



NASAA

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**NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, INC.**

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*Submitted electronically to rule-comments@sec.gov*

Elizabeth M. Murphy, Secretary  
Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549

**RE: Release No. 34-71959, File Number SR-FINRA-2014-020**

Dear Ms. Murphy:

On behalf of the North American Securities Administrators Association (“NASAA”),<sup>1</sup> I hereby submit the following comments in response to Release No. 34-71959, File No. SR-FINRA-2014-020 entitled Notice of Filing of a Proposed Rule Change To Adopt FINRA Rule 2081 (Prohibited Conditions Relating to Expungement of Customer Dispute Information).<sup>2</sup> NASAA appreciates the opportunity to offer its comments on the above-referenced proposal, regarding proposed Financial Industry Regulatory Authority (“FINRA”) Rule 2081, prohibiting the conditioning of settlement of customer disputes on an agreement to consent to, or not oppose, the expungement of a customer complaint.

NASAA strongly supports FINRA’s efforts to improve the expungement process in order to prevent the removal of important information from the CRD. FINRA’s newly proposed Rule 2081 (“the Proposal” or “the Proposed Rule”) aims to supplement FINRA’s expungement rule, Rule 2080, and to prevent firms and their associated persons from conditioning the settlement of customer complaints on the support of, or an agreement by a client not to object to, the expungement of the matter from the CRD. NASAA believes that such a rule is necessary to discourage firms and their associated persons from bargaining for the expungement of potentially valuable regulatory information that should remain available to regulators and employers, as well as customers and potential customers through BrokerCheck.

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<sup>1</sup> NASAA is the association of the 67 state, provincial, and territorial securities regulatory agencies of the United States, Canada, and Mexico. NASAA serves as the forum for these regulators to work with each other in an effort to protect investors at the grassroots level and to promote fair and open capital markets.

<sup>2</sup> 79 Fed. Reg. 22734 (Apr. 23, 2014).

NASAA agrees with FINRA that expungement is and must continue to be an extraordinary remedy, and the Proposal adds important restrictions necessary to ensure that expungement remains such a remedy. Since the promulgation of NASD Rule 2130 (FINRA Rule 2080's predecessor) in December 2003, NASAA has had the occasion to witness the application of the Rule 2080 framework in well over 2000 arbitration matters. As a result, NASAA is very familiar with the FINRA expungement rule framework, its application by arbitration panels and courts, and the need to continually evaluate and reform the expungement process. To this end, NASAA will take the opportunity to comment in support of the Proposal, as well as outline our remaining concerns the Proposal does not address.

FINRA Rule 2080 provides the mechanism by which a firm or an associated person may seek the expungement of a customer complaint or arbitration from the CRD. Rule 2080 is a procedural rule requiring FINRA Arbitration Panels to make specific findings of fact before the Panel may recommend that a dispute be expunged from the CRD. Rule 2080 requires that a hearing be held on the issue of expungement. In practice, this hearing often occurs after a customer dispute has been settled, giving the customer little incentive to oppose or otherwise object to the expungement. If firms or associated persons are not prevented from conditioning the settlement of a dispute on a customer's agreement to support, or at least not oppose, an expungement request, the Panel charged with finding that expungement is appropriate will almost certainly only hear the facts from the firm or associated person's perspective. Even if a claimant participates, after settlement, their motivation to oppose is considerably weakened, and should not be assumed identical to the regulatory interest in preserving the availability of the information.

Expungement conditioned on an investor's agreement not to oppose expungement has been a practice occurring for over a decade. To prohibit such practices, FINRA issued a Notice to Members in 2004<sup>3</sup> cautioning its members against the use of affidavits in expungement proceedings, the basis of which were bargained-for-consideration rather than fact. Despite this guidance, the subsequent rulemaking in 2008 to adopt FINRA Rule 12805, and additional FINRA guidance to arbitrators issued in 2013, the number of expungement recommendations made in connection with settled arbitration claims continues to grow. Proposed Rule 2081 would further prevent firms from using expungement as a bargaining chip in settlement negotiations and could allow for a more balanced presentation to the arbitrators of the facts of a dispute.

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<sup>3</sup> Notice to Members 04-43 (June 2, 2004), available at, <http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p003015.pdf>.

While NASAA supports the proposed rule, NASAA remains concerned with ensuring that the rule will be enforced. The Proposal does not indicate how FINRA would enforce the Proposed Rule or what consequences firms and associated persons would face for failing to comply. Specifically, NASAA is concerned that, despite the Proposed Rule, firms or associated persons may skirt the rule and include such conditions in cover letters or emails that remain unseen by arbitrators. NASAA also is concerned that firms or their associated persons may enter into unrecorded oral agreements with customers that are never reviewed. Without specific enforcement mechanisms and clear consequences for failing to comply, NASAA fears that Proposed Rule 2081 will be ineffective, mirroring many of the effectiveness issues of FINRA Rule 2080—a procedural rule without an enforcement mechanism.

In the Release, the Commission cites to FINRA Guidance provided to arbitrators that suggests 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 . . . .”<sup>4</sup> Given the mandatory nature of Rule 2081 and our concerns regarding enforceability, we would suggest that FINRA instruct arbitrators that they *must* inquire of counsel for the claimant and respondent whether expungement was a condition of settlement. Further, the award should reflect both that such an inquiry was made and the responses of counsel. We also suggest that FINRA instruct its arbitrators how to proceed in instances where counsel is unwilling to respond to the inquiry or otherwise provides a response that suggests that Rule 2081 has been violated. These additional requirements build upon existing FINRA guidance and would increase the effectiveness of the Proposed Rule.

NASAA also is concerned that the Proposed Rule does not clearly define what it means to “condition settlement” on an agreement not to oppose expungement. Without further clarity as to this definition, NASAA foresees situations in which expungement can still be used as a bargaining chip during settlement negotiations. Given the ambiguity currently present in the Proposal, FINRA should issue additional guidance further defining what it means to “condition settlement” on an agreement to support or not oppose expungement in order to clarify to what extent, if any, under the Proposed Rule, agreements not to oppose expungement can remain terms in settlement agreements.

While supportive of the Proposed Rule, NASAA believes that FINRA should consider additional remediation to the expungement process. Proposed Rule 2081 will address some of the issues with expungement that have been noted recently in various studies and press stories. NASAA believes, however, that there is more work to be done to improve the process and to

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<sup>4</sup> See 79 Fed. Reg. at 22735 n.10 (citing Notice to Arbitrators and Parties on Expanded Expungement Guidance, available at <http://www.finra.org/arbitrationandmediation/arbitration/specialprocedures/expungement/>).

address problems that arise when, for instance, arbitrators make expungement findings based on a record from what is essentially an *ex parte* hearing. Arbitrator panels should not recommend expungement on the basis that a claim is false or clearly erroneous without independent evidence in the record demonstrating the falsity of or clear error in the claim. Furthermore, the panel should be prohibited from considering the lack of participation by a claimant in any way relevant to the expungement recommendation.

Improvement of the expungement process is critical for the CRD system from both a system integrity and public policy perspective to ensure the investing public has access to meaningful broker information. While the newly proposed Rule 2081 is a good first step, much more can be done to improve the expungement process. In addition to the Proposed Rule, FINRA should, among other things, partner with NASAA and move toward the adoption of substantive expungement rules, not simply the procedural rules currently in place; 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. While the above list is not exhaustive, NASAA believes such approaches would significantly improve the expungement process. NASAA looks forward to working with FINRA to improve the expungement process.<sup>5</sup>

NASAA applauds FINRA in its efforts to improve the expungement process. NASAA fears, however, that Proposed Rule 2081 will not be sufficiently effective and that the expungement process requires further remediation to ensure that expungement remains an extraordinary remedy. NASAA appreciates the opportunity to offer its comments, and should you have any questions regarding the comments in this letter, please do not hesitate to contact Joseph Brady ([jb@nasaa.org](mailto:jb@nasaa.org)), NASAA General Counsel, or Valerie Mirko ([vm@nasaa.org](mailto:vm@nasaa.org)), NASAA Deputy General Counsel, via email or at 202-737-0900.

Sincerely,



Andrea Seidt  
NASAA President  
Ohio Securities Commissioner

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<sup>5</sup> FINRA, NASAA and state securities regulators developed the CRD system collaboratively. NASAA also partners with FINRA in the development, operation, and maintenance of the Investment Adviser Registration Depository (“IARD”), the electronic system used to handle the registration of investment advisers. See [www.iard.com](http://www.iard.com).