



October 22, 2020

Via E-Mail to rule-comments@sec.gov
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090
Attn: Vanessa A. Countryman, Secretary

Re: File Number SR-FINRA-2020-030
FINRA Proposed Rule Change to Amend the Code of Arbitration Procedure
Relating to Requests to Expunge Customer Dispute Information, Including
Creating a Special Arbitrator Roster to Decide Certain Arbitration Requests
(the "Proposal")¹

Dear Ms. Countryman:

The Securities Industry and Financial Markets Association ("SIFMA")² appreciates the opportunity to comment on the Proposal. SIFMA initially commented on the Proposal in February 2018 in connection with FINRA's publication of Regulatory Notice 17-42.³

The Proposal would amend the Customer and Industry codes of arbitration procedure to:

(1) impose requirements on expungement requests (a) filed during an investment-related, customer initiated arbitration ("Customer Arbitration") by an associated person, or by a party to the customer arbitration on-behalf-of an associated person ("On-Behalf-Of Request"), or (b) filed by an associated person separate from a customer arbitration ("Straight-In Request");

¹ 85 Federal Register 62142 (October 1, 2020), available at <https://www.finra.org/sites/default/files/2020-10/SR-FINRA-2020-030-federal-register-notice.pdf>.

² SIFMA is the leading trade association for broker-dealers, investment banks and asset managers operating in the U.S. and global capital markets. On behalf of our industry's nearly 1 million employees, we advocate on legislation, regulation and business policy, affecting retail and institutional investors, equity and fixed income markets and related products and services. We serve as an industry coordinating body to promote fair and orderly markets, informed regulatory compliance, and efficient market operations and resiliency. We also provide a forum for industry policy and professional development. 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 <http://www.sifma.org>.

³ SIFMA comment to FINRA re: Regulatory Notice 17-42 (February 5, 2018), available at <https://www.sifma.org/resources/submissions/finra-regulatory-notice-17-42/>.

(2) establish a roster of arbitrators with enhanced training and experience from which a three-person panel would be randomly selected to decide Straight-In Requests;

(3) establish procedural requirements for expungement hearings;

(4) codify and update the best practices of the Notice to Arbitrators and Parties on Expanded Expungement Guidance (the “Guidance”)⁴ that arbitrators and parties must follow; and

(5) establish requirements for notifying state securities regulators and customers of expungement requests.

The Proposal would also amend the Customer code to specify procedures for requesting expungement of customer dispute information arising from simplified arbitrations.

* * *

As we stated in our initial comment letter,⁵ SIFMA continues to support the interest of the CRD and FINRA BrokerCheck in providing investors, regulators and member firms with complete and accurate information about firms and registered representatives, as appropriately balanced against the interest of member firms and their employees in protecting their reputations and privacy (including through expungement proceedings). SIFMA generally supports the Proposal to the extent it enhances the transparency and efficiency of the current expungement regime and the qualifications and training of the arbitrators who decide expungement requests. Notwithstanding our general support, we have several significant concerns below that must be addressed in the Proposal.

1. The Proposal Should Not Limit the Grounds for Granting Expungement to the Three Grounds Listed under Rule 2080(b)(1), but Should Also Allow the Grounds under Rule 2080(b)(2).

The Proposal would amend FINRA Rules 12805(c)(8) and 13805(c)(8) to require that “The arbitrator or panel must indicate in the arbitration award which of the Rule 2080**(b)(1)** grounds for expungement serve(s) as the basis for its expungement recommendation.” (emphasis added). In addition, “The arbitrator or panel must also provide a written explanation of the reason(s) for its finding that one or more Rule 2080**(b)(1)** grounds for expungement apply....” (emphasis added). FINRA Rule 2080(b)(1) provides that expungement relief may be based on (A) error, (B) mistake, or (C) falsity. Thus, under the Proposal, expungement in FINRA arbitration could only be granted on one or more of these three grounds (i.e., error, mistake, or falsity).

The Proposal asserts that existing FINRA Rules 12805, 13805 and 2080 *already* require arbitrators to indicate which of the three grounds (i.e., error, mistake, or falsity) upon which they are

⁴ Available at <https://www.finra.org/arbitration-mediation/notice-arbitrators-and-parties-expanded-expungement-guidance> (updated September 2017).

⁵ See fn 3.

granting expungement.⁶ The Proposal further asserts that it is merely a *clarifying revision* to now explicitly require that expungement must be granted on one of the three grounds under Rule 2080(b)(1).⁷ Neither of these two assertions, however, are entirely true.

As authority for these assertions, the Proposal cites to the rules themselves (FINRA Rules 12805, 13805 and 2080),⁸ as well as to FINRA's prior statements of the same assertion in two Regulatory Notices: (i) Notice 17-42 (Feb. 2018) (the precursor to the instant Proposal); and (ii) Notice 08-79 (Dec. 2008) (announcing the SEC's approval of new FINRA Rules 12805 and 13805).⁹

The problem is – the current text of FINRA Rules 12805, 13805 and 2080 does *not* limit the grant of expungement to one of the three grounds under Rule 2080(b)(1). Instead, Rules 12805 and 13805 require the arbitration award to specify “which of the Rule 2080 grounds for expungement serve(s) as the basis for its expungement order”

Rule 2080, in turn, provides that expungement relief may be based upon:

(b)(1)(A) error, (B) mistake, or (C) falsity, or

(b)(2)(A) the expungement and accompanying findings on which it is based are meritorious and (B) expungement would have no material adverse effect on investor protection, the integrity of the CRD system or regulatory requirements.

Thus, under current FINRA Rules, expungement may be appropriate under *not only* the Rule 2080(b)(1)(A)-(C) grounds, *but also* under the Rule 2080(b)(2)(A)-(B) grounds.

Notably, in April 2008, when FINRA published its proposal to create FINRA Rules 12805 and 13805, FINRA never stated, suggested or even hinted that the grounds for expungement should be limited to the grounds under Rule 2080(b)(1).¹⁰ In fact, FINRA's proposal expressly calls out not only the Rule 2080(b)(1) grounds, but also the Rule 2080(b)(2) grounds, i.e.:

FINRA may also waive the requirement to be named as a party if it determines that the expungement relief and accompanying findings on which it is based are meritorious and that expungement would not have a material adverse effect on investor protection, the integrity of the CRD system, or regulatory requirements.¹¹

⁶ Proposal at 62143, 62170.

⁷ Proposal at 62154.

⁸ Proposal at 62143 at fn 9.

⁹ Proposal at 62170 and fn. 238.

¹⁰ Securities Exchange Act Release No. 57572 (March 27, 2008), 73 FR 18308 (April 3, 2008) (stating that purpose of the new rules was to ensure expungement occurs only when arbitrators find and document one of the grounds specified in Rule 2080 (formerly known as Rule 2030)).

¹¹ 73 FR 18309.

The FINRA proposal required arbitrators to indicate which of “the Rule 2080 grounds for expungement serve as the basis for their expungement order” – without drawing any distinction or difference between the (b)(1) versus (b)(2) grounds.¹²

Thus, not surprisingly, none of comments submitted on the proposal addressed whether or why it would be appropriate to limit the grounds for expungement to the Rule 2080(b)(1) grounds. Likewise, because FINRA never requested the change, the SEC in approving new Rules 12805 and 13805 never addressed whether or why it would be appropriate to limit expungement to the Rule 2080(b)(1) grounds, and the SEC never in fact approved such a change.¹³

Most unfortunately, however, in the preamble text describing the approved rule change, the SEC misstated that new Rules 12805 and 13805 require the arbitration award to indicate “which of the grounds for expungement in [Rule 2080](b)(1)(A)-(C) serves as the basis for the expungement...”¹⁴ (emphasis added). Immediately thereafter, in FINRA Reg. Notice 08-79, announcing the SEC’s approval of new FINRA Rules 12805 and 13805, FINRA conveniently repeated the SEC’s misstatement that expungement relief is limited to the grounds in Rule 2080(b)(1).¹⁵ Most recently, in FINRA Reg. Notice 17-42, the precursor to the instant Proposal, FINRA again misstated that its rules *already* limit expungement relief to the Rule 2080(b)(1) grounds.¹⁶

The bottom line is that existing FINRA Rules 12805 and 13805 allow expungement under not only the three grounds under Rule 2080, section (b)(1), but also the additional grounds under (b)(2). Neither FINRA nor the SEC has ever discussed, explained or justified – or invited public comment on – why limiting expungement relief to strictly the (b)(1) grounds is fair or appropriate. A misstatement in the preamble to the SEC approval of FINRA Rules 12805 and 13805, twice repeated by FINRA in regulatory notices, do not a new rule make.

SIFMA strongly objects to the limitation of expungement relief to the grounds in Rule 2080(b)(1). Expungement is and remains appropriate under the grounds in Rule 2080(b)(2) as well. If FINRA wishes to now change the rules, it should be required to go through the usual notice and comment process for rulemaking – and explain and justify the reason for limiting the grounds for granting expungement, subject to public comment and SEC approval – rather than inaccurately suggesting that that process has already been undertaken and approved by the SEC.

It is particularly critical that the FINRA Rule 2080 sections (b)(1) and (b)(2) grounds for expungement be subjected to the formal rulemaking process given that, as discussed below, a plain

¹² 73 FR at 18308, 18309.

¹³ Securities Exchange Act Release No. 58886 (October 30, 2008), 73 FR 66086 (November 6, 2008).

¹⁴ 73 FR at 66087.

¹⁵ FINRA Reg. Notice 08-79 (December 2008) at 3.

¹⁶ FINRA Reg. Notice 17-42 (December 2017) at 18.

English reading of the Proposal appears to strip firms and associated persons of their right to seek expungement in court, which may grant expungement relief on broader equitable grounds.¹⁷

2. **The Proposal Should Not Preclude a Member Firm or Associated Person from Seeking Expungement Relief in Court.**

The Proposal appears to preclude an associated person from seeking expungement relief in court. The Proposal states, “Under the proposed rule change, an associated person would **only** be permitted to seek expungement of customer dispute information **in the arbitration forum administered by FINRA** by complying with the requirements of proposed rule 12805 [Customer Arbitration], 13805 [Straight-In-Request] or 12800(d) (expungement request in a simplified customer arbitration).”¹⁸ (emphasis added).

The proposed new language at the beginning of Rules 12805 and 13805 appears to support this reading. It states: “This Rule applies to **all** requests for expungement of customer dispute **under Rule 2080**...” (emphasis added). It further states: “**Except as otherwise provided in this Rule**, all other provisions of the Code apply to such expungement requests.”

Under current Rule 2080, a member or associated person may go to court to either confirm an arbitration award containing expungement relief, or directly seek an order directing expungement from the court. If, however, the revised Rules 12805 and 13805 apply to *all* expungement requests under Rule 2080, then presumably members and associated persons would no longer have the option to seek expungement directly in court. The “*Except as otherwise provided in this Rule*” language seems to support this reading, as it can be read to mean that the Rule 2080 right to seek expungement directly in court no longer applies because the revised Rules 12805 and 13805 no longer allow it. Thus, the language in the Proposal, coupled with the new proposed language in Rules 12805 and 13805, appears to accomplish a subtle but very troubling override of Rule 2080’s option to go to court to directly seek expungement.

If it is FINRA’s intention to eliminate the Rule 2080 option to go to court directly, then it should say so explicitly. If it is not, then it should say so as well.¹⁹ The Proposal makes no mention of the option to seek expungement directly in court.²⁰ There is no discussion or justification for eliminating the court option, nor did FINRA ever solicit public comment on this critical point.

¹⁷ See, e.g., *Lickiss v. FINRA*, A134179 (Cal. App. 1st, 2012) (a court may exercise its equitable jurisprudence to decide whether and under what circumstances expungement relief is appropriate), available at <https://caselaw.findlaw.com/ca-court-of-appeal/1610198.html#.X34IDVBp9HI.mailto>.

¹⁸ Proposal at 62145.

¹⁹ We note that during recent informal discussions with FINRA-DR staff, they stated that it was not their intention to eliminate the option to go to court to seek expungement.

²⁰ Notably, only eight days prior to publishing the Proposal, FINRA issued a regulatory notice explaining:

An associated person can seek expungement of customer dispute information by going through the FINRA arbitration process or directly to court (without first going through arbitration). Regardless of whether expungement of customer dispute information is sought directly through a court or through arbitration, FINRA Rule 2080 (Obtaining an Order of Expungement of Customer Dispute Information from the CRD System), which was developed in close consultation with representatives of NASAA and state regulators, requires a broker-dealer firm or associated person seeking expungement to obtain an order of a court of competent jurisdiction directing such expungement or confirming an award containing expungement relief.

SIFMA strongly objects to eliminating the Rule 2080 option to go to court directly. We believe denying access to court for expungements is neither appropriate nor fair to member firms, associated persons, or the integrity of the disclosures in the CRD system. Again, if FINRA wishes to now change the rules to eliminate this significant substantive right, then it should be required to go through the usual notice and comment process for rulemaking – and explain and justify the reason for eliminating the court option – subject to public comment and approval by the SEC.

Otherwise, FINRA should modify the proposed rule language to clarify that seeking expungement relief directly from court is always an available option, including without limitation, when an associated person is named in a Customer Arbitration and elects *not* to seek expungement in that proceeding.²¹

3. A Customer Arbitration or On-Behalf-Of Request Arbitration That Closes Other Than by Award or Award Without Hearing Should be Allowed to Use the Same Panel to Decide Expungement.

Under the Proposal, if a Customer Arbitration or On-Behalf-Of arbitration closes other than by award or award without hearing (e.g., by settlement or dismissal), then the associated person may only pursue an expungement request by a separate Straight-In Request under the Industry Code.²²

As support, FINRA asserts that in cases that settle or are dismissed, the existing hearing panel has no special insights into the case.²³ FINRA also asserts that customers do not typically participate in expungement proceedings after their case settles or is dismissed.

Contrary to FINRA’s assertion, however, in cases that settle or are dismissed, the panel has often had an opportunity to review the pleadings, participate in the disposition of discovery and other prehearing motions, and otherwise familiarize itself with the facts of the case. The new Straight-in-Request panel will have none of this learning. Moreover, if the original panel cannot hear the expungement request, then all that time and learning goes to waste. Likewise, the time the parties spent researching and ranking the panel members would be wasted.

In the settlement context, often the dates chosen for the hearing on the merits are also used for the expungement hearing, thereby reducing scheduling hassles for the parties, arbitrators and FINRA administrative staff. Furthermore, in our members’ experience, if the claimant and his or her counsel have already set aside certain dates for the merits hearing, then it is more likely that they will participate in the expungement hearing if it occurs on one of those days. Restarting the process through a new Straight-in Request would make it less likely that the claimant would participate. FINRA explicitly acknowledges this shortcoming for Straight-in Requests.²⁴

FINRA Regulatory Notice 20-25 (September 14, 2020) at 1, available at <https://www.finra.org/rules-guidance/notices/20-25>.

²¹ Proposal at 62144. Proposed Rule 12805(a)(1)(A)

²² Proposal at 62144.

²³ Proposal at 62148.

²⁴ Proposal at 62144.

For all the foregoing reasons, we recommend that if a Customer Arbitration or On-Behalf-Of arbitration closes other than by award or award without hearing (e.g., by settlement or dismissal), then the associated person should continue to be allowed to request an expungement-only hearing before the same panel from the customer arbitration.

This approach would be consistent with FINRA's proposed procedure in simplified arbitrations, which requires the arbitrator to decide the expungement request, regardless of how the simplified arbitration closes (e.g., even if the case settles).²⁵ This approach would also be consistent with FINRA's proposed procedure requiring associated persons named in a Customer Arbitration to bring their expungement claim in that action, or forfeit their right to seek expungement,²⁶ and with FINRA's proposed procedure barring associated persons who are not named, but who nevertheless elect to pursue expungement in an On-Behalf-Of arbitration, from withdrawing that claim in favor of a Straight-In Request.²⁷

4. If a Customer Arbitration or On-Behalf-Of Request Arbitration Closes Other Than by Award or Award Without Hearing, Then the Member Firm Should Not be Required to Pay an Additional Member Surcharge and Process Fee for a Straight-in Request.

Under the Proposal, FINRA would assess a new member surcharge and processing fee against the member firm in a Straight-In Request. FINRA explains:

FINRA believes that it is appropriate to assess the member surcharge and process fee for straight-in requests because they are separate arbitrations before a separate panel of specially trained arbitrators. The member firm, having not previously paid a member surcharge and process fee for the expungement request, would be assessed these fees when and if a straight-in request is filed.²⁸

In a Customer Arbitration or On-Behalf-Of Request arbitration that closes other than by award or by award without a hearing, however, the member firm would have already paid the member surcharge and processing fee. Under the Proposal, the firm would have to pay yet again in the Straight-In Request. Under FINRA's new rules imposing minimal fees for expungement requests,²⁹ those fees have dramatically increased to a whopping \$5,650 (up from \$150 under the old practice of claiming damages of \$1). For many member firms, these hefty fees will quickly mount, thereby imposing an unnecessary and unfair financial burden on firms, particularly given that FINRA is unilaterally imposing the requirement and firms have no option or opportunity to avoid paying twice. Accordingly, FINRA should eliminate this duplicative payment provision.

²⁵ Proposal at 62155 – 62166.

²⁶ Proposal at 62144.

²⁷ Proposal at 62148.

²⁸ Proposal at 62169.

²⁹ FINRA Regulatory Notice 20-25 (September 14, 2020), available at <https://www.finra.org/rules-guidance/notices/20-25>.

5. The Proposal Should Clarify the Timing and Type of Regulator Involvement in the Expungement Process That FINRA Contemplates.

The Proposal requires FINRA to give notice to state securities regulators within 30 days of expungement requests.³⁰ In the Proposal, FINRA states that the purpose of this requirement is to “better facilitate regulator involvement where appropriate.”³¹ Thus, the Proposal seems to suggest that state regulators ought to be somehow more involved in the process.

For that reason, the Proposal should clarify the timing and type of regulator involvement in the expungement process that FINRA contemplates. Depending on how significantly that prospective guidance deviates from current practices, we would like to reserve the opportunity to further comment on that aspect of the Proposal. We note that historically FINRA has wisely elected not to participate in expungement hearings, instead leaving that process in the hands of experienced and capable arbitrators, while reserving the right in rare instances to object to expungement if and when the case goes to court for confirmation. We believe that is an appropriate allocation of FINRA’s limited resources, and that that practice should continue.

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Thank you for the opportunity to further comment. If you have any questions or would like to further discuss these issues, please contact the undersigned.

Sincerely,



Kevin M. Carroll
Managing Director and
Associate General Counsel

cc: *via e-mail to:*
Robert L.D. Colby, Chief Legal Officer, FINRA
Richard W. Berry, Executive Vice President and Director FINRA-DR

³⁰ Proposal at 62154.

³¹ Proposal at 62172.