18, Attachment A (April 2012).

¹⁹ Compare proposed FINRA Rule 13807(c) with 13807(d)(1).

pleadings themselves and do not include other exhibits that may have been submitted in the arbitration itself.²⁰

Regarding document production requests, proposed Rule 13807(l) requires additional clarity. By its terms, Rule 13807(l)(1) states that “arbitrators shall determine whether an unnamed person may receive documents on a case-by-case basis.” In terms of process, it is unclear whether an unnamed person seeking documents must submit those requests directly to the parties to the underlying arbitration, or whether all discovery requests must be submitted to the arbitrator acting in a “gatekeeper” role for all requests. If direct service of such requests to parties is contemplated, should those requests be directed to counsel in the underlying proceedings? If the parties are not represented by counsel, will an unnamed person be provided an address for service of such requests in the event the documents provided do not indicate an address for service?²¹

SIFMA recognizes and agrees with the proposed rules’ limitation of discovery to only those documents that “the unnamed person has demonstrated are substantially and directly related to establishing grounds for expungement under Rule 2080.”²² However, one available ground for expungement relief is that the “claim or allegation is false,”²³ and, therefore, the scope of discovery could include a variety documents from either party to the arbitration (including, but not limited to, those that are presumptively discoverable under the Discovery Guide). Therefore, to promote the efficient functioning of the proposed *In re* process, situations such as those described above should be addressed either through modifications of the relevant language or the issuance of appropriate FINRA guidance on these issues.

Hearings

Proposed Rule 13807(k) allows parties to the underlying arbitration proceeding to “appear and testify” at the proposed *In re* expungement proceeding. The proposed rule also provides that FINRA shall notify the parties of the date, time and location of the proceeding. SIFMA believes that fundamental fairness requires that persons seeking expungement under the proposed new procedures should not be required to wait-and-see until the time of the hearing whether (i) a party from the arbitration intends to appear, and (ii) if the party intends to appear, whether they consent to, oppose, or take no position with respect to the request.

In order to prevent unnecessary surprise, and in order to give a person seeking relief under the *In re* procedure appropriate time to prepare for any such appearance through additional document requests or other discovery, parties should be required to give adequate advance notice of their intent to appear at the proceeding. Parties should also be required to state when they provide

²⁰ FINRA Rule 13100(s) provides that: “A pleading is a statement describing a party's causes of action or defenses. Documents that are considered pleadings are: a statement of claim, an answer, a counterclaim, a cross claim, a third party claim, and any replies.”

²¹ In some cases, especially where an unnamed person is no longer with the firm where the alleged sales practice violation took place, an unnamed person will not have access to a claimant’s address in order to serve discovery requests. FINRA’s Uniform Submission Agreement does not require a claimant’s address and there is no requirement that such addresses be disclosed in a statement of claim.

²² Proposed FINRA Rule 13807(l)(1)(A).

²³ FINRA Rule 2080(b)(1)(C).

such notice whether they consent to, oppose, or take no position with respect to the request for expungement. SIFMA also requests that FINRA issue guidance or develop training modules for arbitrators hearing *In re* proceedings to prevent unwarranted re-litigation of the underlying merits of an arbitration. For example, arbitrators hearing *In re* applications following dismissals or “zero” awards in the underlying arbitrations should take steps to prevent disgruntled litigants from making collateral attacks on underlying panel decisions or awards.

SIFMA also believes that FINRA should generally put claimants on notice that expungement hearings could occur after the resolution of their underlying arbitration proceeding. This notification and discussion of the potential impact to a claimant in connection with the *In re* process could occur through FINRA’s web-based educational materials related to the arbitration process or in appropriate disclosures from FINRA in the case opening letter to the parties.

Arbitrator Selection

SIFMA believes that the proposed *In re* process unfairly excludes qualified non-public arbitrators from hearing expungement applications.²⁴ There is no reason given why FINRA would exclude a qualified non-public panel member in a majority public panel arbitration from being able to hear an expungement application if the public chairperson or public arbitrator are unable or unwilling to serve. Non-public arbitrators are required to take the same training concerning expungement applications as public arbitrators and there is no supported reason given for their exclusion. In particular, where a matter has gone to hearing, the exclusion of a non-public panel member would deprive the person seeking expungement relief of an arbitrator who has heard the testimony and received the evidence in the underlying matter. It is neither efficient nor fair to exclude qualified non-public arbitrators from hearing *In re* applications.

Arbitrator Discretion to Hear Expungement Claims Brought on Behalf of Unnamed Persons

Notice 12-18 indicates a party to the underlying arbitration may still request expungement relief on behalf of an unnamed person. SIFMA believes that arbitrators in underlying proceedings should be expressly required under Rule 13807 or elsewhere to consider and rule on requests made by a named party (i.e. the firm) to expunge unfounded allegations against unnamed parties. Depending on the particular circumstances, this may be a more efficient means than the proposed *In re* process to resolve expungement claims.

SIFMA reiterates its general support for the proposed *In re* expungement process and thanks the FINRA staff for its willingness to consider the issues raised in this letter. We look forward to our next opportunity to comment on any revisions to the *In re* procedures based on these or any other comments FINRA receives.

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²⁴ Proposed FINRA Rule 13807(h).

If you have any questions or require further information, please contact the undersigned at 202-962-7382, kcarroll@sifma.org, or our counsel, Mark D. Knoll, Bressler, Amery & Ross, P.C., at 212-510-6901, mknoll@bressler.com.

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