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Invested in America

February 20, 2024

Via E-Mail to richard.berry@finra.org

Richard Berry
Executive Vice President and Director, FINRA DRS
200 Liberty Street
New York, NY 10281

Re: **Form U5 Defamation Claims for Money Damages:**
Recommendations to improve the fairness of adjudications

Dear Rick:

The Securities Industry and Financial Markets Association ("SIFMA")[1] appreciates the opportunity to express our concerns with the current state of Form U5 defamation claims in FINRA's arbitration forum. As you know, FINRA requires member firms to file a Form U5 within 30 days of an associated person's termination of employment. The Form U5 obligates member firms to disclose, among other things, the reason for termination and whether the associated person is or was under investigation or internal review, and whether the associated person has been the subject of a customer complaint.[2] If a Form U5 contains inaccurate or misleading information, then the associated person's recourse is to file a claim in FINRA's arbitration forum seeking:

- expungement of such information from the person's U5 record; and/or
- monetary damages against the firm under state law for defamation and/or wrongful termination.

Claims for Expungement

Today, associated persons assert claims – in our view, inappropriately so – to expunge Form U5 information based upon the *defamatory nature of the information*. Unfortunately, arbitrators need *not*

[1] 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 one 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).

[2] FINRA Rule 4530 (Reporting Requirements); FINRA Bylaws, Article V, Section 3.

state if they found that all the elements of a defamation claim under governing law have been met.[3] Notably, the only guidance that FINRA has issued to arbitrators and member firms relates *solely* to claims for *expungement* of Form U5 information that is deemed to be *defamatory in nature*, and not to *actual* claims for defamation.

Claims for Money Damages

FINRA has *never* issued guidance to arbitrators on the standards for adjudicating actual claims for defamation. Yet, Form U5 defamation claims are on the rise; in 2020, such claims were the fourth most common intra-industry claim. And, in recent years, FINRA arbitration panels have issued a number of high dollar damage awards in defamation cases, including punitive damages.

A significant concern – for investors, regulators and our industry alike – is that arbitrators, in adjudicating *actual* defamation claims by associated persons against their former firms, may be inappropriately applying a *defamatory nature of the information* standard, instead of applying the actual elements of a defamation claim. Alternatively, arbitrators may be applying some form of wrongful termination standard in lieu of a defamation standard. The truth is that we just don't know, given that arbitrators receive no FINRA training or guidance on the proper standard to apply. Consequently, it seems likely that many arbitration panels may be applying the wrong standard, or the correct standard in an incorrect and/or differential manner, leading to uneven and unfair arbitration outcomes – which of course translate into uneven and unfair reporting on CRD and BrokerCheck.

FINRA should protect investors and the integrity of CRD/BrokerCheck disclosures by encouraging accurate and complete Form U5 reporting, and by discouraging unfounded U5 defamation claims.

The starting point is the Form U5 filing, which is a regulatory requirement. In the interest of investor protection and for regulatory purposes, FINRA should encourage accurate and complete U5 reporting by firms. Investors deserve timely information about when and why a financial advisor was terminated from employment. Regulators require the same.

In the current environment, however, firms who are diligent in making accurate and complete U5 filings nevertheless face unfounded U5 defamation claims – and increasingly awards –for money damages in FINRA arbitration. The proliferation of these claims further incentivizes the filing of even frivolous defamation actions, given the potential for large, yet unfounded awards. It also incentivizes firms to make their U5 disclosures as narrow, limited and bare bones as possible (but consistent with regulatory requirements) to minimize their legal exposure.

If unfounded U5 defamation claims for money damages are allowed to prevail and proliferate, then the value of the original U5 disclosure is diluted and countervailed by the competing narrative of the defamation damages award against the firm. FINRA should discourage this outcome as a policy matter by encouraging the fair and consistent adjudication of defamation claims in its arbitration forum. To do so, FINRA should establish baseline standards for defamation claims and appropriately train arbitrators on how to apply those standards.

[3] FINRA Notice 99-54 (July 1999) at p. 353, https://www.finra.org/sites/default/files/NoticeDocument/p004219.pdf.

At a minimum, defamation requires an affirmative finding of *a false statement of fact.*

Defamation laws have some variation by state. Regardless of state, however, the central element of *all* defamation claims under black letter law is *a false statement of fact*.[4] No defamation claim can prevail unless the alleged defamatory statement is shown to be a false statement of fact.

Defamation claims based on statements *required* by industry rules should also be subject to a qualified immunity defense.

But for the U5 filing obligation, firms would not be exposed to unfounded U5 defamation claims. Unfounded U5 defamation awards, in turn, contribute to potentially less robust U5 disclosures and/or misleading CRD/BrokerCheck disclosures. Qualified immunity for U5 defamation claims recognizes that investors and regulators have a strong interest in ensuring the integrity of U5 filings so that investors have access to important information, and regulators can investigate and enforce charges of misconduct by associated persons. For that reason, most states provide qualified immunity for U5 statements made *in good faith and without malice in fact*.[5]

We offer the following recommendations to improve the fairness of adjudication of U5 defamation claims.

Based on the foregoing, we offer the following recommendations:

- **Guidance, Training, Instructions.** Provide guidance, training materials and instructions to arbitrators that state: (1) A defamation claim for monetary damages for a U5 statement cannot prevail if the relevant statement is a *true statement of fact*; and (2) Even if the statement is inaccurate, the defamation claim nevertheless cannot prevail if the statement was made in *good faith and without malice in fact*. A U5 statement is presumed to be made in good faith and the claimant bears the burden to produce evidence showing that the statement was made with malice in fact.

- **Required Findings.** Before making an award for monetary damages for U5 defamation, require an explicit finding by the panel that: (1) the alleged defamatory statement is *a false statement of fact*; and (2) the statement was made in *bad faith and with malice in fact*.

- **Amend the Form U5.** The compelled narrative fields in the Form U5 create unnecessary legal exposure to defamation claims for firms. To the extent possible, the narrative fields should be entirely replaced with regulator-generated, drop-down menus of check-the-box disclosures. To the extent that a firm checks the appropriate boxes, without making other

[4] Black's Law Dictionary, https://thelawdictionary.org/defamation/.

[5] *See Baravati v. Josephthal, Lyon & Ross*, 28 F.3d 704 (7th. Cir. 1994). Fifteen states (HI, ID, IN, IO, KS, ME, MI, MN, MS, MO, NM, OK, SC, SD, VT) have adopted the Uniform Securities Act (2002 version) providing qualified immunity for U5 statements required by industry rules. New York provides absolute privilege for Form U5 statements. *Rosenberg v. Metlife*, 8 N.Y.3d 359, 361 – 68.

narrative comments, FINRA should instruct arbitrators that the firm is entitled to safe harbor protection from a U5 defamation claim related to such disclosures.

* * *

We would like to further discuss our recommendations with you, and any relevant staff, at our upcoming Arbitration Committee meeting on April 18, 2024.

Sincerely,

Kevin M. Carroll
Deputy General Counsel

cc: Robert W. Cook, President and CEO, FINRA
Robert L.D. Colby, Chief Legal Officer, FINRA