

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-95455; File No. SR-FINRA-2022-024)

August 9, 2022

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of a Proposed Rule Change to Amend the Codes of Arbitration Procedure to Modify the Current Process Relating to the Expungement of Customer Dispute Information

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Exchange Act” or “Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on July 29, 2022, the Financial Industry Regulatory Authority, Inc. (“FINRA”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by FINRA. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

FINRA is proposing to amend the Code of Arbitration Procedure for Customer Disputes (“Customer Code”) and the Code of Arbitration Procedure for Industry Disputes (“Industry Code”) (together, “Codes”) to modify the current process relating to the expungement of customer dispute information.

The proposed rule change would amend the Codes to impose requirements on expungement requests (a) filed by an associated person during an investment-related, customer-initiated arbitration (“customer arbitration”), or filed 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”). Specifically, the proposed rule

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

change would: (1) require that a straight-in request be decided by a three-person panel that is randomly selected from a roster of experienced public arbitrators with enhanced expungement training;<sup>3</sup> (2) prohibit parties to a straight-in request from agreeing to fewer than three arbitrators to consider their expungement requests, striking any of the selected arbitrators, stipulating to an arbitrator's removal, or stipulating to the use of pre-selected arbitrators; (3) provide notification to state securities regulators of all expungement requests and a mechanism for state securities regulators to attend and participate in expungement hearings in straight-in requests; (4) impose strict time limits on the filing of straight-in requests; (5) codify and update the best practices in the Notice to Arbitrators and Parties on Expanded Expungement Guidance ("Guidance") applicable to all expungement hearings, including amendments to establish additional requirements for expungement hearings, to facilitate customer attendance and participation in expungement hearings and to codify the panel's<sup>4</sup> ability to request any evidence relevant to the expungement request;<sup>5</sup> (6) require the unanimous agreement of the panel to issue an award containing expungement relief; and (7) establish procedural requirements for filing expungement requests, including for on-behalf-of requests. The proposed rule change would also amend the Customer Code to specify procedures for requesting expungement of customer dispute information during simplified arbitrations.

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<sup>3</sup> Among other requirements, public arbitrators are not employed in the securities industry and do not devote 20 percent or more of their professional work to the securities industry or to parties in disputes concerning investment accounts or transactions or employment relationships within the financial industry. See FINRA Rules 12100(aa) and 13100(x).

<sup>4</sup> Under the Codes, the term "panel" means the arbitration panel, whether it consists of one or more arbitrators. See FINRA Rules 12100(u) and 13100(s). Unless otherwise specified, the rule filing uses the term "panel" to mean either a panel or single arbitrator.

<sup>5</sup> See FINRA Dispute Resolution Services, Notice to Arbitrators and Parties on Expanded Expungement Guidance, <https://www.finra.org/arbitration-and-mediation/notice-arbitrators-and-parties-expanded-expungement-guidance> (last updated Sept. 2017).

The text of the proposed rule change is available on FINRA's website at <http://www.finra.org>, at the principal office of FINRA and at the Commission's Public Reference Room.

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, FINRA included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. FINRA has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

I. Background and Discussion

A. Overview

Over the course of many years, FINRA has adopted a number of rules<sup>6</sup> governing the use of the arbitration forum administered by FINRA Dispute Resolution Services ("DRS") to seek expungement of customer dispute information.<sup>7</sup> These rules seek to balance the interests of

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<sup>6</sup> A chronology of the steps FINRA has taken to strengthen the expungement framework is available at <https://www.finra.org/rules-guidance/key-topics/expungement>.

<sup>7</sup> The DRS arbitration forum is operated in accordance with rules approved by the SEC and is subject to ongoing oversight by the SEC. Decisions in the DRS arbitration forum are made by independent arbitrators selected by the parties, not by DRS staff. In almost every arbitration proceeding seeking expungement of customer dispute information, all or a majority of the arbitrators reviewing requests for expungement are public arbitrators (who, among other requirements, have never been employed in the securities industry). See also *supra* note 3. DRS's role in the arbitration process is to administer cases brought to the DRS arbitration forum in a neutral, efficient and fair manner.

securities regulators in having accurate and relevant information to fulfill their regulatory responsibilities; the interests of investors in having access to accurate and meaningful information about associated persons with whom they may entrust their money; the interests of broker-dealer firms in having accurate information for use in making informed employment decisions; and the interests of the brokerage community in having a fair process to address inaccurate customer dispute information.

FINRA is concerned, however, that the current expungement process is not working as intended—as a remedy that is appropriate only in limited circumstances in accordance with the narrow standards in FINRA rules. As a result, over the past several years, FINRA has taken numerous, meaningful steps to address the concerns that FINRA and other interested parties have identified with the current expungement process<sup>8</sup> and to enhance that process, including by:

- publishing Regulatory Notice 17-42 to seek comment on proposed changes to further enhance the current expungement process;<sup>9</sup>

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<sup>8</sup> See infra Item II.A.1.I.D., “Concerns With the Current Expungement Process,” (discussing concerns with the current expungement process).

<sup>9</sup> Regulatory Notice 17-42 (December 2017) (“Notice”), <https://www.finra.org/rules-guidance/notices/17-42>. The Notice requested comment on, among other things: establishing a roster of public chairpersons with additional training and experience from which a panel would be selected to decide straight-in requests; imposing time limits on when an associated person can request expungement in a straight-in request; limiting an associated person who is named as a party in a customer arbitration to one opportunity to request expungement, and that opportunity must be exercised during the customer arbitration; codifying a party’s ability to request expungement on behalf of an associated person who is the subject of a customer arbitration, but unnamed, and establishing procedures for such requests; and applying a minimum fee to expungement requests.

- amending FINRA rules to apply minimum fees to requests for expungement of customer dispute information to address concerns about practices to avoid fees that were intended to be applicable to expungement requests;<sup>10</sup> and
- in September 2020, filing with the SEC a rule filing to make several significant enhancements to the current expungement process by establishing special arbitration procedures for expungement requests (“2020 Rule Filing”).<sup>11</sup>

On May 28, 2021, following discussions with SEC staff, FINRA withdrew the 2020 Rule Filing from the SEC in order to consider whether modifications to the filing were appropriate in response to concerns raised by SEC staff and commenters.<sup>12</sup> At that time, FINRA indicated its intent to continue pursuing enhancements to the current expungement process, while also continuing discussions with the North American Securities Administrators Association

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<sup>10</sup> An expungement request is a non-monetary or not specified claim (“non-monetary claim”). The fees applicable to non-monetary claims are higher than those applicable to small monetary claims. See FINRA Rule 13900(a)(1). If an associated person files a straight-in request and does not add a monetary claim to the request, the associated person will be assessed the filing fee associated with a non-monetary claim. The Codes require that non-monetary claims are decided by a three-person panel unless the parties agree in writing to one arbitrator. See FINRA Rules 12401 and 13401. FINRA amended the Codes to apply minimum fees to expungement requests, whether the request is made as part of the customer arbitration or the associated person files a straight-in request. As a result of the amendments, parties requesting expungement can no longer avoid the fees intended for such requests under the Codes or automatically qualify for a single arbitrator. The amendments also apply a minimum process fee and member surcharge to straight-in requests, as well as a minimum hearing session fee to expungement-only hearings. See Securities Exchange Act Release No. 88945 (May 26, 2020), 85 FR 33212 (June 1, 2020) (Order Approving File No. SR-FINRA-2020-005); see also Regulatory Notice 20-25 (July 20, 2020) (announcing a September 14, 2020 effective date), <https://www.finra.org/rules-guidance/notices/20-25>.

<sup>11</sup> See infra note 263. The 2020 Rule Filing, comments received in response to the filing and FINRA’s responses to the comments are discussed below in Item II.C.

<sup>12</sup> See FINRA Statement on Temporary Withdrawal of Specialized Arbitrator Roster Rule Filing (May 28, 2021), <https://www.finra.org/media-center/newsreleases/2021/finra-statement-temporary-withdrawal-specialized-arbitrator-roster>.

(“NASAA”) and other interested parties regarding a more fundamental redesign of the current expungement process, separate from and in addition to the changes included in the 2020 Rule Filing.<sup>13</sup>

FINRA believes the proposed amendments discussed below are responsive to the concerns that have been identified with the current expungement process and would help protect the integrity of the Central Registration Depository (“CRD®”), the central licensing and registration system used by the U.S. securities industry and its regulators,<sup>14</sup> by making substantial improvements to the current expungement process. Key proposed changes include:

➤ For All Requests for Expungement of Customer Dispute Information

- Requiring that the panel deciding the expungement request issue an award containing expungement relief only if the panel unanimously finds that the information to be expunged is factually impossible, clearly erroneous or false, or that the associated person was not involved in the alleged misconduct.
- Providing state securities regulators with notification of all expungement requests.
- Requiring associated persons to appear at the expungement hearing in person or by video conference.

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<sup>13</sup> See supra note 12. In addition, FINRA recently published a Discussion Paper on Expungement of Customer Dispute Information (April 2022) (“Discussion Paper”), [https://www.finra.org/sites/default/files/2022-04/Expungement\\_Discussion\\_Paper.pdf](https://www.finra.org/sites/default/files/2022-04/Expungement_Discussion_Paper.pdf). The Discussion Paper provides background and data regarding expungement of customer dispute information and explores potential alternatives to the current expungement process. The Discussion Paper also explains how the proposed changes in the 2020 Rule Filing would address key concerns with the current expungement process and that FINRA’s Board of Governors was continuing to consider further changes to enhance the 2020 Rule Filing.

<sup>14</sup> See infra note 18 and accompanying text (discussing the CRD system).

- Facilitating customer attendance and participation by notifying customers of the time, date and place of any prehearing conferences and the expungement hearing; codifying that customers are entitled to attend and participate in prehearing conferences and the expungement hearing and to be represented, if they choose; and providing customers with access to all relevant documents filed in the arbitration.
  - Specifically authorizing the panel to request any documentary, testimonial or other evidence that it deems relevant from the broker-dealer firm or associated person seeking expungement.
  - Requiring that the panel provide enough detail in the award to explain its rationale for including expungement relief in the award.
  - Precluding an associated person from requesting expungement of customer dispute information if a panel previously considered the merits of, or a court previously denied, a request to expunge the same customer dispute information.
  - Prohibiting an associated person who withdraws an expungement request from refiling the request at a later date, thereby preventing “arbitrator shopping.”
- For Straight-in Requests:<sup>15</sup>
- Imposing strict time limits within which associated persons may request expungement—DRS would deny the DRS arbitration forum if the expungement request is made:

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<sup>15</sup> As discussed in more detail below, under the proposed amendments, a straight-in request would include a request to expunge customer dispute information from the CRD system filed under the Industry Code: (1) by an associated person named in a customer arbitration after the customer arbitration closes other than by award or by award without a hearing; (2) arising from a customer complaint or civil litigation rather than a customer

- more than three years after the date the customer complaint was initially reported in the CRD system (if the customer complaint does not evolve into a customer-initiated arbitration or civil litigation); or
  - more than two years after the close of the customer-initiated arbitration or civil litigation associated with the customer dispute information.
- Requiring that straight-in requests be filed under the Industry Code against the broker-dealer firm at which the associated person was associated at the time of the events giving rise to the customer dispute.
- Permitting an authorized representative of state securities regulators to attend and participate as a non-party in prehearing conferences and the expungement hearing to the same extent as customers could attend and participate.
- Requiring that all straight-in requests be decided by a three-person panel, randomly selected from a roster of experienced public arbitrators with enhanced expungement training and with no significant ties to the industry (“Special Arbitrator Roster”).
- Prohibiting the parties from: (1) agreeing to fewer than three arbitrators to consider their expungement requests; (2) striking any of the selected arbitrators;

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arbitration; or (3) by an associated person who was the subject of a customer arbitration, but unnamed, and where a named party in the customer arbitration did not request expungement on behalf of the unnamed associated person, or where a named party made an on-behalf-of request, but the customer arbitration closed other than by award or by award without a hearing.



(3) stipulating to an arbitrator's removal; or (4) stipulating to the use of pre-selected arbitrators.<sup>16</sup>

➤ For Expungement Requests Considered During a Customer Arbitration

- Requiring an associated person named in a customer arbitration to request expungement during that customer arbitration or forfeit the opportunity to request expungement in any subsequent proceeding, thereby ensuring that the panel that hears the full merits of a customer arbitration also reviews a related expungement request.
- Conditioning and limiting the ability of a party to a customer arbitration to request expungement during the customer arbitration on behalf of an associated person who is the subject of a customer arbitration, but unnamed, so that the associated person cannot later claim they were not aware of the prior expungement request made on their behalf.

Prior to discussing each of the proposed amendments, FINRA provides below background information regarding the reporting of customer dispute information to the CRD system and its public disclosure through BrokerCheck®,<sup>17</sup> the current process for requesting expungement through the DRS arbitration forum and concerns regarding the current process.

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<sup>16</sup> Under the Codes, the DRS arbitrator selection process uses the Neutral List Selection System (“NLSS”), a computer algorithm, to generate lists of arbitrators on a random basis from DRS’s rosters of arbitrators for the selected hearing location. After the parties receive the arbitrator lists, the parties select their panel through a process of striking and ranking the arbitrators on the lists. Under the proposed amendments, NLSS would randomly select three arbitrators from the Special Arbitrator Roster to consider the straight-in request. The parties, whose interests may be aligned, would not have the ability to select the arbitrators.

<sup>17</sup> See infra note 22 and accompanying text.

## B. Customer Dispute Information in the CRD System

FINRA is mandated by federal statute to collect and maintain registration information about broker-dealer firms and their associated persons. To satisfy this statutory responsibility, FINRA operates the CRD system, the central licensing and registration system used by FINRA, the SEC, other self-regulatory organizations (“SROs”), state securities regulators and broker-dealer firms.<sup>18</sup> FINRA operates the CRD system pursuant to policies developed by FINRA and NASAA. FINRA, state securities regulators and the SEC use the CRD system as an important source of regulatory information to help inform registrations, examinations, investigations and disciplinary actions to protect investors and safeguard the markets. In addition, broker-dealer firms use information in the CRD system to help them make informed employment decisions.<sup>19</sup>

In general, the information in the CRD system is reported by registered broker-dealer firms, associated persons and regulatory authorities in response to questions on the uniform registration forms.<sup>20</sup> These forms are used to collect registration information, which includes, among other things, administrative, regulatory, criminal history, financial and other information about associated persons, such as investment-related, customer-initiated arbitrations, civil

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<sup>18</sup> The concept for the CRD system was developed by FINRA jointly with NASAA. The CRD system fulfills FINRA’s statutory obligation to establish and maintain a system to collect and retain registration information set forth in Section 15A(i) of the Exchange Act. NASAA and state regulators play a critical role in the ongoing development and implementation of the CRD system.

<sup>19</sup> As of December 31, 2021, over 60 million registrations for associated persons have been processed through the CRD system over a period spanning more than 20 years.

<sup>20</sup> The uniform registration forms are Form BD (Uniform Application for Broker-Dealer Registration), Form BDW (Uniform Request for Broker-Dealer Withdrawal), Form BR (Uniform Branch Office Registration Form), Form U4 (Uniform Application for Securities Industry Registration or Transfer), Form U5 (Uniform Termination Notice for Securities Industry Registration) and Form U6 (Uniform Disciplinary Action Reporting Form).

litigations or customer complaints (i.e., “customer dispute information”). Customer dispute information maintained in the CRD system is reported through Forms U4 and U5.<sup>21</sup>

Pursuant to rules approved by the SEC and pursuant to its statutory mandate, FINRA makes specific CRD information publicly available through BrokerCheck.<sup>22</sup> BrokerCheck is a free tool available on FINRA’s website to help investors make informed choices about the associated persons and broker-dealer firms with whom they may conduct business.<sup>23</sup> As part of its statutory obligation, FINRA publishes on BrokerCheck extensive disclosure information, including customer dispute information for associated persons who are currently or were formerly registered with FINRA.<sup>24</sup>

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<sup>21</sup> FINRA, NASAA and state securities regulators developed Forms U4 and U5. Any amendments to these uniform registration forms require collaboration with, and agreement between FINRA, NASAA and state securities regulators before being filed with the SEC for approval. Several questions on Forms U4 and U5 require associated persons to disclose certain investment-related, customer-initiated arbitrations, civil litigations or customer complaints which allege sales practice violations. See Form U4, Question 14I, <https://www.finra.org/sites/default/files/form-u4.pdf> and Form U5, Question 7E, <https://www.finra.org/sites/default/files/form-u5.pdf>.

<sup>22</sup> BrokerCheck fulfills FINRA’s statutory obligation under Section 15A(i) of the Exchange Act to establish and maintain a readily accessible electronic or other process, to receive and promptly respond to inquiries regarding registration information on, among others, broker-dealer firms and associated persons. A detailed description of the information made available through BrokerCheck is available at <http://www.finra.org/investors/about-brokercheck>.

<sup>23</sup> In 2021 alone, almost 38.3 million searches of firms and financial professionals were conducted on BrokerCheck.

<sup>24</sup> As of December 31, 2021, BrokerCheck disclosed information about approximately 3,400 broker-dealer firms and approximately 612,000 associated persons. BrokerCheck also disclosed information about more than 17,000 broker-dealer firms and 548,000 associated persons formerly registered with FINRA. Formerly registered associated persons, although no longer in the securities industry in a registered capacity, may work in other investment-related industries or may seek to attain other positions of trust with potential investors. Pursuant to FINRA rules which are approved by the SEC, records for formerly registered associated persons are available in BrokerCheck for 10 years after an associated person leaves the brokerage industry, and associated persons who are the

The collection of registration information in the CRD system and the disclosure of the information through BrokerCheck serves three important purposes: (1) allowing investors to obtain information about an associated person or broker-dealer firm with whom they may do business; (2) providing securities regulators with a critical regulatory tool in overseeing the activities of associated persons and in detecting regulatory problems; and (3) providing broker-dealer firms with information for use in making informed employment decisions. The value of the information is dependent on its completeness and accuracy. The absence of accurate information, as well as the presence of clearly inaccurate information, decreases the reliability and hence the value of the disclosure regime.

Sometimes, associated persons seek to remove, or “expunge,” customer dispute information from the CRD system and, thereby, from BrokerCheck. To do this, FINRA rules require that an associated person must obtain an order from a court of competent jurisdiction (1) directing such expungement or (2) confirming an arbitration award containing expungement relief.<sup>25</sup> FINRA will expunge customer dispute information from the CRD system only pursuant to a court order.

As discussed in more detail below, FINRA rules specify a narrow set of circumstances in which expungement of customer dispute information from the CRD system is appropriate. An arbitrator considering an expungement request in the DRS arbitration forum must make a finding that the information to be expunged is factually impossible, clearly erroneous or false, or that the associated person was not involved in the alleged misconduct.<sup>26</sup> When these standards were

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subject of disciplinary actions and certain other disclosure events remain on BrokerCheck permanently.

<sup>25</sup> See FINRA Rule 2080.

<sup>26</sup> See FINRA Rules 2080, 12805 and 13805.

approved by the SEC, it was contemplated that expungement would be an extraordinary remedy that would be allowed only in these limited circumstances.<sup>27</sup>

C. Requesting Expungement Through the DRS Arbitration Forum

The process of seeking expungement through the DRS arbitration forum originally developed when associated persons who were not found liable in a customer arbitration asked the panel in that same case to expunge the underlying customer dispute from the CRD system. Use of the DRS arbitration forum for expungement subsequently expanded when associated persons began requesting expungement through straight-in requests. Typically, these straight-in requests for expungement are filed after the customer arbitration settles or where a customer complaint has not evolved into a customer arbitration. Straight-in requests present inherent difficulties and panels deciding straight-in requests issue awards containing expungement relief more often than panels deciding expungement requests made in customer arbitrations.<sup>28</sup>

For either type of expungement request initiated in the DRS arbitration forum, an independent arbitrator or a panel of independent arbitrators decides whether the party requesting expungement has established one of the Rule 2080(b)(1) grounds for expungement.<sup>29</sup> Pursuant to FINRA rules, in order to issue an award containing expungement relief, the panel shall first hold a recorded hearing session regarding the appropriateness of expungement of the customer

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<sup>27</sup> See Securities Exchange Act Release No. 58886 (October 30, 2008), 73 FR 66086 (November 6, 2008) (Order Approving File No. SR-FINRA-2008-010).

<sup>28</sup> From January 2016 to December 2021 (the “sample period”), an arbitrator or panel issued awards containing expungement relief in response to 58 percent of requests made during a customer arbitration but issued awards containing expungement relief in response to 84 percent of straight-in requests. See *infra* Item II.B.2., “Economic Baseline,” for further discussion.

<sup>29</sup> See *infra* note 31 and accompanying text (discussing the grounds for issuing an award containing expungement relief).

dispute information, and in cases involving settlements, review settlement documents and consider the amount of payments made to any party and any other terms and conditions of the settlement.<sup>30</sup>

FINRA rules also require the panel to specify in the award which of the Rule 2080(b)(1) grounds serves as a basis for the expungement order and provide a brief written explanation of the reasons for its finding that one or more of the Rule 2080(b)(1) grounds applies to the facts of the case.<sup>31</sup> Thus, to include expungement relief in an award, the panel must find that: (1) the claim, allegation or information is factually impossible or clearly erroneous; (2) the associated person was not involved in the alleged investment-related sales practice violation, forgery, theft, misappropriation or conversion of funds; or (3) the claim, allegation or information is false.<sup>32</sup> Arbitration awards are final and binding unless vacated based on one of the limited grounds set forth in applicable state or federal statutes.<sup>33</sup>

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<sup>30</sup> See FINRA Rules 12805 and 13805.

<sup>31</sup> See *supra* note 30; see also Securities Exchange Act Release No. 58886 (October 30, 2008), 73 FR 66086, 66087 (November 6, 2008) (Order Approving File No. SR-FINRA-2008-010) (stating that new Rules 12805 and 13805 require the arbitration panel to indicate “which of the grounds for expungement in Rule [2080](b)(1)(A)-(C) serves as the basis for the expungement . . .”); Regulatory Notice 08-79 (December 2008) (stating that “[t]he arbitration panel must indicate which of the grounds for expungement under Rule [2080](b)(1)(A)-(C) serve as the basis for their expungement order, and provide a brief written explanation of the reasons for ordering expungement”); FINRA Dispute Resolution Services Arbitrators Guide, p. 74, <https://www.finra.org/sites/default/files/arbitrators-ref-guide.pdf> (explaining that “FINRA Rule 2080 establishes procedures to ensure that expungement occurs only when the arbitrators find and document one of [the three grounds that are listed in FINRA Rule 2080(b)]”); Guidance, *supra* note 5. DRS’s Basic Arbitrator Training Program also explains that expungement may occur only after the arbitrators find and document one of these three grounds. See also *infra* note 162.

<sup>32</sup> See FINRA Rules 2080(b)(1), 12805 and 13805.

<sup>33</sup> Arbitration awards are subject to very limited judicial review under the Federal Arbitration Act and state arbitration statutes. A court of competent jurisdiction will typically confirm an award unless it is vacated or modified. Generally, an award that

These FINRA rules are supplemented with extensive guidance and training provided to DRS's independent arbitrators. DRS has enhanced its expungement training for arbitrators to emphasize the importance of the information in the CRD system and BrokerCheck, and to underscore the arbitrator's important role in maintaining the relevancy and integrity of the information in those systems. DRS requires arbitrators to take mandatory online training on expungement to be eligible to serve as an arbitrator. The training includes materials that arbitrators should review when considering expungement requests, with a particular focus on the Guidance, first published in 2013 and expanded further periodically thereafter.<sup>34</sup> The Guidance explains the requirements of FINRA Rules 12805 and 13805 and provides arbitrators with best practices and recommendations to follow when deciding expungement requests.<sup>35</sup>

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contains expungement of customer dispute information will not be vacated unless there is evidence that the panel exceeded its authority, was biased, or engaged in misconduct. See 9 U.S.C. 10 (providing grounds for vacatur of an arbitration award under the Federal Arbitration Act).

<sup>34</sup> See Guidance, supra note 5.

<sup>35</sup> See Guidance, supra note 5. DRS also periodically provides additional materials to arbitrators to keep them informed about any changes to the expungement rules or DRS arbitration forum practices. DRS offers an updated online "Neutral Workshop" on expungement, which further emphasizes the best practices described in the Guidance. A Neutral Workshop is an online discussion between or among experienced arbitrators on a specific arbitration topic, with a DRS staff member as a moderator. The discussions are posted on FINRA's website as a free, educational tool. Additional information about expungement rules and DRS arbitration forum practices have been provided to arbitrators via a number of articles in a DRS staff quarterly newsletter, The Neutral Corner, which provides arbitrators and mediators with updates on important rules and procedures within the DRS arbitration forum and is distributed to FINRA neutrals (arbitrators and mediators) and published on FINRA's website. See, e.g., The Neutral Corner Volume 1-2016 (Changes to Expungement Requests), [https://www.finra.org/sites/default/files/The\\_Neutral\\_Corner\\_Volume\\_1\\_2016\\_0.pdf](https://www.finra.org/sites/default/files/The_Neutral_Corner_Volume_1_2016_0.pdf); The Neutral Corner Volume 4-2015 (Questions and Answers: Parties Making Second Expungement Requests After Previous Denial), [https://www.finra.org/sites/default/files/The\\_Neutral%20Corner\\_Volume\\_4\\_2015.pdf](https://www.finra.org/sites/default/files/The_Neutral%20Corner_Volume_4_2015.pdf); The Neutral Corner Volume 1-2015 (Updated Expungement Guidance), [https://www.finra.org/sites/default/files/Neutral\\_Corner\\_Volume.1\\_2015.pdf](https://www.finra.org/sites/default/files/Neutral_Corner_Volume.1_2015.pdf); and The Neutral Corner Volume 3-2014 (Prohibited Conditions Relating to Expungement of

As stated above, FINRA will expunge customer dispute information from the CRD system only pursuant to a court order. FINRA Rule 2080, which was developed in close consultation with representatives of NASAA and state securities regulators, provides that associated persons seeking expungement of customer dispute information from the CRD system must obtain an order from a court of competent jurisdiction directing expungement relief or confirming an arbitration award that contains expungement relief.<sup>36</sup> If a court directs expungement or confirms an arbitration award containing expungement, the customer dispute information is removed from the CRD system, and is no longer made public through BrokerCheck.

D. Concerns With the Current Expungement Process

While commenters have raised concerns generally about associated persons' use of the DRS arbitration forum to seek expungement, their concerns have been particularly focused on straight-in requests. Some of these concerns, however, also apply to expungement requests filed in customer arbitrations that settle, where the panel from the customer arbitration then holds a hearing to consider the expungement request.<sup>37</sup>

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Customer Dispute Information; Expanded Expungement Guidance; Questions and Answers: Expungement; Expungement Training: Updated to Include Rule 2081), [https://www.finra.org/sites/default/files/Neutral%20Corner\\_Volume%203\\_0.pdf](https://www.finra.org/sites/default/files/Neutral%20Corner_Volume%203_0.pdf).

<sup>36</sup> FINRA Rule 2080(a). FINRA Rule 2080 also requires that FINRA be named as an additional party in any court proceeding related to the expungement of customer dispute information, unless FINRA waives being named. See FINRA Rule 2080(b).

<sup>37</sup> Concerns with the expungement process were previously considered by the FINRA Dispute Resolution Task Force ("Task Force"), whose members included representatives from the industry and the public with a broad range of interests in securities dispute resolution. See FINRA Dispute Resolution Task Force, <https://www.finra.org/arbitration-mediation/finra-dispute-resolution-task-force>. FINRA formed the Task Force to consider possible enhancements to the DRS arbitration and mediation forum. At the time, the Task Force noted that the majority of issues that arise in the expungement process are those involving settled cases that do not go to final resolution because in such cases: (1) the panel selected by the parties may not have heard



First, straight-in requests often involve aged customer dispute information reported on the associated person's CRD record a number of years prior to the expungement request.<sup>38</sup> As a result, documents or information relating to the dispute may no longer be available.<sup>39</sup>

Second, although the Guidance provides that an arbitrator must ensure the customer has notice and an opportunity to participate in the expungement hearing, customers and their

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the full merits of the customer dispute and, therefore, may not bring to bear any special insights in determining whether to grant an expungement request and (2) claimants or their counsel have little incentive to participate in an expungement hearing once their dispute has been settled. The Task Force unanimously recommended, in its final report, the creation of a special arbitration panel consisting of experienced arbitrators from the chairperson roster who have received enhanced training on expungement to decide expungement requests in settled customer arbitrations. See Final Report and Recommendations of the FINRA Dispute Resolution Task Force (Dec. 16, 2015), <http://www.finra.org/sites/default/files/Final-DR-task-force-report.pdf>. The Task Force issued its final report with 51 recommendations. DRS has taken action on all of the 51 recommendations. See FINRA Dispute Resolution Task Force Recommendations Final Status Report (Jan. 15, 2019), [https://www.finra.org/sites/default/files/DR\\_task\\_report\\_status\\_011519.pdf](https://www.finra.org/sites/default/files/DR_task_report_status_011519.pdf).

<sup>38</sup> FINRA rules provide that no claim shall be eligible for submission to arbitration under the Codes where six years have elapsed from the occurrence or event giving rise to the claim. See FINRA Rules 12206(a) and 13206(a). This six-year eligibility rule applies to all arbitration claims, including those requesting expungement of customer dispute information. The issue of eligibility may be raised in a motion by the parties or sua sponte by the arbitrators. See *Horst v. FINRA*, No. A-18-777960-C (Dist. Ct. Nevada Oct. 25, 2018) (Order Denying Motion to Vacate Arbitration Award). In addition, FINRA Rules 12409 and 13413 provide that the arbitrators have the authority to interpret and determine the applicability of all provisions under the Codes. Thus, the decision of whether to dismiss a claim pursuant to this six-year eligibility rule is within the sole discretion of the panel. See *Howsam v. Dean Witter Reynolds*, 537 U.S. 79, 85-86 (2002) (finding that an arbitrator properly decides issues of eligibility). Such interpretations and decisions are final and binding upon the parties.

<sup>39</sup> For example, during the sample period, approximately three-fifths of the 6,476 customer dispute information disclosures were sought to be expunged in straight-in requests that were filed six years or longer after the close of a customer arbitration or the initial reporting of the customer complaint.

representatives typically do not participate in hearings in straight-in requests and, therefore, the panel may receive information only from the associated person requesting expungement.<sup>40</sup>

Third, the broker-dealer firm named in the straight-in request by the associated person may not have any relevant documents pertaining to the customer dispute because the event occurred while the associated person was employed at a different firm, or the respondent firm may support the expungement request because it has an interest in removing negative information from the associated person's CRD record.<sup>41</sup>

Fourth, associated persons are also making repeated attempts to seek expungement of the same customer dispute information. For example, some associated persons make requests for expungement (by filing straight-in requests) after withdrawing or deciding not to pursue an expungement request made in the customer arbitration, presumably believing that another panel that has not heard the merits of the customer's claim may be more likely to decide expungement in their favor. FINRA is concerned about this practice of "arbitrator shopping," particularly when associated persons withdraw an original expungement request after the panel has been made aware of evidence that could result in the denial of the expungement request.

FINRA has also observed that persons who are not named as a party in a customer arbitration may attempt to seek expungement (using straight-in requests) after expungement was denied in the customer arbitration to which they were not a party, claiming they were not aware

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<sup>40</sup> See also supra note 37 (discussing similar concerns with expungement hearings in settled customer arbitrations).

<sup>41</sup> FINRA rules do not currently specify who associated persons must name when filing a straight-in request. Typically, associated persons file their straight-in requests against the broker-dealer firm at which the associated person is currently employed. On rare occasions, straight-in requests are filed against a customer. As discussed below, the proposed amendments would prohibit these filings against the customer. See proposed Rule 12805(a)(3).

of the expungement request in the customer arbitration.<sup>42</sup> In addition, FINRA has observed that associated persons are moving to vacate arbitration awards that deny expungement relief and then seeking expungement in a new proceeding.<sup>43</sup>

As discussed in detail below, the proposed amendments would make significant enhancements to the current expungement process. These enhancements would address the concerns identified by FINRA, the Task Force and other interested parties and provide additional safeguards for ensuring that the information maintained in the CRD system and disclosed through BrokerCheck is accurate and complete.<sup>44</sup>

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<sup>42</sup> In these circumstances, the customer arbitration is filed against the broker-dealer firm, without formally naming the associated person, but alleging that the associated person was involved in the alleged violation. In 2009, the SEC approved amendments to Forms U4 and U5 to require a broker-dealer firm to report allegations of sales practice violations made against an associated person in an arbitration or a civil litigation even when the associated person is not a named party in the proceeding. The information reported about such disputes is now maintained in the CRD system as part of the associated person's record and is disclosed through BrokerCheck. See Securities Exchange Act Release No. 59916 (May 13, 2009), 74 FR 23750 (May 20, 2009) (Order Approving File No. SR-FINRA-2009-008).

These "unnamed persons" may seek to expunge customer dispute information from the CRD system by: (1) asking a party to the customer arbitration, usually the firm, to request expungement on their behalf; (2) seeking to intervene in the customer arbitration; (3) initiating a new arbitration in which the unnamed person requests expungement and names the customer or firm as the respondent; or (4) seeking expungement in a court of competent jurisdiction.

<sup>43</sup> If an award denying expungement is vacated and the associated person then seeks expungement in court, FINRA may oppose expungement in court if FINRA was not provided notice or an opportunity to be heard in the proceeding to vacate the award.

<sup>44</sup> The proposed rule change would apply to all members, including members that are funding portals or have elected to be treated as capital acquisition brokers ("CABs"), given that the funding portal and CAB rule sets incorporate the impacted FINRA rules by reference.

## II. Proposed Rule Change

Under the proposed rule change, an associated person would only be permitted to seek expungement of customer dispute information in the DRS arbitration forum by complying with the requirements of proposed Rules 12805 (expungement requests in a customer arbitration), 13805 (straight-in requests under the Industry Code) or 12800(d) (expungement requests in a simplified customer arbitration). The discussion below of the proposed rule change is divided into seven areas: (A) requests for expungement under the Customer Code; (B) straight-in requests under the Industry Code and the Special Arbitrator Roster; (C) limitations on expungement requests; (D) requirements relating to all expungement hearings; (E) notifications to customers and to state securities regulators regarding expungement requests; (F) attendance and participation of an authorized representative of state securities regulators in straight-in requests; and (G) expungement requests during simplified customer arbitrations.

### A. Requests for Expungement under the Customer Code

FINRA Rule 12805 sets forth requirements that arbitrators must meet in order to issue an award containing expungement of customer dispute information under the Customer Code.<sup>45</sup> The rule does not, however, provide guidance for associated persons on how and when they may request expungement during the customer arbitration, or on when arbitrators must make

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<sup>45</sup> FINRA Rule 12805 provides that a panel must comply with the following requirements in order to grant expungement: (a) hold a recorded hearing session (by telephone or in person) regarding the appropriateness of expungement; (b) in cases involving settlements, review settlement documents and consider the amount of payments made to any party and any other terms and conditions of a settlement; (c) indicate in the arbitration award which of the Rule 2080 grounds for expungement serve(s) as the basis for its expungement order and provide a brief written explanation of the reason(s) for its finding that one or more Rule 2080 grounds for expungement applies to the facts of the case; and (d) assess all DRS arbitration forum fees for hearing sessions in which the sole topic is the determination of the appropriateness of expungement against the parties requesting expungement relief. See also FINRA Rule 13805.

expungement determinations. The proposed rule change would amend FINRA Rule 12805 to set forth requirements for expungement requests filed by an associated person during a customer arbitration.

1. Expungement Requests During the Customer Arbitration
  - a. By a Respondent Named in a Customer Arbitration

Under current practice, an associated person who is named as a respondent in a customer arbitration (“named associated person”) may request expungement at any time during the customer arbitration or separately from the customer arbitration in a straight-in request.<sup>46</sup> If a named associated person requests expungement during the customer arbitration, does not withdraw the request and the case goes to hearing and closes by award, the panel in the customer arbitration will also decide the expungement request and include the decision as part of the award. If the customer arbitration does not close by award after a hearing (e.g., settles) and the associated person continues to pursue the expungement request, the panel from the customer arbitration will hold a hearing regarding the appropriateness of expungement.<sup>47</sup>

Under the proposed rule change, if a named associated person seeks to expunge customer dispute information associated with the customer’s statement of claim, the named associated

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<sup>46</sup> There are several ways in which a named associated person may request expungement during a customer arbitration. The request may be included in the answer to the statement of claim that must be submitted within 45 days of receipt of the statement of claim, and may include other claims and remedies requested. See FINRA Rules 12303(a) and (b); see also FINRA Rules 13303(a) and (b). The expungement request may also be included in other pleadings (e.g., a counterclaim, a cross claim, or a third party claim) and must be filed with the Director. See FINRA Rule 12100(x). The associated person may also request at any time during the case (outside of a pleading) that the panel consider the person’s expungement request during the hearing. Under FINRA Rule 12503, such a request is treated like a motion, which gives the other parties an opportunity to state objections. If there is an objection, the panel must decide the motion pursuant to FINRA Rule 12503(d)(5). See also FINRA Rules 13503 and 13503(d)(5).

<sup>47</sup> See FINRA Rule 12805.

person must make the expungement request during the customer arbitration.<sup>48</sup> As discussed below, these requests would be subject to limitations on how and when the requests may be made.<sup>49</sup> If the associated person does not request expungement of the customer dispute information associated with the customer’s statement of claim during the customer arbitration, the associated person would forfeit the opportunity to seek expungement of the same customer dispute information in any subsequent proceeding.<sup>50</sup> The Director would be authorized to deny the DRS arbitration forum to requests made during a customer arbitration to expunge customer dispute information that is not associated with the customer’s statement of claim.<sup>51</sup> The Director would also be authorized to deny the forum if a named associated person does not request expungement of the customer dispute information associated with the customer’s statement of claim during the customer arbitration but then seeks expungement of the same customer dispute information in a subsequent proceeding.<sup>52</sup>

FINRA is proposing to require that a named associated person request expungement of customer dispute information associated with a customer’s statement of claim during the customer arbitration because, if the arbitration closes by award after a hearing, the panel from the customer arbitration will be best situated to decide the related issue of expungement. Requiring

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<sup>48</sup> See proposed Rule 12805(a)(1)(A). The customer dispute information associated with a customer’s statement of claim would include a written customer complaint or civil litigation brought by the same customer that addresses the same allegations.

<sup>49</sup> See proposed Rule 12805(a)(1)(B); see also *infra* Item II.A.1.II.C., “Limitations on Expungement Requests.”

<sup>50</sup> See proposed Rule 12805(a)(1)(A).

<sup>51</sup> See proposed Rule 12203(b); see also *infra* Item II.A.1.II.C.3., “Director’s Authority to Deny the Forum.”

<sup>52</sup> See proposed Rules 12805(a)(1)(A), 13203(b) and 13805(a)(2)(A)(vi); see also *infra* Item II.A.1.II.C.3., “Director’s Authority to Deny the Forum.”

the named associated person to request expungement in the customer arbitration increases the likelihood that a panel will have input from all parties and access to all of the evidence, testimony and other documents to make an informed decision on the expungement request.

FINRA recognizes that this requirement could result in some named associated persons filing expungement requests to preserve their ability to make an expungement request, regardless of the potential outcome. FINRA believes, however, that the potential costs that would be incurred by associated persons, arbitrators and the DRS arbitration forum if named associated persons file expungement requests to preserve the ability to request expungement are appropriate given the potential benefit of having customer input and a complete factual record for the panel to decide an expungement request.

i. Method of Requesting Expungement

The proposed rule change would limit how and when expungement requests may be made during the customer arbitration. Under the proposed rule change, if a named associated person requests expungement during the customer arbitration, the request must be included in the answer or a separate pleading requesting expungement.<sup>53</sup> If the request is included in the answer, it must be filed within 45 days of receipt of the customer's statement of claim in accordance with existing requirements under the Codes.<sup>54</sup> If the named associated person requests expungement in a separate pleading requesting expungement, rather than the answer, the request must be filed no later than 60 days before the first scheduled hearing begins.<sup>55</sup> The

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<sup>53</sup> See proposed Rule 12805(a)(1)(C)(i). FINRA Rules 12100(x) and 13100(v) would be amended to define a "separate document requesting expungement" as a pleading under the Codes.

<sup>54</sup> See *supra* note 46.

<sup>55</sup> See proposed Rule 12805(a)(1)(C)(i).

proposed deadline should provide the named associated person with enough time to assess the customer's case and the potential merits of an expungement request and decide whether to file the request. The 60-day timeframe would also provide the parties to the customer arbitration with reasonable case preparation time, since the expungement issues will overlap with the issues raised by the customer's claim. If a named associated person seeks to request expungement after the 60-day filing deadline, the associated person would be required to file a motion requesting an extension, which would be decided by the panel.<sup>56</sup>

ii. Required Contents of an Expungement Request

Under the proposed rule change, a request for expungement by a named associated person in a customer arbitration must include the applicable filing fee under the Code.<sup>57</sup> In addition, a named associated person would be required to provide the CRD number of the party requesting expungement, each CRD occurrence number that is the subject of the request and the case name and docket number associated with the customer dispute information.<sup>58</sup> These requirements would help ensure that FINRA, the panel, and the parties understand who is requesting expungement and which customer dispute information is the subject of the request.

The proposed rule change would also require the named associated person requesting expungement to explain whether expungement of the same customer dispute information was (i)

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<sup>56</sup> See proposed Rule 12805(a)(1)(C)(i). Pursuant to FINRA Rule 12503, if an associated person files a motion seeking an extension of the 60-day deadline, the opposing parties may state objections to extending the deadline, and the panel would decide the motion.

<sup>57</sup> See proposed Rule 12805(a)(1)(C)(ii)a.

<sup>58</sup> See proposed Rule 12805(a)(1)(C)(ii)b. through d. An occurrence is a disclosure event that is reported to the CRD system via one or more Disclosure Reporting Pages. Each occurrence contains details regarding a specific disclosure event. An occurrence can have as many as three sources reporting the same event: Forms U4, U5 and U6.



previously requested and, if so (ii) how it was decided.<sup>59</sup> This requirement would assist with implementation of the proposed prohibition on parties making second requests for expungement, discussed in more detail below.<sup>60</sup> This proposed requirement is also consistent with language in the existing Guidance stating that arbitrators should ask a party requesting expungement whether an arbitration panel or a court previously denied expungement of the customer dispute information at issue and, if there was a prior denial, the expungement request should be denied.<sup>61</sup>

Under the proposed rule change, if an expungement request fails to include any of the proposed requirements for requesting expungement, the request would be considered deficient and would not be served unless the deficiency is corrected.<sup>62</sup>

FINRA believes these proposed requirements for named associated persons requesting expungement are necessary for the timely consideration and orderly administration of expungement requests as well as to maintain the integrity of the CRD system.

b. Expungement Requests by a Party Named in the Customer Arbitration On Behalf Of an Unnamed Person

The Codes do not specifically address on-behalf-of requests, *i.e.*, expungement requests made by a party named in a customer arbitration on behalf of an unnamed person.<sup>63</sup> Under

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<sup>59</sup> See proposed Rule 12805(a)(1)(C)(ii)e.

<sup>60</sup> See *infra* Item II.A.1.II.A.1.b.i., “Method of Requesting Expungement On Behalf Of an Unnamed Person.”

<sup>61</sup> See Guidance, *supra* note 5.

<sup>62</sup> See proposed Rules 12307(a)(8) through (11) and 12805(a)(1)(C)(ii).

<sup>63</sup> The proposed rule change would define an unnamed person as “an associated person, including a formerly associated person, who is identified in a Form U4, Form U5, or Form U6, as having been the subject of an investment-related, customer-initiated arbitration claim that alleged that the associated person or formerly associated person was involved in one or more sales practice violations, but who is not named as a respondent in the arbitration.” See proposed Rule 12100(ff).

current practice, a party to a customer arbitration may file an on-behalf-of request for expungement during the customer arbitration. If the party (typically, a firm) files the request and the customer arbitration closes by award after a hearing, the panel will decide the expungement request and include the decision in the award. If the customer arbitration does not close by award after a hearing (e.g., settles), either the requesting party or the unnamed person could ask the panel to consider and decide the expungement request before it disbands. In this circumstance, the panel from the customer arbitration will hold a hearing regarding the appropriateness of expungement.<sup>64</sup>

The proposed rule change would codify the ability of a party to the customer arbitration to file an on-behalf-of request during a customer arbitration.<sup>65</sup> Under the proposed rule change, a party to a customer arbitration may file an on-behalf-of request that seeks to expunge customer dispute information associated with the customer's statement of claim, provided the request is eligible for arbitration under proposed Rule 12805.<sup>66</sup> Filing an on-behalf-of request would be permissive, not mandatory.<sup>67</sup> However, as discussed below, if the named party and the unnamed person agree to such a request, FINRA would require them to sign a form consenting to the on-behalf-of request which would help ensure that the unnamed person is fully aware of the request and that the firm is agreeing to represent the unnamed person for the purpose of requesting expungement during the customer arbitration.

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<sup>64</sup> See FINRA Rule 12805.

<sup>65</sup> See proposed Rule 12805(a)(2).

<sup>66</sup> See proposed Rule 12805(a)(2)(B).

<sup>67</sup> See proposed Rule 12805(a)(2)(A).

i. Method of Requesting Expungement On Behalf Of an Unnamed Person

The unnamed person would be required to consent to the on-behalf-of request in writing.<sup>68</sup> In particular, the party filing an on-behalf-of request would be required to submit a signed Form Requesting Expungement on Behalf of an Unnamed Person (“Form”) and a statement requesting expungement with the Director.<sup>69</sup> The proposed rule change would not require that an on-behalf-of request be included in an answer or a separate pleading requesting expungement (although it could be), since the request seeks relief on behalf of a person who is not a party to the arbitration. However, the party making the request would be required to file the request, which would include the Form, no later than 60 days before the first scheduled hearing.<sup>70</sup> By filing and serving the expungement request on behalf of the unnamed person, the requesting party would be agreeing to represent the unnamed person and the unnamed person’s interests and to pursue the request for expungement on behalf of the unnamed person during the customer arbitration.<sup>71</sup>

FINRA believes that requiring the submission of the Form would help address the issue of an unnamed person not being made aware of the on-behalf-of request. As discussed above, FINRA is concerned that some associated persons are filing arbitration claims seeking expungement of the same customer dispute information that was the subject of a previous denial

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<sup>68</sup> See proposed Rule 12805(a)(2)(A).

<sup>69</sup> See proposed Rule 12805(a)(2)(C)(i) and (ii). The unnamed person whose CRD record would be expunged and the party requesting expungement on the unnamed person’s behalf must sign the Form.

<sup>70</sup> See proposed Rule 12805(a)(2)(C)(iii). The 60-day deadline is the same as the proposed deadline for a named associated person to request expungement through a separate pleading requesting expungement in a customer arbitration.

<sup>71</sup> See proposed Rule 12805(a)(2)(D)(iii).

by a panel of an on-behalf-of request.<sup>72</sup> By signing the Form, the unnamed person would be consenting to the on-behalf-of request and agreeing to be bound by the panel's decision on the request.<sup>73</sup> In addition, the Form would provide that, if the customer arbitration closes by award after a hearing, the unnamed person would be barred from filing a request for expungement for the same customer dispute information in a subsequent proceeding. The unnamed person's signature would serve as acknowledgement of this consequence.

ii. Required Contents of an On-Behalf-Of Expungement Request

Under the proposed rule change, an on-behalf-of request would be required to include the same elements as a request for expungement by a named associated person during a customer arbitration.<sup>74</sup> Thus, the party requesting expungement on behalf of an unnamed person (typically, the firm) would be required to provide the applicable filing fee; the CRD number of the unnamed person; each CRD occurrence number that is the subject of the request; the case name and docket number associated with the customer dispute information; and an explanation of whether expungement of the same customer dispute information was (i) previously requested and, if so (ii) how it was decided. In addition, as discussed above, the party requesting

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<sup>72</sup> See supra note 42 and accompanying text.

<sup>73</sup> See proposed Rule 12805(a)(2)(D)(i). By signing the Form, the unnamed person would also be agreeing to maintain the confidentiality of documents and information from the customer arbitration to which the unnamed person is given access and to adhere to any confidentiality agreements or orders associated with the customer arbitration. See proposed Rule 12805(a)(2)(D)(ii). The breach of this provision by the unnamed person could potentially subject the unnamed person to a claim for damages by an aggrieved party.

<sup>74</sup> See proposed Rule 12805(a)(1)(C)(ii) and 12805(a)(2)(C)(i); see also supra Item II.A.1.II.A.1.a.ii., "Required Contents of an Expungement Request."

expungement would be required to include the Form, signed by the unnamed person whose CRD record is the subject of the expungement request and the party filing the request.

c. Deciding Expungement Requests during Customer Arbitrations

The proposed amendments would require that if a named associated person or a party on behalf of an unnamed person has requested expungement during a customer arbitration and the case closes by award after a hearing, the panel from the customer arbitration must decide the expungement request during the customer arbitration in accordance with Rule 12805(c) and issue its decision on the request in the same award.<sup>75</sup> If the customer arbitration closes other than by award (e.g., settles) or by award without a hearing, the panel would not consider the expungement request.<sup>76</sup> Instead, to seek expungement relief, the associated person would need to file a straight-in request to expunge the customer dispute information associated with the customer arbitration as a new claim under proposed Rule 13805 against the member firm at which the associated person was associated at the time the customer dispute arose.<sup>77</sup> A panel from the Special Arbitrator Roster would decide the straight-in request, as discussed in more detail below.<sup>78</sup>

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<sup>75</sup> See proposed Rules 12805(a)(1)(D)(i) and (a)(2)(E)(i).

<sup>76</sup> See proposed Rules 12805(a)(1)(D)(ii) and (a)(2)(E)(ii).

<sup>77</sup> Under the Codes, a “member” includes any broker or dealer admitted to membership in FINRA, whether or not the membership has been terminated, suspended, cancelled, revoked, the member has been expelled or barred from FINRA or the member is otherwise defunct. See FINRA Rules 12100(s) and 13100(q); see also Securities Exchange Act Release No. 88254 (February 20, 2020), 85 FR 11157 (February 26, 2020) (Order Approving File No. SR-FINRA-2019-027).

<sup>78</sup> See infra Item II.A.1.II.B.2., “Panel from the Special Arbitrator Roster Decides Requests Filed Under the Industry Code.”

i. Panel Decides the Expungement Request if the Customer's Arbitration Closes by Award after a Hearing

Currently, if a named associated person requests expungement, or a party files an on-behalf-of request, and the customer's claim closes by award after a hearing, the panel may consider and decide the expungement request during the customer arbitration and issue its decision in the award. If, however, the party requesting expungement does not raise the issue of expungement during the hearing, the panel may not decide the request and may deem it withdrawn.<sup>79</sup> In this instance, the associated person may seek to file the request again at a later date.

Under the proposed rule change, if a named associated person requests expungement or a party files an on-behalf-of request during a customer arbitration and the customer's claim closes by award after a hearing, the panel in the customer arbitration would be required to consider and decide the expungement request and issue its decision in the same award.<sup>80</sup> This would help ensure that the panel from the customer's arbitration—which has received input from all parties, reviewed the pleadings, and considered the evidence on the merits—would decide the expungement request.<sup>81</sup>

The proposed rule change would require the panel to decide the request even if the requesting party withdraws or fails to pursue the request. In this instance, the panel would deny the expungement request with prejudice.<sup>82</sup> This would prevent associated persons from withdrawing expungement requests to avoid having their requests decided by the panel that

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<sup>79</sup> See FINRA Rules 12702 and 13702.

<sup>80</sup> See proposed Rules 12805(a)(1)(D)(i) and 12805(a)(2)(E)(i).

<sup>81</sup> See proposed Rules 12805(a)(1)(D) and 12805(a)(2)(E).

<sup>82</sup> See proposed Rules 12805(a)(1)(D)(i) and 12805(a)(2)(E)(i).

heard the evidence on the customer's arbitration claim, then seeking to re-file the request and receiving a potentially more favorable decision from a different set of arbitrators.

ii. Panel Does Not Decide Expungement if the Customer's Arbitration Closes Other than by Award or by Award without a Hearing

Currently, if a named associated person requests expungement or a party files an on-behalf-of request, the customer arbitration does not close by award after a hearing (e.g., settles) and the requesting party continues to pursue the expungement request, the panel from the customer arbitration will hold a hearing regarding the appropriateness of expungement.<sup>83</sup> If the named associated person or party requesting expungement does not request that the panel hold a separate hearing to decide the expungement request, the panel may deem the request withdrawn, and the associated person may seek to file the request again at a later date.

The proposed rule change would provide that if, during a customer arbitration, a named associated person requests expungement or a party files an on-behalf-of request and the customer arbitration closes other than by award or by award without a hearing, the panel from the customer arbitration would not be permitted to decide the expungement request.<sup>84</sup> Instead, the associated person would be required to seek expungement by filing a request to expunge the same customer dispute information as a straight-in request against the member firm at which the

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<sup>83</sup> See FINRA Rule 12805.

<sup>84</sup> See proposed Rules 12805(a)(1)(D)(ii)a. and 12805(a)(2)(E)(ii)a.

person was associated at the time the customer dispute arose under proposed Rule 13805, where a panel that is randomly selected from the Special Arbitrator Roster would decide the request.<sup>85</sup>

FINRA believes this approach reflects the importance of maintaining the integrity of information in the CRD system. When the customer arbitration closes other than by award or by award without a hearing, the panel selected by the parties in the customer arbitration may not have heard the presentation of the evidence on the merits of the case and, therefore, may not bring to bear any special insights in determining whether to issue an award containing expungement relief. In addition, customers or their representatives have little incentive to attend and participate in an expungement hearing once their case has settled. Requiring that an associated person file the expungement request as a straight-in request under the Industry Code to be heard and decided by a three-person panel that is randomly selected from the Special Arbitrator Roster would strengthen the expungement framework. As discussed in more detail below, while keeping in mind the importance of maintaining the integrity of information in the CRD system, this corps of experienced and specially trained arbitrators would follow the procedures set forth in proposed Rule 13805 to decide whether one or more of three grounds—the same three grounds contained in FINRA Rule 2080(b)(1)—exist in order to issue an award containing expungement relief.

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<sup>85</sup> See proposed Rules 12805(a)(1)(D)(ii)b. and 12805(a)(2)(E)(ii)b.; see also *infra* Item II.A.1.II.B.2., “Panel from the Special Arbitrator Roster Decides Requests Filed Under the Industry Code.”



## 2. No Intervening in Customer Arbitrations to Request Expungement

The proposed amendments would prohibit unnamed persons from intervening in a customer arbitration and requesting expungement.<sup>86</sup> If the associated person is neither a party to the arbitration nor the subject of an on-behalf-of request by another party to the arbitration, the associated person should not be able to intervene in the customers' arbitration to request expungement. In these circumstances, the associated person's conduct is unlikely to be fully addressed by the parties during the customer arbitration, and FINRA does not believe that the customer should have the presentation of their case interrupted or delayed by an associated person's intervention to request expungement. In addition, there have been instances in customer arbitrations in which the unnamed person learns that the customer's arbitration case is nearing conclusion. The associated person then files a motion to intervene in the case to ask the panel to consider an expungement request. As an unnamed person, the individual is not a party to the case and, therefore, has not made any arguments in support of the expungement request. Further, if the motion is granted, the parties to the case will be required to wait for a decision on the expungement request (which may necessitate another hearing) before their dispute is resolved, causing delay and additional cost to the parties.

Accordingly, under the proposed rule change, unnamed persons would be prohibited from intervening in a customer arbitration and requesting expungement. Instead, the unnamed person would be able to file the request as a new claim against the member firm at which the person was associated at the time the customer dispute arose under proposed Rule 13805, where a panel from the Special Arbitrator Roster would decide the request.<sup>87</sup>

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<sup>86</sup> See proposed Rules 12805(a)(2)(E)(iii) and 12800(d)(2)(D).

<sup>87</sup> See proposed Rule 12805(a)(2)(E)(iii)b.

### 3. No Straight-in Requests Against Customers

The proposed amendments would also prohibit an associated person from filing a straight-in request against a customer.<sup>88</sup> Currently, straight-in requests are rarely filed against a customer.<sup>89</sup> FINRA does not believe that customers should be compelled to attend or participate in a separate proceeding to decide an expungement request after the customer has resolved their arbitration claim or civil litigation. Accordingly, the proposed amendments would prohibit an associated person from filing a straight-in request against a customer. As discussed below, however, under the proposed rule change, customers would have the option to attend and participate in expungement hearings in straight-in requests, and the proposed rule change would include provisions to facilitate such attendance and participation.

#### B. Straight-in Requests under the Industry Code and the Special Arbitrator Roster

Under the proposed rule change, all requests to expunge customer dispute information that is not associated with a customer arbitration would be required to be filed as a straight-in request under proposed Rule 13805.<sup>90</sup> In addition, an associated person could request expungement of customer dispute information associated with a customer arbitration under

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<sup>88</sup> See proposed Rule 12805(a)(3).

<sup>89</sup> During the sample period, FINRA is able to identify requests to expunge 11,619 customer dispute information disclosures from the CRD system. Of those, 6,476 were sought to be expunged in straight-in requests; 116 were sought to be expunged in straight-in requests filed against a customer. See infra Item II.B.2., “Economic Baseline,” for further discussion.

<sup>90</sup> See proposed Rules 12805(a)(1)(A) and 13805(a)(1). As discussed above, under proposed Rule 12805, an associated person may request expungement in a customer arbitration of a customer complaint or civil litigation associated with a customer’s statement of claim. See supra note 48 and accompanying text.

proposed Rule 13805 if: (1) the associated person is named in the arbitration or is the subject of an on-behalf-of request and the customer arbitration closes other than by award or by award without a hearing; or (2) the associated person is the subject of a customer arbitration, but is neither named in the arbitration nor the subject of an on-behalf-of request, and the customer arbitration closes for any reason. If an associated person requests expungement under proposed Rule 13805, a three-person panel randomly selected from the Special Arbitrator Roster in accordance with proposed Rule 13806 would decide the expungement request.<sup>91</sup>

1. Filing a Straight-in Request Under the Industry Code

- a. Applicability

Under the proposed rule change, an associated person requesting expungement of customer dispute information as a straight-in request under the Industry Code must file a statement of claim in accordance with FINRA Rule 13302 against the member firm at which the person was associated at the time the customer dispute arose, unless the request is ineligible for arbitration under proposed Rule 13805(a)(2).<sup>92</sup> The only way to request expungement of customer dispute information under the Industry Code would be to file the request under proposed Rule 13805.

The requirement that the associated person file the straight-in request against the member firm at which the person was associated at the time the customer dispute arose would help ensure that there is a connection between the respondent firm and the subject matter of the expungement

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<sup>91</sup> See *infra* Item II.A.1.II.B.2.a. and b. (discussing eligibility requirements for and composition of the Special Arbitrator Roster).

<sup>92</sup> See proposed Rule 13805(a)(1). FINRA Rule 13302 provides, in relevant part, that to initiate an arbitration, a claimant must file with the Director a signed and dated Submission Agreement, and a statement of claim specifying the relevant facts and remedies requested.

request. For example, the firm at which the person requesting expungement was associated at the time the dispute arose should have knowledge of the dispute and access to documents or other evidence relating to the dispute. In addition, the proposed requirement would help ensure that the panel from the Special Arbitrator Roster would be able to request evidence from the member firm with information that is relevant to the expungement request. If the requisite connection is not present, the Director would be authorized to deny the use of the DRS arbitration forum for the request.<sup>93</sup>

b. Required Contents of Straight-in Requests

The required contents of a straight-in request would be the same as those required for expungement requests filed under proposed Rule 12805.<sup>94</sup> Thus, the associated person's straight-in request would be required to contain the applicable filing fee;<sup>95</sup> the CRD number of the party requesting expungement; each CRD occurrence number that is the subject of the request; the case name and docket number associated with the customer dispute information, if applicable; and an explanation of whether expungement of the same customer dispute information was previously requested and, if so, how it was decided.<sup>96</sup> In addition, as discussed

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<sup>93</sup> See proposed Rule 13203(b).

<sup>94</sup> See proposed Rule 13805(a)(3); see also *supra* Item II.A.1.II.A.1.a.ii., "Required Contents of an Expungement Request."

<sup>95</sup> FINRA would not assess a second filing fee when an associated person files a straight-in request if the associated person, or the requesting party in the case of an on-behalf-of request, had previously paid the filing fee to request expungement of the same customer dispute information during a customer arbitration.

<sup>96</sup> See proposed Rule 13805(a)(3). If an expungement request under the Industry Code fails to include any of the proposed requirements for requesting expungement, the request would be considered deficient and would not be served unless the deficiency is corrected. See proposed Rules 13307(a)(7) through (11).

below, the proposed rule change would impose limitations on when such requests may be made.<sup>97</sup>

2. Panel from the Special Arbitrator Roster Decides Requests Filed Under the Industry Code

If a straight-in request is filed in accordance with proposed Rule 13805, a three-person panel randomly selected from the Special Arbitrator Roster pursuant to proposed Rule 13806 would be required to hold an expungement hearing, decide the expungement request and issue an award.<sup>98</sup> The proposed amendments would also provide that if the associated person withdraws or does not pursue the request, the panel would be required to deny the expungement request with prejudice.<sup>99</sup> This requirement would foreclose the ability of associated persons to withdraw expungement requests to avoid having their requests decided by a panel that they believe does not favor their request, and then seek to re-file the request with the hope of obtaining a potentially more favorable decision from a different panel.

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<sup>97</sup> See *infra* Item II.A.1.II.C., “Limitations on Expungement Requests.” As discussed in more detail below, the straight-in request would be ineligible for arbitration under the Industry Code if: (1) a panel held a hearing to consider the merits of the associated person’s request for expungement of the same customer dispute information; (2) a court of competent jurisdiction previously denied the associated person’s request to expunge the same customer dispute information; (3) the customer arbitration or civil litigation or customer complaint associated with the customer dispute information is not closed; (4) more than two years have elapsed since the customer arbitration or civil litigation associated with the customer dispute information has closed; (5) there was no customer arbitration or civil litigation associated with the customer dispute information and more than three years have elapsed since the date that the customer complaint was initially reported to the CRD system; or (6) a named associated person is prohibited from seeking expungement because they did not request expungement in the associated customer arbitration under proposed Rule 12805(a)(1)(A). See proposed Rule 13805(a)(2).

<sup>98</sup> See proposed Rule 13805(a)(4).

<sup>99</sup> See proposed Rule 13805(a)(4).

a. Eligibility Requirements for the Special Arbitrator Roster

The proposed rule change would include several requirements to help ensure that arbitrators on the Special Arbitrator Roster have the qualifications and training to decide straight-in requests.

First, arbitrators on the Special Arbitrator Roster would be public arbitrators who are eligible for the chairperson roster.<sup>100</sup> Public arbitrators are not employed in the securities industry and do not devote 20 percent or more of their professional work to the securities industry or to parties in disputes concerning investment accounts or transactions or employment relationships within the financial industry.<sup>101</sup> Arbitrators are eligible for the chairperson roster if they have completed chairperson training provided by FINRA and: (1) have a law degree and are a member of a bar of at least one jurisdiction and have served as an arbitrator through award on at least one arbitration administered by an SRO in which hearings were held; or (2) have served as an arbitrator through award on at least three arbitrations administered by an SRO in which hearings were held.<sup>102</sup> These requirements would help ensure that the persons conducting the expungement hearing are impartial and experienced in managing and conducting arbitration hearings in the DRS arbitration forum.<sup>103</sup>

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<sup>100</sup> See proposed Rule 13806(b).

<sup>101</sup> See supra note 3.

<sup>102</sup> See FINRA Rules 12400(c) and 13400(c). For purposes of this proposed rule change, public arbitrators who are eligible for the chairperson roster would include those arbitrators who have met the chairperson eligibility requirements of FINRA Rules 12400(c) or 13400(c), regardless of whether they have already served as a chair on an arbitration case.

<sup>103</sup> The Task Force suggested that the arbitrators on its recommended special arbitration panel be chair-qualified, in part because of the training that arbitrators must complete before they can be added to the chairperson roster. See FINRA, Advanced Arbitrator Training, <https://www.finra.org/arbitration-mediation/advanced-arbitrator-training>; see also supra note 37.

Second, the public chairpersons must have evidenced successful completion of, and agreement with, enhanced expungement training provided by FINRA.<sup>104</sup> FINRA currently provides an Expungement Training module for arbitrators.<sup>105</sup> This training, however, would be expanded for arbitrators seeking to qualify for the Special Arbitrator Roster. This would allow FINRA to further emphasize with the arbitrators on the Special Arbitrator Roster the unique, distinct role they play in determining whether to issue an award containing expungement relief, and that expungement should be issued in limited circumstances and only if the arbitrators unanimously find that the information to be expunged is factually impossible, clearly erroneous or false, or that the associated person was not involved in the alleged misconduct.

Third, arbitrators on the Special Arbitrator Roster would also be required to have served as an arbitrator through award on at least four customer arbitrations administered by FINRA or by another SRO in which a hearing was held.<sup>106</sup> FINRA believes that if an arbitrator has served on four arbitrations through to award, it would indicate that the arbitrator has gained the knowledge and experience in the DRS arbitration forum to conduct hearings.<sup>107</sup>

b. Composition of the Panel

To minimize the potential for influence in the arbitrator selection process by the associated person and member firm, whose interests may be aligned, and to help ensure the development of a more complete factual record, the proposed rule change would require NLSS to select randomly the three public chairpersons from the Special Arbitrator Roster to decide a

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<sup>104</sup> See proposed Rule 13806(b)(2)(A).

<sup>105</sup> See supra note 35 and accompanying text.

<sup>106</sup> See proposed Rule 13806(b)(2)(B). This requirement would not be satisfied by serving on arbitrations administered under the special proceeding option of the simplified arbitration rules. See FINRA Rule 12800(c)(3)(B).

<sup>107</sup> In 2021, 87 percent of FINRA customer arbitrations closed other than by award.

straight-in request filed by an associated person.<sup>108</sup> The parties would not be permitted to agree to fewer than three arbitrators. The parties also would not be permitted to strike any arbitrators selected by NLSS nor stipulate to their removal,<sup>109</sup> but would be permitted to challenge an arbitrator selected for cause.<sup>110</sup> If an arbitrator is removed, NLSS would randomly select a replacement.<sup>111</sup>

The current process for selecting arbitrators—striking and combining ranked lists—would not be appropriate to use to select arbitrators to decide straight-in requests.<sup>112</sup> In arbitrations outside of the expungement context, the parties are typically adverse, which means that during arbitrator selection, each side may rank arbitrators on the lists whom they believe may be favorable to their case. The adversarial nature of the proceedings serves to minimize the impact of each party’s influence in arbitrator selection. In contrast, a straight-in request filed by an associated person against a firm is less likely to be adversarial in nature. FINRA believes that the proposed rule change would prevent the associated person and member firm from collaboratively seeking to influence the outcome of the expungement request through arbitrator selection.

FINRA recognizes that the proposed arbitrator selection process for straight-in requests would also limit the associated person and member firm’s input on arbitrator selection for

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<sup>108</sup> See proposed Rule 13806(b)(1). The first arbitrator selected would be the chair of the panel. See proposed Rule 13806(b)(3).

<sup>109</sup> The parties also would not be permitted to stipulate to the use of pre-selected arbitrators (i.e., arbitrators that the parties find on their own to use in their cases). See proposed Rule 13806(b)(1).

<sup>110</sup> See proposed Rule 13806(b)(4).

<sup>111</sup> See proposed Rule 13806(b)(4).

<sup>112</sup> See generally FINRA Rules 13403 and 13404.



reasons that may be unrelated to whether the arbitrator would potentially be sympathetic to the expungement request, such as their perception of the arbitrator's competence or efficiency. However, the arbitrators on the Special Arbitrator Roster would have the experience, qualifications and training necessary to conduct a fair and impartial expungement hearing in accordance with the proposed rules, and to make their determination based on a complete factual record developed during the expungement hearing. FINRA believes that the higher standards that the arbitrators must meet to serve on the Special Arbitrator Roster should mitigate the impact of the absence of party input on the selection of arbitrators. In addition, associated persons and member firms would still be permitted to challenge any arbitrator for cause.<sup>113</sup>

### C. Limitations on Expungement Requests

Currently, Rules 12805 and 13805 do not address when a party would not be permitted to file an expungement request in the DRS arbitration forum.<sup>114</sup> The Guidance, however, describes several circumstances in which an expungement request should be ineligible for arbitration. The proposed rule change would incorporate the limitations contained in the Guidance and add time limits to when an associated person may file a straight-in request.

#### 1. Limitations Applicable to Both Straight-in Requests and Expungement Requests During a Customer Arbitration

The Guidance provides that if a panel or a court has issued an award or decision denying an associated person's expungement request, the associated person may not request expungement of the same customer dispute information in another arbitration proceeding. In particular, the Guidance states that arbitrators should ask a party requesting expungement whether an

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<sup>113</sup> See proposed Rule 13806(b)(4).

<sup>114</sup> But see supra note 38 (describing time limits that apply to all arbitration claims, including expungement requests).

arbitration panel or a court previously denied expungement of the customer dispute information at issue and, if there has been a prior denial, the arbitration panel must deny the expungement request.<sup>115</sup>

The proposed rule change would codify the Guidance by providing that an associated person may not file a request for expungement of customer dispute information if (1) a panel held a hearing to consider the merits of the associated person's expungement request for the same customer dispute information or (2) a court of competent jurisdiction previously denied the associated person's request to expunge the same customer dispute information.<sup>116</sup> These proposed amendments would prevent an associated person from forum shopping, or seeking to return to the DRS arbitration forum to garner a favorable outcome on his or her expungement request.<sup>117</sup>

## 2. Limitations Applicable to Straight-in Requests Only

As discussed below, under the proposed amendments, four additional limitations would apply to straight-in requests.

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<sup>115</sup> See Guidance, *supra* note 5.

<sup>116</sup> See proposed Rules 12805(a)(1)(B)(i) and (ii) and 13805(a)(2)(A)(i) and (ii). The proposed rule change would require that the requesting party provide information about previous expungement requests and how such requests were decided. See proposed Rules 12805(a)(1)(C)(ii)e. and 13805(a)(3)(E).

<sup>117</sup> FINRA notes that if a panel holds a hearing that addresses the merits of an associated person's request for expungement, the Director would be authorized to deny the DRS arbitration forum to any subsequent request by the associated person or another party on behalf of the associated person to expunge the same customer dispute information. See proposed Rules 12203(b) and 13203(b).

a. No Straight-In Request If the Customer Arbitration, Civil Litigation or Customer Complaint Has Not Closed

The Guidance provides that an associated person may not file a separate request for expungement of customer dispute information arising from a customer arbitration until the customer arbitration has concluded. The proposed rule change would codify and expand upon this limitation in the Guidance by providing that an associated person may not file a straight-in request under proposed Rule 13805 if the customer arbitration, civil litigation or customer complaint associated with the customer dispute information has not closed.<sup>118</sup>

The proposed rule change would prevent an associated person from filing a straight-in request while a customer arbitration or civil litigation associated with the customer dispute information that is the subject of the straight-in request is pending. It would also prevent potentially inconsistent expungement decisions on related customer dispute information. The proposed rule change would also help ensure that the panel which will decide the straight-in request is able to consider the final factual record from the customer arbitration or civil litigation.

b. Straight-in Request Prohibited if Named Associated Person Did Not Request Expungement in Customer Arbitration

Under the proposed change, an associated person who is named in a customer arbitration must request expungement during the arbitration or forfeit the ability to seek to expunge the customer dispute information associated with the customer's statement of claim in any subsequent proceeding.<sup>119</sup> Accordingly, the proposed rule change would prohibit these

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<sup>118</sup> See proposed Rule 13805(a)(2)(A)(iii).

<sup>119</sup> See *supra* Item II.A.1.II.A.1.a., "Expungement Requests During the Customer Arbitration, By a Respondent Named in a Customer Arbitration," and accompanying text.

associated persons from filing a straight-in request under the Industry Code seeking to expunge the customer dispute information associated with the customer's statement of claim.<sup>120</sup>

c. Time Limits Applicable to Disclosures Arising After the Effective Date of the Proposed Rule Change

FINRA is aware that many straight-in requests are filed many years after the customer arbitration closes or the customer complaint is reported in the CRD system.<sup>121</sup> To encourage prompt filing of expungement requests, the proposed amendments would establish time limits for expungement requests that are specifically tied to the closure of customer arbitrations and civil litigations, or the reporting of customer complaints in the CRD system, as applicable.<sup>122</sup> The proposed time limits should help encourage customer attendance and participation in expungement proceedings and help ensure that straight-in requests are brought before relevant evidence and testimony becomes stale or unavailable.<sup>123</sup> The proposed time limits may also curtail the common practice of bundling multiple unrelated and aged expungement requests in one straight-in request.<sup>124</sup>

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<sup>120</sup> See proposed Rule 13805(a)(2)(A)(vi).

<sup>121</sup> See *supra* note 39.

<sup>122</sup> FINRA Rules 12206 and 13206 provide that no claim shall be eligible for submission to arbitration where six years have elapsed from the occurrence or event giving rise to the claim. Under these Rules, the panel has discretion to determine if the claim, including an expungement request, is eligible for arbitration. See *supra* note 38. As discussed below, if the proposed rule change is approved by the Commission, this six-year eligibility rule would continue to apply to requests to expunge customer dispute information that arose prior to the effective date of the proposed rule change.

<sup>123</sup> All customers from a customer arbitration or civil litigation, and all customers who initiated a customer complaint, would be notified of the expungement request and encouraged to attend and provide their input. See proposed Rule 13805(b)(1)(A).

<sup>124</sup> For example, under the proposed time limits, associated persons would not have been able to include all customer dispute information disclosures in 44 percent of the straight-

(i) Two Years from the Close of a Customer Arbitration or Civil  
Litigation

Under the proposed rule change, an associated person would be permitted to file a straight-in request within two years of the close of a customer arbitration or a civil litigation associated with the customer dispute information.<sup>125</sup> The proposed amendments would allow an associated person to request expungement of customer dispute information associated with the customer arbitration or civil litigation—including any associated customer complaint disclosures—within two years after the customer arbitration or civil litigation closes.<sup>126</sup>

A two-year limitation period would allow the associated person sufficient time to determine whether to seek expungement by filing a straight-in request and provide a reasonable amount of time for the associated person to gather the documents, information and other resources required to file the expungement request. In addition, a two-year period would help ensure that the expungement hearing is held close enough in time to the customer arbitration or civil litigation, when information regarding the customer arbitration or civil litigation is available and in a timeframe that could increase the likelihood for the customer to attend and participate if the customer chooses to do so. The two-year time limit may also curtail the common practice of bundling multiple unrelated and aged expungement requests in one straight-in request.

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in requests. See infra Item II.B.3.D, "Time Limits for Filing Straight-in Requests – Quantitative Description."

<sup>125</sup> See proposed Rule 13805(a)(2)(A)(iv).

<sup>126</sup> With respect to requests to expunge customer dispute information associated with a customer arbitration, an associated person would be permitted to file a straight-in request under this two-year time limitation only if expungement of the customer dispute information was not required to be decided during the customer arbitration.

(ii) Three Years from the Date a Customer Complaint Is Reported to the CRD System

Under the proposed rule change, an associated person would be prohibited from filing a straight-in request to expunge a customer complaint where more than three years have elapsed since the customer complaint was initially reported to the CRD system and there was no customer arbitration or civil litigation associated with the customer dispute information.<sup>127</sup> This means that if no customer arbitration or civil litigation associated with the customer complaint is filed, the associated person would have three years from the date the customer complaint was initially reported in the CRD system to file the expungement request.<sup>128</sup>

The three-year time limitation would help ensure that the expungement hearing is held close in time to the events that gave rise to the customer dispute and increase the likelihood of customer attendance and participation. Three years should also provide sufficient time for firms to complete their investigation of the complaint, for associated persons to develop a sense of whether the complaint may evolve into an arbitration or civil litigation, and for the associated person to gather the necessary resources and determine whether to seek expungement. The three-year time limitation may also curtail requests to expunge customer complaints that are filed many years after first being reported to the CRD system and the bundling of multiple unrelated and aged disclosures in a single expungement request.

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<sup>127</sup> See proposed Rule 13805(a)(2)(A)(v).

<sup>128</sup> A customer complaint can be reported to the CRD system via a Form U4 or Form U5. Pursuant to FINRA Rule 1010, an associated person should be made aware of the filing of a Form U4 and any amendments thereto by the associated person's member firm. In addition, Article V, Section 3 of the FINRA By-Laws requires that a member firm provide an associated person a copy of an amended Form U5, including one reporting a customer complaint involving the associated person. FINRA also provides several methods for associated persons and former associated persons to check their records, including online through BrokerCheck.

As discussed above, the Codes provide that no claim shall be eligible for submission to arbitration where six years have elapsed from the occurrence or event giving rise to the claim.<sup>129</sup> As a result of this six-year eligibility rule, a customer arbitration may be filed after an associated person has filed and received an award in connection with a customer complaint associated with the customer arbitration. To avoid unfairly impacting a customer arbitration filed after a panel has issued an award on a request to expunge a customer complaint associated with the customer arbitration, the proposed rule change would provide that a prior expungement award shall not be admissible in the customer arbitration.<sup>130</sup>

d. Time Limits Applicable to Disclosures Arising on or Prior to the Effective Date of the Proposed Rule Change

The proposed amendments would also establish time limits for requests to expunge customer dispute information arising from customer arbitrations and civil litigations that close, and for customer complaints that were initially reported to the CRD system, on or prior to the effective date of the proposed rule change.

Specifically, the proposed amendments would provide that if an expungement request is otherwise eligible under the six-year limitation period of FINRA Rule 13206(a), an associated person would be permitted to file a straight-in request under the Industry Code if: (1) the request for expungement is made within two years of the effective date of proposed rule change, and the disclosure to be expunged is associated with a customer arbitration or civil litigation that closed on or prior to the effective date;<sup>131</sup> or (2) the request for expungement is made within three years

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<sup>129</sup> See supra note 38.

<sup>130</sup> See proposed Rules 12604(c) and 13604(c).

<sup>131</sup> See proposed Rule 13805(a)(2)(B)(i).

of the effective date of the proposed rule change, and the disclosure to be expunged is associated with a customer complaint initially reported to the CRD system on or prior to its effective date.<sup>132</sup>

### 3. Director's Authority to Deny the Forum

The Codes provide the Director with authority to decline the use of the DRS arbitration forum if the Director determines that “given the purposes of FINRA and the intent of the Code, the subject matter of the dispute is inappropriate, or that accepting the matter would pose a risk to the health or safety of arbitrators, staff, or parties or their representatives.”<sup>133</sup>

To ensure additional safeguards around the expungement process, the proposed rule change would provide the Director with express authority to decline the use of the DRS arbitration forum if an associated person files an expungement request that the Director determines is ineligible for arbitration under proposed Rules 12805 and 13805.<sup>134</sup> For example, the Director would decline the use of the DRS arbitration forum if an expungement request is ineligible under the proposed time limitations. The Director would also decline the use of the DRS arbitration forum if a panel has previously considered the merits of, or a court has previously decided, an expungement request associated with the same customer dispute information. The Director would also decline the use of the DRS arbitration forum if an associated person was named as a respondent in a customer arbitration but did not request expungement; if an associated person requested expungement but withdrew or did not pursue the expungement request; or if a party to a customer arbitration requested expungement on behalf of

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<sup>132</sup> See proposed Rule 13805(a)(2)(B)(ii).

<sup>133</sup> See FINRA Rules 12203 and 13203.

<sup>134</sup> See proposed Rules 12203(b) and 13203(b).



an unnamed person but the party withdrew or did not pursue an expungement request on behalf of the unnamed person.

The proposed rule change would also provide the Director with express authority to decline the use of the DRS arbitration forum if the Director determines that the expungement request was not filed under, or considered in the DRS arbitration forum in accordance with, proposed Rules 12805 or 13805.<sup>135</sup> For example, the Director may decline the use of the DRS arbitration forum if the Director determines that a panel is proposing to issue an award containing expungement of customer dispute information other than pursuant to proposed Rules 12805, 12800(d) and (e) or 13805, as applicable. The Director may also decline the use of the DRS arbitration forum if an associated person seeks expungement of customer dispute information other than pursuant to proposed Rules 12805, 12800(d) and (e) or 13805, as applicable.

D. Requirements Relating to All Expungement Hearings

FINRA Rules 12805 and 13805 currently provide a list of requirements panels must follow in order to issue an award containing expungement relief.<sup>136</sup> In addition, the Guidance provides best practices that arbitrators should follow when deciding expungement requests. To further guide the arbitrators' decision-making, the proposed rule change would expand the expungement hearing requirements currently in FINRA Rules 12805 and 13805 and incorporate relevant provisions from the Guidance. The proposed requirements would apply to all expungement hearings.<sup>137</sup>

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<sup>135</sup> See proposed Rules 12203(c) and 13203(c).

<sup>136</sup> See supra note 45.

<sup>137</sup> See proposed Rules 12805(c) and 13805(c). The proposed requirements for expungement hearings would apply to expungement hearings held during a customer arbitration under proposed Rule 12805, a simplified customer arbitration under proposed

## 1. Recorded Hearing Sessions

The Codes require a panel that is deciding an expungement request to hold a recorded hearing session (by telephone or in person) regarding the appropriateness of expungement.<sup>138</sup>

The proposed rule change would provide that the panel must hold one or more separate recorded hearing sessions regarding the expungement request, clarifying that the panel would not be limited in the number of hearing sessions it should hold to decide the expungement request.<sup>139</sup>

The proposed amendments would also remove the specific reference to the hearing being held by telephone or in person because, as discussed below, the participants in the hearing may appear by different methods.

## 2. Associated Person's Appearance

The proposed rule change would require the associated person whose information in the CRD system is the subject of the expungement request to appear in person or by video conference at the expungement hearing.<sup>140</sup> A party requesting expungement on behalf of an unnamed person or the party's representative would also be required to appear in person or by video conference at the hearing. The panel would determine the method of appearance.

As the associated person is seeking the permanent removal of information from the CRD system, FINRA believes the associated person should be required to appear in person or by video conference at the expungement hearing and be available to respond to questions. Requiring that the associated person's appearance be in person or by video conference would help the panel

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Rule 12800 (see *infra* Item II.A.1.II.G., "Expungement Requests During Simplified Customer Arbitrations") and a straight-in request under proposed Rule 13805, unless otherwise specified.

<sup>138</sup> See FINRA Rules 12805(a) and 13805(a).

<sup>139</sup> See proposed Rules 12805(c)(1) and 13805(c)(1).

<sup>140</sup> See proposed Rules 12805(c)(2) and 13805(c)(2).

assess the associated person’s credibility, which may be particularly important if the request is unopposed.

### 3. Customer’s Attendance and Participation during the Expungement Hearing

The Guidance states that it is important to allow customers and their representatives to participate in the expungement hearing if they wish to do so.<sup>141</sup> Specifically, the Guidance provides that arbitrators should:

- Allow the customer and their representative to appear at the expungement hearing;
- Allow the customer to testify (telephonically, in person, or other method) at the expungement hearing;
- Allow the representative for the customer or a pro se customer to introduce documents and evidence at the expungement hearing;
- Allow the representative for the customer or a pro se customer to cross-examine the associated person or other witnesses called by the party seeking expungement; and
- Allow the representative for the customer or a pro se customer to present opening and closing arguments if the panel allows any party to present such arguments.

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<sup>141</sup> The Guidance directs arbitrators to permit customers and their counsel to participate in the expungement hearing. See Guidance, supra note 5. FINRA Rules 12208 and 13208 permit a party to be represented pro se, by an attorney or by a person who is not an attorney. Accordingly, the proposed amendments use the term “representative” rather than “counsel.” See also Securities Arbitration—Should You Hire an Attorney? (Jan. 3, 2019), <https://www.finra.org/investors/insights/securities-arbitration>; How to Find an Attorney, <https://www.finra.org/arbitration-mediation/how-find-attorney>; and Resources for Investors Representing Themselves, <https://www.finra.org/arbitration-mediation/resources-investors-representing-themselves>.

The proposed rule change would codify these provisions of the Guidance. The proposed rule change would make clear that all customers whose customer arbitrations, civil litigations or customer complaints are a subject of the expungement request are entitled to representation and may attend and participate in the expungement hearing.<sup>142</sup> These customers would also be entitled to attend and participate in any prehearing conferences held for straight-in requests.<sup>143</sup> Because expungement requests may otherwise be unopposed, FINRA believes that the customers should be allowed to attend and participate in the entirety of the expungement hearing and any prehearing conferences.

The proposed rule change would provide that the customer could choose to attend and participate by telephone, in person or by video conference.<sup>144</sup> Customer attendance and participation during an expungement hearing provides the panel with important information and perspective that it might not otherwise receive. By providing customers with options for how to attend and participate in hearings, FINRA seeks to encourage customer attendance and participation by making it easier for customers to do so.

The proposed rule change would also specify ways in which the customer must be allowed to attend and participate in the expungement hearing. First, the proposed rule change would provide that customers or customers' representatives must be allowed to introduce

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<sup>142</sup> See proposed Rules 12805(c)(3)(A), 12805(c)(4), 13805(c)(3)(A) and 13805(c)(4). The proposed rule change would make clear that customers also have the option to provide their position on the expungement request in writing in lieu of attending the hearing.

<sup>143</sup> See proposed Rule 13805(c)(3)(A). A prehearing conference is any hearing session, including an Initial Prehearing Conference (“IPHC”), that takes place before the hearing on the merits begins. See FINRA Rules 12100(y) and 13100(w); see also FINRA Rules 12500 and 13500. Under the proposal, all customers whose customer arbitrations, civil litigations or customer complaints are a subject of the straight-in request would be entitled to representation at prehearing conferences. See proposed Rule 13805(c)(4).

<sup>144</sup> See proposed Rules 12805(c)(3)(B) and 13805(c)(3)(B).

evidence during the expungement hearing.<sup>145</sup> If the customer or customer's representative introduces any evidence at the expungement hearing, a party could state objections to the introduction of the evidence during the expungement hearing.<sup>146</sup>

Second, the customers and the customers' witnesses would be allowed to testify at the expungement hearing and be questioned by the customer or customer's representative.<sup>147</sup> If customers or their witnesses testify, the associated person or a party requesting expungement on behalf of an unnamed person would be allowed to conduct cross-examination.<sup>148</sup>

Third, the customer or customer's representative would be permitted to state objections to evidence and cross-examine the associated person or party requesting expungement on behalf of an unnamed person and any other witnesses called during the expungement hearing.<sup>149</sup>

Fourth, the customer or customer's representative would be permitted to present opening and closing arguments if the panel permits any party to present such arguments.<sup>150</sup>

FINRA believes the proposal strikes the right balance of allowing the customer to attend and participate in the hearing and giving the associated person or party requesting expungement on behalf of an unnamed person the opportunity to substantiate arguments in support of the expungement request.

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<sup>145</sup> See proposed Rules 12805(c)(5)(A) and 13805(c)(5)(A).

<sup>146</sup> See proposed Rules 12805(c)(5)(A) and 13805(c)(5)(A).

<sup>147</sup> See proposed Rules 12805(c)(5)(B) and 13805(c)(5)(B).

<sup>148</sup> See proposed Rules 12805(c)(5)(B) and 13805(c)(5)(B).

<sup>149</sup> See proposed Rules 12805(c)(5)(C) and 13805(c)(5)(C).

<sup>150</sup> See proposed Rules 12805(c)(5)(D) and 13805(c)(5)(D).

#### 4. Panel Requests for Additional Documents or Evidence

Arbitrators on the panel do not conduct their own research when hearing an arbitration case; instead, they review the materials provided by the parties. If they need more information, they can request it from the parties. In deciding an expungement request, particularly in cases that settle before an evidentiary hearing or in cases where the customer does not attend or participate in the expungement hearing, the panel's role as fact finder is critical. Given this significant role, the panel must ensure that it has all of the information necessary to make a fully informed decision on the expungement request on the basis of a complete factual record.

Thus, the proposed rule change would codify the ability of the panel to request from the associated person, the party requesting expungement on behalf of an unnamed person and the member firm at which the person was associated at the time the customer dispute arose, as applicable, any documentary, testimonial or other evidence that the panel deems relevant to the expungement request.<sup>151</sup> This would allow the panel, for example, to require the associated person to produce documents that the panel deems relevant at the prehearing conference, to testify in response to questions by the panel at the hearing or to provide transcripts of previously obtained witness testimony.

#### 5. Review of Settlement Documents

Current FINRA Rules 12805(b) and 13805(b) provide that, in the event a customer dispute is resolved by settlement, the panel considering the expungement request must review the

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<sup>151</sup> See proposed Rules 12805(c)(6) and 13805(c)(7). The Guidance also suggests that arbitrators should ask the associated person seeking expungement or the party seeking expungement on an associated person's behalf to provide a current copy of the BrokerCheck report for the person whose record would be expunged, paying particular attention to the "Disclosure Events" section of the report. See Guidance, *supra* note 5. FINRA continues to encourage arbitrators to request a current copy of the associated person's BrokerCheck report.

settlement documents and consider the amount of payments made to any party and any other terms and conditions of the settlement.<sup>152</sup> The proposed rule change would retain this requirement.<sup>153</sup>

In addition, the Guidance encourages arbitrators to inquire and fully consider whether a party conditioned a settlement of a customer dispute upon an agreement not to oppose the request for expungement in cases in which the customer does not attend or participate in the expungement hearing or the requesting party states that a customer has indicated that the customer will not oppose the expungement request. Because conditioned settlements violate FINRA Rule 2081 and may be grounds to deny an expungement request, the proposed rule change would codify the language in the Guidance.<sup>154</sup>

#### 6. Unanimous Decision to Issue an Award Containing Expungement Relief

Current FINRA Rules 12805 and 13805 require that, in order to issue an award containing expungement of customer dispute information, the panel must indicate in the arbitration award which of the FINRA Rule 2080 grounds for expungement serves as the basis

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<sup>152</sup> The panel must review settlement documents that are related to the customer dispute information that is the subject of the expungement request, regardless of whether the associated person was a party to the settlement.

<sup>153</sup> See proposed Rules 12805(c)(7) and 13805(c)(8). FINRA Rule 2081 provides that no member firm or associated person shall condition or seek to condition settlement of a dispute with a customer on, or to otherwise compensate the customer for, the customer's agreement to consent to, or not to oppose, the member's or associated person's request to expunge such customer dispute information from the CRD system. See also Prohibited Conditions Relating to Expungement of Customer Dispute Information FAQ, <https://www.finra.org/arbitration-mediation/faq/prohibited-conditions-relating-expungement-customer-dispute-information>.

<sup>154</sup> See proposed Rules 12805(c)(7) and 13805(c)(8).

for its expungement order. Consistent with arbitration cases generally, the panel may award expungement based on a majority decision of the arbitrators.<sup>155</sup>

The proposed rule change would require that the arbitrators agree unanimously to issue an award containing expungement relief.<sup>156</sup> Although the vast majority of expungement decisions are already unanimous,<sup>157</sup> FINRA believes that this change would help protect the integrity of the information in the CRD system and help ensure that the expungement process operates as intended—as a remedy that is appropriate only in limited circumstances in accordance with the narrow standards in FINRA rules.<sup>158</sup>

To further protect the integrity of the information in the CRD system, the proposed amendments would also provide that in order to issue an award containing expungement relief, the unanimous finding must be that one or more of the grounds for expungement enumerated in the proposed rule has been established: (1) the claim, allegation or information is factually impossible or clearly erroneous; (2) the associated person was not involved in the alleged investment-related sales practice violation, forgery, theft, misappropriation or conversion of funds; or (3) the claim, allegation or information is false.<sup>159</sup> To help ensure there is no confusion as to which standard the arbitrators must apply, the proposed rule change would also state that

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<sup>155</sup> See FINRA Rules 12410 and 13414.

<sup>156</sup> See proposed Rules 12805(c)(8)(A) and 13805(c)(9)(A). FINRA notes that when deciding a customer’s claims, a majority decision of the arbitrators would continue to be sufficient.

<sup>157</sup> During the sample period, in arbitrations decided by a three-person arbitration panel and involving an expungement request, the panel decision was unanimous (not unanimous) in 98 percent (two percent) of arbitrations. In one percent of the arbitrations, the decision awarding expungement was not unanimous and would not have been permitted under the proposed change.

<sup>158</sup> See supra note 27 and accompanying text.

<sup>159</sup> See proposed Rules 12805(c)(8)(A)(i) and 13805(c)(9)(A)(i).



the panel shall not issue, and the Director shall not serve, an award containing expungement relief based on any other grounds.<sup>160</sup>

The Codes, which include FINRA Rules 12805 and 13805, govern the processes by which all arbitration cases are administered in the DRS arbitration forum.<sup>161</sup> Accordingly, the three grounds referenced in proposed Rules 12805(c)(8)(A)(i) and 13805(c)(9)(A)(i) on which a panel must unanimously make a finding to issue an award containing expungement relief would be the exclusive grounds upon which a panel could award expungement in the DRS arbitration forum.<sup>162</sup>

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<sup>160</sup> See proposed Rules 12805(c)(8)(A)(ii) and 13805(c)(9)(A)(ii). FINRA further notes that it would be inappropriate to award expungement of customer dispute information that is associated with a customer arbitration or civil litigation in which the associated person was found liable. In this circumstance, the liability finding would be inconsistent with a finding that one of the three grounds has been established to issue an award containing expungement relief.

<sup>161</sup> See FINRA Rules 12101 and 13101 (describing how the Codes apply to disputes submitted to arbitration).

<sup>162</sup> FINRA Rule 2080 is not part of the Codes, and FINRA is not proposing amendments to FINRA Rule 2080 at this time. With this proposed rule change, FINRA is proposing to codify the grounds identified in FINRA Rule 2080(b)(1) as the exclusive grounds upon which an arbitration panel may issue an award containing expungement of customer dispute information from the CRD system. See also *supra* note 31 (discussing prior statements by the SEC and FINRA that expungement may occur only after the arbitrators find that one or more of the grounds in FINRA Rule 2080(b)(1) serves as the basis for the expungement award). The discretionary standard in FINRA Rule 2080(b)(2) would not be a basis for a panel to award expungement relief in the DRS arbitration forum. FINRA Rule 2080(b)(2) provides “FINRA”—not arbitrators in the DRS arbitration forum—the ability, “in [FINRA’s] sole discretion and under extraordinary circumstances,” to waive the obligation to name FINRA as an additional party to a court proceeding related to expungement of customer dispute information from CRD if FINRA “determines that: (A) the expungement relief and accompanying findings on which it is based are meritorious; and (B) the expungement would have no material adverse effect on investor protection, the integrity of the CRD system or regulatory requirements.”

Although FINRA is not proposing to amend FINRA Rule 2080 at this time, it is considering whether enhancements to the current expungement process through changes to FINRA Rule 2080 may be warranted. See Discussion Paper, *supra* note 13 (exploring

## 7. Contents of the Expungement Award

The panel is currently required to provide a “brief” written explanation of the reasons for its finding that one or more of the grounds for expungement applies to the facts of the case.<sup>163</sup> The proposed rule change would retain the requirement to provide the written explanation, but would remove the word “brief” such that the panel would be required to provide enough detail in the award to explain its rationale for awarding expungement relief.<sup>164</sup> As the Guidance suggests, the panel’s explanation must be complete and not solely a recitation of one of the FINRA Rule 2080(b)(1) grounds or language provided in the expungement request. For the same reason, the proposed rule change would incorporate language from the Guidance that the panel’s explanation should identify any specific documentary, testimonial or other evidence on which the panel relied in awarding expungement relief.<sup>165</sup>

## 8. Evidentiary Weight of Decision of Customer or Authorized Representative Not to Attend or Participate

The proposed amendments would also instruct the panel that the decision of a customer or an authorized representative of state securities regulators (“authorized representative”) not to attend or participate in the expungement hearing shall not be material to the determination of whether expungement is appropriate.<sup>166</sup> FINRA is aware that some panels have indicated in

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potential alternatives to the current expungement process, including potential changes to FINRA Rule 2080).

<sup>163</sup> See FINRA Rules 12805(c) and 13805(c).

<sup>164</sup> See proposed Rules 12805(c)(8)(B) and 13805(c)(9)(B).

<sup>165</sup> See proposed Rules 12805(c)(8)(B) and 13805(c)(9)(B).

<sup>166</sup> See proposed Rules 12805(c)(8)(C) and 13805(c)(9)(C); see also *infra* Item II.A.1.II.F., “Attendance and Participation of an Authorized Representative of State Securities Regulators in Straight-in Requests” (discussing the attendance and participation in straight-in requests of an authorized representative of state securities regulators).

expungement awards that a customer did not appear at the expungement hearing. A customer or an authorized representative may not attend, participate in or appear at an expungement hearing for a variety of reasons that may be unrelated to the merits of the expungement request.

Accordingly, FINRA believes that a customer's or an authorized representative's decision not to attend or participate should not be given any evidentiary weight by the panel when making the expungement determination.

#### 9. Forum Fees

The proposed rule change would retain the current requirements in FINRA Rules 12805(d) and 13805(d) that address how DRS arbitration forum fees are assessed in expungement hearings. Specifically, the panel must assess against the parties requesting expungement all DRS arbitration forum fees for each hearing session in which the sole topic is the determination of the appropriateness of expungement.<sup>167</sup>

#### E. Notifications to Customers and to State Securities Regulators Regarding Expungement Requests

##### 1. Notification to Customers by the Associated Person

The Guidance suggests that when a straight-in request is filed against a firm, arbitrators order the associated person to provide a copy of the statement of claim to the customers involved in the customer dispute that gave rise to the customer dispute information maintained in the CRD system. This helps ensure that the customers know about the expungement request and have an opportunity to attend and participate in the expungement hearing or provide a position in writing on the associated person's request. The proposed rule change would codify this practice in the Industry Code by requiring that the associated person serve all customers whose customer

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<sup>167</sup> See proposed Rules 12805(c)(9) and 13805(c)(10).

arbitrations, civil litigations or customer complaints are a subject of the expungement request with a copy of the statement of claim requesting expungement and any answer.<sup>168</sup> The associated person would be required to serve a copy of the statement of claim and a copy of any answer within 10 days of filing.<sup>169</sup> The panel would be authorized to decide whether extraordinary circumstances exist that make service on the customers impracticable.<sup>170</sup>

Given the associated person's personal interest in obtaining expungement, FINRA believes that the panel should review all documents that the associated person used to inform the customers about the expungement request as well as any customer responses received. Accordingly, the proposed rule change would require the associated person to file with the panel proof of service for the statement of claim and any answers, copies of all documents provided by the associated person to the customers, and copies of all communications sent by the associated person to the customers and any responses received from the customers.<sup>171</sup> The proposed requirement would also help ensure that the associated person does not attempt to dissuade a customer from attending or participating in the expungement hearing.

## 2. Notifications to the Customer by the Director

Customer attendance and participation in expungement hearings helps the panel fully develop a record on which to decide the expungement request. Accordingly, the proposed rule change would require the Director to notify all customers whose customer arbitrations, civil

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<sup>168</sup> See proposed Rule 13805(b)(1)(A)(i) and (ii). This requirement would apply to straight-in requests filed under the Industry Code; notice to customers would not be necessary for requests filed under proposed Rule 12805 of the Customer Code as the customer would be a named party.

<sup>169</sup> See proposed Rule 13805(b)(1)(A)(ii).

<sup>170</sup> See proposed Rule 13805(b)(1)(A)(i).

<sup>171</sup> See proposed Rule 13805(b)(1)(A)(iv).

litigations or customer complaints are a subject of the expungement request, of the time, date and place of any prehearing conferences and the expungement hearing.<sup>172</sup>

The Director would include language in the notice to encourage the customer to attend and participate in the expungement hearing. The associated person would be required to provide a current address for the customer,<sup>173</sup> or the expungement request would be considered deficient and would not be served.<sup>174</sup> The Director's notice to the customer would serve as a reminder of the expungement request and would provide the customer with timely notice of any prehearing conferences and expungement hearings so that customers may plan and prepare to attend and participate if they choose.

The Director would also provide the notified customers with access to all documents that are relevant to (a) the expungement request that are filed in the straight-in request and (b) any prior customer arbitration brought by the customer that is a subject of the expungement request.<sup>175</sup> This would provide the customer with access to the key documents surrounding the request for expungement prior to their attendance and participation in the expungement hearing.

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<sup>172</sup> See proposed Rule 13805(b)(1)(B)(i). This requirement would apply to straight-in requests filed under the Industry Code; notice to customers would not be necessary for requests filed under proposed Rule 12805 of the Customer Code as the customer would be a named party. See also *infra* Item II.A.1.II.G.3., "Customer Notification of Expungement Hearings during Simplified Arbitrations" (discussing customer notification of expungement hearings in connection with simplified arbitrations).

<sup>173</sup> See proposed Rule 13805(b)(1)(B)(i).

<sup>174</sup> See proposed Rule 13307(a)(7).

<sup>175</sup> See proposed Rule 13805(b)(1)(B)(ii). FINRA would provide customers with access to the documents through the DR Portal. The DR Portal has two parts: the DR Neutral Portal is for FINRA neutrals serving on the Dispute Resolution roster, and the DR Party Portal is for arbitration and mediation case participants. Once registered on the DR Portal, parties may use the portal to, among other things, file an arbitration claim, view case documents, submit documents to FINRA and send documents to other portal case participants, and schedule hearing dates. See FINRA Dispute Resolution Services, DR Portal, <https://www.finra.org/arbitration-mediation/dr-portal>.

### 3. Notifications to State Securities Regulators

The proposed rule change would require FINRA to notify state securities regulators, in the manner determined by the Director in collaboration with state securities regulators, of an expungement request within 15 days of receiving an expungement request.<sup>176</sup> The proposed notification requirement would help ensure that state securities regulators are timely notified of expungement requests.

#### F. Attendance and Participation of an Authorized Representative of State Securities Regulators in Straight-in Requests

The current expungement process does not include a mechanism to facilitate state securities regulator involvement in expungement hearings in the DRS arbitration forum. The proposed rule change would provide a mechanism for an authorized representative to provide the state securities regulators' position or positions on an expungement request in writing or by attending and participating in the expungement hearing in person or by video conference.<sup>177</sup> This attendance and participation by an authorized representative of the state securities regulators would be limited to straight-in requests, where the panel may otherwise only hear evidence from the party requesting expungement.

At the same time as providing notification to state securities regulators of a straight-in request, the Director would provide state securities regulators with access to all documents relevant to (a) the expungement request filed in the arbitration requesting expungement relief and (b) any other customer arbitration brought under the Customer Code that is associated with the

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<sup>176</sup> See proposed Rules 12800(f)(1), 12805(b) and 13805(b)(2)(A). FINRA would make this notification in connection with expungement requests under the Customer and Industry Codes. Such notification could be achieved by notifying NASAA of the expungement requests.

<sup>177</sup> See proposed Rule 13805(c)(6)(A).

customer dispute information that is a subject of the expungement request.<sup>178</sup> Providing state securities regulators with these documents would help facilitate a determination of whether to attend and participate in the expungement hearing.

If the Director receives notification from an authorized representative no later than 30 days after the last answer is due that the authorized representative intends to attend and participate in the expungement hearing, the Director shall notify the authorized representative of the time, date and place of any prehearing conferences and the expungement hearing.<sup>179</sup> At the expungement hearing, the authorized representative would be permitted to: (1) introduce documentary, testimonial, or other evidence; (2) cross-examine witnesses; and (3) present opening and closing arguments if the panel allows any party to present such arguments.<sup>180</sup> The other persons appearing at the expungement hearing could state objections to the authorized representative's evidence and cross-examine the authorized representative's witnesses.<sup>181</sup>

The authorized representative would not be considered a party to the proceeding and their attendance and participation would be limited to what is authorized by proposed Rule 13805(c)(6).<sup>182</sup> In addition, the panel would not be permitted to allow the attendance or

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<sup>178</sup> See proposed Rule 13805(b)(2)(B). The state securities regulators' access to the documents would be subject to confidentiality restrictions. Outside of the DRS arbitration process, state securities regulators could choose to seek access to additional documents and information pursuant to their separate authority.

<sup>179</sup> See proposed Rule 13805(b)(3).

<sup>180</sup> See proposed Rule 13805(c)(6)(B).

<sup>181</sup> See proposed Rule 13805(c)(6)(C).

<sup>182</sup> As such, an authorized representative would not be entitled to seek discovery from the parties through the DRS arbitration forum, file motions, or seek to postpone a hearing.

participation of the authorized representative to materially delay the scheduling of the expungement hearing.<sup>183</sup>

Allowing an authorized representative to attend and participate in straight-in requests may provide meaningful opposition to the expungement request, which might otherwise be unopposed, and thus help create a more complete factual record for the panel to rely upon to decide the expungement request. NASAA and state securities regulators have a shared interest with FINRA in protecting the integrity of the information contained in the CRD system, as it is a crucial tool in their registration and oversight responsibilities. According to NASAA, “[s]tate securities regulators are often legally obligated to maintain the information in the CRD system as a state record. Much of the information in the CRD system is filed with state securities regulators as part of the registration and qualification process, or filed by state securities regulators themselves. The Uniform Securities Acts, which form the basis of most state securities statutes, generally provide that securities regulators must retain all information filed as part of a registration application or as an amendment to the information filed as part of the application.”<sup>184</sup> Thus, NASAA has indicated that expungement of customer dispute information potentially implicates the public records obligations of state governments.<sup>185</sup>

The proposal would not allow an authorized representative to attend or participate in a customer arbitration where expungement has been requested; such attendance or participation

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<sup>183</sup> See proposed Rule 13805(c)(6)(A).

<sup>184</sup> Brief of Amicus Curiae North American Securities Administrators Association, Inc. in Support of the Division of Securities and Retail Franchising, at 6-7, <https://www.nasaa.org/wp-content/uploads/2021/06/Brief-of-Amicus-Curiae-NASAA-in-Support-of-the-Div-of-Securities-and-Retail-Franchising-06.23.21.pdf>.

<sup>185</sup> See supra note 184.



could substantially disrupt the customer's case and would be less impactful, as the panel hears the customer's evidence on the merits.

FINRA believes that the proposed rule change strikes the appropriate balance between respecting states' interest in the information in the CRD system and maintaining the integrity of the arbitration process.

G. Expungement Requests During Simplified Customer Arbitrations

Customer arbitrations involving \$50,000 or less, called simplified arbitrations, are governed by FINRA Rule 12800. FINRA Rule 12800 provides customers with expedited procedures to make the DRS arbitration forum economically feasible for these smaller claims. Simplified arbitrations are decided on the pleadings and other materials submitted by the parties, unless the customer requests a hearing.<sup>186</sup> Further, a single arbitrator from the public chairperson roster is appointed to consider and decide simplified arbitrations, unless the parties agree in writing otherwise.<sup>187</sup>

The customer who files a simplified arbitration determines how the claim will be decided. In particular, the customer has the option of having the case decided in one of three ways: (1) without a hearing (referred to as "on the papers"), where the arbitrator decides the case on the pleadings or other materials; (2) in an "Option One" full hearing, in which prehearings and hearings on the merits take place pursuant to the regular provisions of the Code; or (3) in an

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<sup>186</sup> See FINRA Rule 12800(a).

<sup>187</sup> See FINRA Rule 12800(b). The parties could agree to have a three-person panel decide the simplified case. For ease of reference, when discussing expungement requests in simplified arbitrations under the proposed rule change, the rule filing uses the term "arbitrator," unless otherwise specified, to mean either a panel or single arbitrator.

“Option Two” special proceeding, whereby the parties present their case in a hearing to the arbitrator in a compressed timeframe, so that the hearings last no longer than one day.<sup>188</sup>

Currently, named associated persons and parties requesting expungement on behalf of unnamed persons request expungement during simplified arbitrations. FINRA Rule 12800 does not, however, expressly address how an expungement request should be filed or considered during a simplified arbitration. The proposed rule change would codify an associated person’s ability to request expungement when named as a respondent in a simplified arbitration, and for other parties to request expungement on behalf of an unnamed person. The proposed rule change would also establish procedures for requesting and considering expungement requests in simplified arbitrations that are consistent with the expedited nature of these proceedings.<sup>189</sup>

#### 1. Requesting Expungement

The proposed rule change would permit a named associated person to request expungement, or a party to file an on-behalf-of request, during a simplified arbitration. As discussed in more detail below, unlike in a non-simplified arbitration, if expungement is not requested during the simplified arbitration, the associated person would be permitted to request it as a straight-in request filed under the Industry Code.<sup>190</sup>

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<sup>188</sup> See FINRA Rule 12800(c). Among the customer arbitrations that closed in 2021, 14 percent were simplified cases. Among the simplified customer cases which closed, 23 percent closed on the papers, four percent closed with a full hearing, and four percent closed by special proceeding. The remaining 69 percent closed by other means including by settlement and withdrawal.

<sup>189</sup> See proposed Rules 12800(d) and (e). Under the proposed rule change, an associated person would not be permitted to request expungement in a simplified arbitration administered under the Industry Code, FINRA Rule 13800. All expungement requests under the Industry Code must be filed in accordance with proposed Rule 13805.

<sup>190</sup> See infra Item II.A.1.II.G.1.c., “When No Expungement Request is Filed in a Simplified Arbitration.”

a. By a Named Associated Person During the Simplified Arbitration

Under the proposed rule change, an associated person named as a respondent in a simplified arbitration could request expungement during the arbitration of the customer dispute information associated with the customer's statement of claim, provided the request is eligible for arbitration.<sup>191</sup>

If a named associated person requests expungement during a simplified arbitration, the proposed rule change would require the request to be filed in an answer or a separate pleading requesting expungement.<sup>192</sup> If the named associated person requests expungement in a pleading other than an answer, the request must be filed within 30 days after the date FINRA notifies the parties of the appointment of the arbitrator.<sup>193</sup> Given the expedited nature of the simplified arbitration process, tying the request to these milestones would ensure that parties receive timely notice of the expungement request so that they may prepare their cases accordingly. The request would be required to include the same information as a request filed in a non-simplified arbitration.<sup>194</sup>

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<sup>191</sup> See proposed Rule 12800(d)(1)(A). The limitations that apply to expungement requests filed by a named associated person under proposed Rule 12805(a)(1)(B) would apply to these requests. See *supra* Item II.A.1.II.C., "Limitations on Expungement Requests."

<sup>192</sup> See proposed Rule 12800(d)(1)(B)(i). A respondent's answer must be submitted within 45 days of receipt of the statement of claim. See *supra* note 46.

<sup>193</sup> See proposed Rule 12800(d)(1)(B)(i). When FINRA notifies the parties when an arbitrator has been appointed, FINRA informs the parties that they have 30 days from the date of notification to submit additional documents or other information before the case is submitted to the arbitrator.

<sup>194</sup> See proposed Rules 12800(d)(1)(B)(i) and 12805(a)(1)(C)(ii). Thus, the associated person's expungement request would be required to contain the applicable filing fee; the CRD number of the party requesting expungement; each CRD occurrence number that is the subject of the request; the case name and docket number associated with the customer dispute information; and an explanation of whether expungement of the same customer dispute information was previously requested and, if so, how it was decided.

To limit arbitrator shopping, the arbitrator would be required to decide an expungement request once it is filed by the associated person.<sup>195</sup> If an associated person withdraws or does not pursue the request after filing, the arbitrator would be required to deny the request with prejudice so that it could not be re-filed.<sup>196</sup>

b. By a Party On Behalf Of an Unnamed Person

Under the proposed amendments, the requirements for a party to file an on-behalf-of request during a simplified arbitration would be the same as the requirements for a named associated person filing an expungement request during a simplified arbitration. A named party would only be able to file an on-behalf-of request during a simplified arbitration with the consent of the unnamed person.<sup>197</sup> As with on-behalf-of requests filed in customer arbitrations under proposed Rule 12805(a)(2), the unnamed person who would benefit from the expungement request must consent to such filing by signing the Form.<sup>198</sup>

To limit arbitrator shopping, the arbitrator would be required to decide an on-behalf-of request once it is filed by the requesting party.<sup>199</sup> If the requesting party withdraws or does not pursue the on-behalf-of request after filing, the arbitrator would be required to deny the request with prejudice so that it could not be re-filed.<sup>200</sup>

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<sup>195</sup> See proposed Rules 12800(d)(1)(B)(ii) and 12800(e)(1).

<sup>196</sup> See proposed Rule 12800(d)(1)(C).

<sup>197</sup> See proposed Rule 12800(d)(2)(A).

<sup>198</sup> See proposed Rule 12800(d)(2). The request must also meet the same requirements as an on-behalf-of request filed under proposed Rule 12805(a)(2). See proposed Rules 12805(a)(1)(C)(ii), 12805(a)(2)(C)(ii) and 12805(a)(2)(D); see also *supra* Item II.A.1.II.A.1.b., “Expungement Requests By a Party Named in the Customer Arbitration On Behalf Of an Unnamed Person.”

<sup>199</sup> See proposed Rules 12800(d)(2)(B)(ii) and 12800(e)(1).

<sup>200</sup> See proposed Rule 12800(d)(2)(C).

c. When No Expungement Request is Filed in a Simplified Arbitration

If expungement is not requested during the simplified arbitration under proposed Rule 12800(d), the associated person would be able to file a straight-in request under proposed Rule 13805 and have the request decided by a three-person panel randomly selected from the Special Arbitrator Roster.<sup>201</sup> The request would be subject to the limitations on whether and when such requests may be filed under the Industry Code.<sup>202</sup>

Due to the expedited nature of simplified arbitrations, FINRA believes that fairness dictates that the associated person have the option to seek expungement separately under the Industry Code and have the expungement request decided by a panel randomly selected from the Special Arbitrator Roster. In simplified arbitrations, there may be less discovery, and the customer can dictate the extent of the evidence presented to the arbitrator. The customer may, for example, determine to have the arbitration decided on the papers. Because there may be less information available for the arbitrator to evaluate an expungement request during a simplified arbitration—even when the simplified arbitration results in an award—the associated person would retain the ability to choose to file the request as a straight-in request under the Industry Code.<sup>203</sup>

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<sup>201</sup> See proposed Rules 12800(e)(2), 13805(a)(1) and 13806.

<sup>202</sup> See proposed Rule 13805(a)(2); see also supra Item II.A.1.II.C., “Limitations on Expungement Requests.”

<sup>203</sup> This would allow the associated person to obtain and present evidence from the member firm at which they were associated at the time the customer dispute arose without interfering with the simplified customer arbitration process. See proposed Rule 13805(a)(1) and FINRA Rule 13506.

## 2. Deciding Expungement Requests during Simplified Arbitrations

If a named associated person or party on behalf of an unnamed person requests expungement during a simplified arbitration, the arbitrator would be required to decide the expungement request, regardless of how the simplified arbitration closes (e.g., even if the arbitration settles).<sup>204</sup> As discussed in more detail below, arbitrators deciding expungement requests in simplified arbitrations would be experienced public arbitrators who would be required to evidence successful completion of, and agreement with, the enhanced expungement training provided by DRS prior to considering and deciding the expungement request.

Under the proposed rule change, how and when the expungement request is decided would depend on which option the customer selects to decide the simplified arbitration.

### a. No Hearing or Option Two Special Proceeding

If the customer opts not to have a hearing or chooses an Option Two special proceeding, the arbitrator would decide the customer's dispute first and issue an award.<sup>205</sup> After the customer's dispute is decided, the arbitrator must hold a separate expungement-only hearing to consider and decide the expungement request and issue a separate, subsequent award.<sup>206</sup>

The arbitrator would decide the customer's dispute first and issue an award to minimize any delays in resolving the customer arbitration and any delays in potential recovery that a customer may be awarded. Further, because the customer arbitration may not be as fully developed when an "on the papers" or special proceeding is requested, the arbitrator would

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<sup>204</sup> See proposed Rule 12800(e)(1).

<sup>205</sup> See proposed FINRA Rule 12800(e)(1)(A).

<sup>206</sup> See proposed Rule 12800(e)(1)(A). The arbitrator must conduct the expungement hearing pursuant to proposed Rule 12805(c). The expungement award must meet the requirements of proposed Rule 12805(c)(8), and the DRS arbitration forum fees would be assessed pursuant to proposed Rule 12805(c)(9).

conduct a separate expungement-only hearing to develop the factual record and make a fully informed decision on the expungement request, and could request any documentary, testimonial or other evidence it deems relevant to the expungement request.

b. Option One Hearing

If the customer chooses to have a full “Option One” hearing on his or her claim and it closes by award, the arbitrator would be required to consider and decide the expungement request during the customer arbitration and include the decision on the expungement request in the same award as the decision on the customer arbitration.<sup>207</sup> This process would be the same as deciding an expungement request during a non-simplified customer arbitration that closes by award after a hearing, where the customer’s claim and expungement request are addressed during the customer arbitration.

If the customer arbitration closes other than by award or by award without a hearing, the arbitrator would be required to hold a separate expungement-only hearing to consider and decide the expungement request and issue a separate award containing the decision on the expungement request.<sup>208</sup> The arbitrator would conduct a separate expungement-only hearing to develop the factual record and make a fully informed decision on the expungement request.

FINRA does not believe that it is necessary for a panel from the Special Arbitrator Roster to decide an expungement request if a simplified customer arbitration is decided on the papers, in an Option Two special proceeding, or if the simplified customer arbitration closes other than by award or by award without a hearing. FINRA believes that the public chairpersons who decide simplified arbitrations would be fully capable of making appropriate expungement decisions on

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<sup>207</sup> See proposed Rule 12800(e)(1)(B)(i).

<sup>208</sup> See proposed Rule 12800(e)(1)(B)(ii).

the basis of their experience.<sup>209</sup> In addition, the public chairperson would be required to evidence successful completion of, and agreement with, the enhanced expungement training provided by DRS prior to considering and deciding the expungement request and, therefore, would have the same enhanced expungement training as the arbitrators on the Special Arbitrator Roster.

If the Commission approves the proposed rule change, FINRA notes, however, that it will continue to monitor expungement requests and decisions in simplified arbitrations to determine if such requests should be decided by the Special Arbitrator Roster.

### 3. Customer Notification of Expungement Hearings during Simplified Arbitrations

The Director would notify all customers from the simplified arbitration of the separate expungement-only hearing.<sup>210</sup> The Director's notice would serve as a reminder of the expungement request and would provide the customers with timely notice of the expungement hearing so that the customers and their representatives may plan and prepare to attend and participate if they choose.

#### H. Non-substantive changes

FINRA is also proposing to amend the Codes to make non-substantive, technical changes to the rules impacted by the proposed rule change. For example, the proposed rule change would require the renumbering of paragraphs and the updating of cross-references in the rules impacted by the proposed rule change. In addition, the title of Part VIII of the Customer Code would be amended to add a reference to "Expungement Proceedings." Similarly, the title of Part VIII of the Industry Code would be amended to add a reference to "Expungement Proceedings" and

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<sup>209</sup> See supra note 102 and accompanying text.

<sup>210</sup> See proposed Rule 12800(f)(2).



“Promissory Note Proceedings.” FINRA believes the proposed changes to the titles would more accurately reflect the contents of Part VIII of the Customer and Industry Codes. FINRA is also proposing to re-number current FINRA Rule 13806 (Promissory Note Proceedings) as new FINRA Rule 13807, without substantive change to the current rule language and to amend FINRA Rule 13214 to change the cross references from Rules 13806(d)(1) and 13806(f) to Rules 13807(d)(1) and 13807(f), respectively. Finally, FINRA would also amend FINRA Rule 13600 to change the cross reference from Rule 13806(e)(1) to Rule 13807(e)(1).

If the Commission approves the proposed rule change, FINRA will announce the effective date of the proposed rule change in a Regulatory Notice following Commission approval.

## 2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,<sup>211</sup> which requires, among other things, that FINRA rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest.

The proposed rule change seeks to balance the interests of securities regulators in having accurate and relevant information to fulfill their regulatory responsibilities; the interests of investors in having access to accurate and meaningful information about associated persons with whom they may entrust their money; the interests of member firms in having accurate information for use in making informed employment decisions; and the interests of the brokerage community in having a fair process to address inaccurate customer dispute information. The proposed rule change will help ensure that the expungement process works as intended—as a

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<sup>211</sup> 15 U.S.C. 78o.

remedy that is appropriate only in limited circumstances in accordance with the narrow standards in FINRA rules.

The current expungement framework has limitations that can make deciding straight-in requests more challenging, particularly if the customer or customer's representative does not attend and participate in the hearing. By having three specially trained and randomly selected arbitrators available to ask questions, request evidence and generally to serve as fact-finders in the absence of customer input, the proposed rule change will help ensure that a more complete factual record is created to support the arbitrators' expungement decision. In addition, the proposed rule change will specifically authorize all panels that consider expungement requests to request any documentary, testimonial or other evidence that they deem relevant to the expungement request from a member firm or associated person.

To further support the development of a more complete factual record, the proposed rule change will require that the associated person appear at the expungement hearing in person or by video conference. The proposed rule change will also codify the Guidance as rules that arbitrators and parties must follow and facilitate the attendance and participation of customers in all expungement hearings, and by state securities regulators, through an authorized representative, in expungement hearings in straight-in requests. If they attend and participate, customer and authorized representative attendance and participation will provide arbitrators with additional insight to make more informed decisions on expungement requests. In the absence of such input, however, the proposal will clarify that a customer or authorized representative's decision not to attend or participate in the expungement hearing is not evidence that is material to the determination of whether expungement is appropriate.

The proposed rule change will also maintain the integrity of the information in the CRD system by imposing strict time limits on the filing of straight-in requests. The DRS arbitration forum will be denied if the expungement request is made more than two years after the close of the customer arbitration or civil litigation associated with the customer dispute information or three years after the date the customer complaint was initially reported in the CRD system. These changes will ensure that expungement requests are timely filed and will curtail the bundling of multiple aged, and often unrelated, disclosures in a single arbitration.

The proposed rule change will also protect investors and the public interest by requiring arbitrators to unanimously agree to issue an award containing expungement relief, to make their finding for expungement relief based on one or more of three grounds specified in the proposed rule change, to identify the specific grounds on which that relief is based and to provide a more detailed explanation in the award of those grounds.

In addition, the proposed rule change will foreclose a practice that has emerged in the existing expungement process where parties seek expungement after a prior denial by a court or arbitration panel of a request to expunge the same customer dispute information, or where parties withdraw or do not pursue an expungement request and then make another request for expungement of the same customer dispute information before a potentially more favorable fact finder. The proposed rule change imposes procedures and requirements around when and how a party may request expungement, and expressly provides that omission of certain of the requirements will make the expungement request deficient. Further, the proposed rule change provides the Director with express authority to deny the DRS arbitration forum if an expungement request is ineligible for arbitration under the proposed rules or if a request to expunge customer dispute information is not filed under, or considered in accordance with, the

requirements of the proposed rules. Thus, FINRA believes the proposed rule change will add tighter controls, additional safeguards and more transparency to the expungement process.

In addition, the process of requesting expungement during a simplified arbitration will be codified to help ensure that customers are aware they can attend and participate in the expungement hearing and how an expungement request will affect (and not affect) their arbitration claims. By expressly incorporating the practice of requesting expungement during simplified proceedings, the proposed amendments add consistency and transparency to the rules and provide more guidance to the arbitrators and the parties requesting expungement.

For these reasons, the proposed rule change represents a significant step towards addressing concerns with the current expungement framework. FINRA believes that these changes will help to maintain the accuracy and integrity of the information in the CRD system and BrokerCheck, while also protecting associated persons from the publication of inaccurate information about them.

B. Self-Regulatory Organization's Statement on Burden on Competition

FINRA does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

Economic Impact Assessment

FINRA has undertaken an economic impact assessment to analyze the regulatory need for the proposed rule change, its potential economic impacts, including anticipated costs, benefits and distributional and competitive effects, relative to the current baseline, and the alternatives FINRA considered in assessing how best to meet FINRA's regulatory objectives.

## 1. Regulatory Need

The proposed rule change would address concerns relating to the expungement process that are not consistent with the regulatory intent to permit expungement in limited circumstances in accordance with the narrow standards in FINRA rules. The concerns include the timing of expungement requests, the resulting impact on customer attendance and participation in expungement hearings, and the ultimate impact on expungement decisions made when customers do not attend or participate and the panel receives information only from the associated person requesting expungement. The concerns also include the selection of arbitrators to hear straight-in requests when the associated person files a statement of claim against a member firm whose interest in expungement might be aligned with the associated person, and requests to expunge the same customer dispute information in multiple proceedings. The proposed rule change would also codify and expand upon the provisions of the Guidance to help ensure that arbitrators and parties are adhering to these procedures for all expungement requests.

## 2. Economic Baseline

The economic baseline for the proposed rule change includes the current provisions under the Codes that address the process for parties to seek expungement relief. The economic baseline includes the recent amendments to the Codes to apply minimum fees to expungement requests.<sup>212</sup> In addition, because arbitrators are generally believed to be adhering to the best practices and recommendations that are a part of the Guidance, the economic baseline also includes the Guidance.<sup>213</sup> The proposed rule change is expected to affect associated persons and other parties to expungement requests including member firms, customers, state securities

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<sup>212</sup> See supra note 10.

<sup>213</sup> See Guidance, supra note 5.

regulators, and arbitrators. The proposed rule change is also expected to affect users of customer dispute information contained in the CRD system and displayed through BrokerCheck.<sup>214</sup>

The customer dispute information contained in the CRD system is submitted by registered securities firms in response to questions on the uniform registration forms.<sup>215</sup> The customer dispute information must be reported regardless of the merit of the allegations. FINRA makes specific CRD information disclosed by firms publicly available through BrokerCheck.<sup>216</sup>

The information in BrokerCheck can be valuable to current and prospective customers to learn about the conduct of associated persons.<sup>217</sup> Current and prospective customers may not select or remain engaged with an associated person or a member firm that employs an associated person with a record of customer disputes. Similarly, member firms and other companies in the financial services industry may use the information when making employment decisions. In this manner, the customer dispute information contained in the CRD system (and displayed through BrokerCheck) may positively or negatively affect the business and professional opportunities of

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<sup>214</sup> Users of customer dispute information include investors, member firms and other companies in the financial services industry; associated persons or individuals seeking employment in the brokerage industry; and FINRA, state securities regulators, and other regulators.

<sup>215</sup> See supra notes 20 and 21 and accompanying text for additional discussion of the uniform registration forms and the information contained in the CRD system. Some of the information may involve pending actions or allegations that have not been resolved or proven.

<sup>216</sup> See supra note 22 and accompanying text.

<sup>217</sup> Recent academic studies provide evidence that the past disciplinary and other regulatory events associated with a firm or individual can be predictive of similar future events. See Hammad Qureshi & Jonathan Sokobin, Do Investors Have Valuable Information About Brokers? FINRA Office of the Chief Economist Working Paper, Aug. 2015; see also Mark Egan, Gregor Matvos, & Amit Seru, The Market for Financial Adviser Misconduct, 127(1) Journal of Political Economy 233-295 (2019).

associated persons. Where the information is reliable, it also provides for customer protections and information useful for member firms.<sup>218</sup>

A negative impact on the business and professional opportunities of associated persons may be appropriate and consistent with investor protection, such as when the customer dispute information has merit. A negative impact may be inappropriate, however, if, for example, the customer dispute information is factually impossible, clearly erroneous or false, or the associated person was not involved in the alleged misconduct. Regardless of the merit, associated persons have an incentive to remove customer dispute information from the CRD system and its public display through BrokerCheck.

An associated person, or a party on-behalf-of an unnamed person, typically begins the process to remove customer dispute information from the CRD system by filing an expungement request in the DRS arbitration forum. During the sample period (January 2016 through December 2021), FINRA is able to identify requests to expunge 11,619 customer dispute information disclosures in the DRS arbitration forum.<sup>219</sup> More than one customer dispute information disclosure may be sought to be expunged in a single arbitration, and multiple expungement requests may relate to the same arbitration, civil litigation, or complaint if the dispute relates to more than one associated person.

The 11,619 customer dispute information disclosures consist of 5,143 disclosures (44 percent) that were sought to be expunged during a customer arbitration, and 6,476 disclosures

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<sup>218</sup> FINRA, state securities regulators, and other regulators also use customer dispute information submitted to the CRD system to regulate associated persons. See supra Item II.A.1.I.B., “Customer Dispute Information in the CRD System.”

<sup>219</sup> The 11,619 requests to expunge customer dispute information disclosures include some requests to expunge the same customer dispute information disclosure in more than one arbitration.

(56 percent) that were sought to be expunged in a straight-in request.<sup>220</sup> The 5,143 disclosures sought to be expunged during a customer arbitration include 4,714 sought to be expunged during a non-simplified customer arbitration and 429 sought to be expunged during a simplified customer arbitration. The associated person was a named party for 2,322 of the 5,143 disclosures (45 percent), and an unnamed party for 2,821 of the 5,143 disclosures (55 percent). The 6,476 customer dispute information disclosures sought to be expunged in a straight-in request include 116 disclosures where the associated person named the customer as a respondent.

Associated persons often file a straight-in request long after the close of the customer arbitration or civil litigation or the initial reporting of the customer complaint to the CRD system. For example, approximately three-fifths of customer dispute information disclosures that were sought to be expunged in straight-in requests were filed more than six years after the close of a customer arbitration or the initial reporting of the customer complaint.<sup>221</sup>

As of December 2021, 10,156 of the 11,619 customer dispute information disclosures were sought to be expunged in an arbitration that closed.<sup>222</sup> The 10,156 disclosures consist of 4,346 disclosures (43 percent) sought to be expunged during a customer arbitration and 5,810 disclosures (57 percent) sought to be expunged in a straight-in request. A panel made a decision in arbitrations relating to 6,997 of the 10,156 disclosures in arbitrations that closed and made no

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<sup>220</sup> Fifty requests to expunge customer dispute information were made during industry arbitrations that were not straight-in requests. To simplify the analysis, FINRA excludes these 50 requests from the sample.

<sup>221</sup> A six-year time-period from the time-period start date reflects the six-year eligibility rule which applies to all arbitration claims, including those claims requesting expungement of customer dispute information. See supra note 38.

<sup>222</sup> In order to focus on the rate at which panels award expungement under different scenarios, the remaining discussion considers only arbitrations in the sample period that closed.



decision in arbitrations relating to the remaining 3,159 disclosures. A single arbitrator made a decision in arbitrations relating to 5,311 of the 6,997 disclosures, and a (two- or) three-person panel made a decision in arbitrations relating to the remaining 1,686 disclosures. For the customer arbitrations, the decision by a panel may relate to the arbitration, an expungement request, or both. For the straight-in requests, the decision would relate to the expungement request only. In arbitrations where no decision on the merits of the customer case or an expungement request was made, the requests were either not eligible, withdrawn, or otherwise not pursued by the associated person or party that filed the request.

Overall, 5,443 of the customer dispute information disclosures sought to be expunged resulted in a panel issuing an award containing expungement relief. The 5,443 disclosures reflect 54 percent of the 10,156 disclosures sought to be expunged in arbitrations that closed, and 78 percent of the 6,997 disclosures sought to be expunged in arbitrations where a panel made a decision.<sup>223</sup> The percentage of expungement requests that are awarded is higher when the panel receives information only from the associated person or other party requesting expungement. The panel is likely to receive information only from the party requesting expungement when (1) the customer arbitration is resolved without a hearing on the merits (e.g., settles), or (2) an associated person files a straight-in request against a member firm. In both circumstances, the customer has little incentive to attend or participate in an expungement hearing and, in the experience of FINRA staff, generally does not.

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<sup>223</sup> Another recent academic study provides evidence that associated persons who receive an award containing expungement relief in the DRS arbitration forum are “3.3 times as likely to engage in new misconduct as the average broker.” See Colleen Honigsberg & Matthew Jacob, *Deleting Misconduct: The Expungement of BrokerCheck Records*, 139(3) *Journal of Financial Economics* 800-831 (2021): 800-831.

Among the 6,997 disclosures sought to be expunged in arbitrations where a panel made a decision, 1,632 disclosures were sought to be expunged during a non-simplified or simplified customer arbitration, and 5,365 disclosures were sought to be expunged in a straight-in request. A panel awarded expungement for 943 of the 1,632 disclosures (58 percent) sought to be expunged during a customer arbitration. This includes 267 of the 632 disclosures (42 percent) sought to be expunged during a customer arbitration that resolved after a hearing on the merits, and 676 of the 1,000 disclosures (68 percent) sought to be expunged during a customer arbitration not resolved after a hearing on the merits. A panel awarded expungement for 4,500 of the 5,365 disclosures sought to be expunged in a straight-in request (84 percent).

In general, whether an associated person obtains an award containing expungement relief does not appear to be significantly impacted by the number of arbitrators deciding the request. For example, among the 1,632 disclosures sought to be expunged during a non-simplified or simplified customer arbitration, a similar percentage of requests were awarded by a one-person panel (279 of 490 disclosures, or 57 percent) as were awarded by a three-person panel (664 of 1,142 disclosures, or 58 percent). In addition, among the 5,365 disclosures sought to be expunged in straight-in requests, a similar percentage of requests were awarded by a one-person panel (4,035 of 4,821 disclosures, or 84 percent) as were awarded by a three-person panel (465 of 544 disclosures, or 85 percent).

Requests to expunge older customer dispute information also are awarded at a similar rate to requests to expunge more recent customer dispute information. FINRA measures the age of customer dispute information from either the close of the customer arbitration or civil litigation, or, if no customer arbitration or civil litigation, from the initial reporting of the customer complaint to the CRD system (i.e., time limit start date). Among the 5,365 customer

dispute information disclosures sought to be expunged in straight-in requests, a similar percentage resulted in an award that were filed less than six years from the time limit start date (1,673 of 1,984 disclosures, or 84 percent) as were filed more than six years from the time limit start date (2,827 of 3,381 disclosures, or 84 percent).

Factors other than, or in combination with, the number of arbitrators deciding the expungement request or the timing of the expungement request, however, may affect whether an associated person receives an award containing expungement relief. These factors include the merits of the request, the attendance and participation by customers or the availability of documents or information relating to the dispute, and the potential influence of associated persons and member firms on the selection of the panel who decides the request.

As stated above, FINRA will expunge customer dispute information from the CRD system only pursuant to a court order. If the panel awards expungement, then the firm or associated person must confirm the arbitration award in a court of competent jurisdiction and serve the confirmed award on FINRA.<sup>224</sup> As of December 2021, FINRA had removed 4,717 customer dispute information disclosures from the CRD system from the possible 5,443 disclosures (87 percent) for which a panel issued an award containing expungement relief. Firms or associated persons may have not yet sought or obtained a court order for the remaining disputes. There also may be instances where expungement was sought and awarded by a panel, but a court order was never obtained.

During the sample period, approximately one-third of the 4,717 customer dispute information disclosures (1,447, or 31 percent) that were expunged were submitted to the CRD

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<sup>224</sup> See supra note 25 and accompanying text.

system. The 1,447 customer dispute information disclosures reflect five percent of the total number of customer dispute information disclosures submitted to the CRD system during the sample period (approximately 31,900). The remaining 3,270 customer dispute information disclosures were submitted to the CRD system prior to the sample period. The number of customer dispute information disclosures expunged during the sample period that were submitted to the CRD system prior to 2016 suggests that associated persons may yet still expunge customer dispute information disclosures submitted to the CRD system during the sample period. The five percent of expunged customer dispute information disclosures should therefore be considered a lower bound for the share of customer dispute information disclosures submitted during the sample period that may ultimately be expunged.

An associated person may seek a court order directing expungement of customer dispute information without first seeking expungement through arbitration (“direct-to-court expungement cases”). During the sample period, associated persons sought expungement of 194 customer dispute information disclosures in direct-to-court expungement cases, or less than 2 percent of the customer dispute information disclosures that were sought to be expunged in the DRS arbitration forum. As of December 2021, court proceedings had concluded for 173 of those disclosures and proceedings remained ongoing for 21 disclosures. One hundred seven of the 173 disclosures (62 percent) were ordered expunged by a court and 66 disclosures (38 percent) were not ordered to be expunged.

### 3. Economic Impact

#### A. Overview

The proposed rule change would codify the best practices described in the Guidance.<sup>225</sup> Codifying the best practices in the Guidance should clarify among parties how the practices should be applied, including what is permitted during the expungement hearing and the responsibilities of the parties and the panel when expungement is requested.<sup>226</sup> In addition, parties may incur fewer costs from the codification of the practices, including the costs from actions or decisions (e.g., requesting expungement of customer dispute information that was previously denied in another arbitration or court) that would be denied by an arbitration panel pursuant to the Guidance. Based on FINRA staff observations, arbitrators are generally believed to be adhering to these best practices and, therefore, codifying them should not result in new material economic impacts. To the extent that some arbitrators currently do not adhere to these best practices, codifying them should increase the consistency of the forum and may impact associated persons, customers, and member firms.

The proposed rule change would also introduce other changes to the Codes that expand upon or that are not a part of the Guidance. The proposed rule change would restrict when an associated person is permitted to request expungement in the DRS arbitration forum. In general, the proposed rule change would also require a panel from a customer arbitration who decides the underlying customer dispute or a panel from the Special Arbitrator Roster to decide an expungement request. Three-person arbitration panels would also be required to unanimously

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<sup>225</sup> See Guidance, supra note 5.

<sup>226</sup> Codifying the Guidance may also help inform customers more generally of the practices that the forum has implemented to encourage and facilitate customer attendance and participation in expungement hearings.

agree to issuing an award containing expungement relief. Finally, the proposed rule change would address the participation by associated persons, customers, and state securities regulators in expungement hearings. These changes may result in new material economic benefits and costs to associated persons, customers, and member firms. FINRA discusses these impacts below and quantifies them when doing so is feasible and informative.

#### B. Expungement Requests during Customer Arbitrations

The proposed rule change would set forth requirements for expungement requests made during customer arbitrations. The proposed rule change would establish different requirements for non-simplified customer arbitrations and simplified customer arbitrations, and for associated persons named or unnamed to a (non-simplified or simplified) customer arbitration.

##### i. Expungement Requests by Named Associated Persons during Non-Simplified Customer Arbitrations

The proposed rule change would require an associated person named in a non-simplified customer arbitration to request expungement during the customer arbitration of the customer dispute information in the CRD system that is associated with the customer's statement of claim.<sup>227</sup> During the sample period, associated persons named in a non-simplified customer arbitration sought to expunge 1,622 of the 4,346 disclosures that associated persons sought to expunge in a customer arbitration that closed. Otherwise, the associated person would forfeit the opportunity to seek expungement of the same customer dispute information in any subsequent proceeding. The panel from a non-simplified customer arbitration would decide the request if the arbitration closes by award after a hearing.<sup>228</sup>

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<sup>227</sup> See proposed Rule 12805(a)(1)(A).

<sup>228</sup> See proposed Rule 12805(a)(1)(D)(i).

The proposed rule change would help ensure that, if possible, the panel that decides a non-simplified customer arbitration, with input from all parties and access to all evidence, testimony and documents, would also decide an expungement request relating to the same underlying dispute. These arbitrators or panels would be best situated to decide the related issue of expungement, and thereby help ensure that expungement awards and the customer dispute information contained in the CRD system reflect the conduct of associated persons.

The proposed rule change would impose time limits on when an expungement request can be filed during a non-simplified customer arbitration.<sup>229</sup> The proposed time limits may increase the ability of customers to address the expungement request during the customer arbitration. The proposed time limits, however, may cause a named associated person to lose the ability to assess the additional information that arises during a customer arbitration within sixty days of the hearing on the merits. In this case, the associated person must either incur the costs of filing a request for expungement based on potentially more limited information about whether the request will be successful or lose their ability to seek expungement in the DRS arbitration forum. Consequently, associated persons may incur costs to preserve their ability to request expungement in the DRS arbitration forum.<sup>230</sup>

- ii. Expungement Requests during a Non-Simplified Customer Arbitration that Closes other than by Award or by Award without a Hearing

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<sup>229</sup> See proposed Rule 12805(a)(1)(C)(i).

<sup>230</sup> Under the proposed rule change, a party that does not file an expungement request at least 60 days before the first scheduled hearing begins could file a motion seeking an extension. See *supra* note 229. The motion, however, may be opposed by another party and denied by the panel.

As described above, during the sample period, associated persons named in a non-simplified customer arbitration sought to expunge 1,622 of the 4,346 disclosures that associated persons sought to expunge in a customer arbitration that closed. The 1,622 disclosures include 1,285 disclosures that were sought to be expunged in a non-simplified customer arbitration that closed other than by award or by award without a hearing. Associated persons who request expungement during a non-simplified customer arbitration (either as a named party or as an unnamed party that consents to an on-behalf-of request) that closes other than by award or by award without a hearing (and would not have their expungement request decided as part of the customer arbitration) would incur additional costs to file and resolve a straight-in request (e.g., legal fees).<sup>231</sup> Associated persons would also incur a delay in receiving a decision on the request. The member firm with which the associated person was associated at the time the customer dispute arose would also incur the legal and forum fees corresponding to the straight-in request.<sup>232</sup>

The costs to file and resolve a straight-in request following the conclusion of the customer arbitration would be imposed by the proposed rule change if the requests would have otherwise been decided as part of the non-simplified customer arbitration. The costs would not

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<sup>231</sup> Associated persons who would otherwise request expungement as a counterclaim during an industry arbitration, which is rare, would instead be required to file a straight-in request under proposed Rule 13805. These associated persons and member firms with which the associated persons were associated would incur similar costs.

<sup>232</sup> Associated persons would not incur an additional filing fee to file the straight-in expungement request. See supra note 95. Consistent with the fees associated with non-monetary claims, the parties to a straight-in request would incur the minimum hearing session fee of \$1,150 for each session the panel conducts to decide the expungement request. The member firm at which the individuals were associated at the time the customer dispute arose would also be assessed a minimum surcharge fee of \$2,000 and a minimum process fee of \$3,850. See FINRA Rules 13901, 13902, and 13903 for the fee amounts related to non-monetary claims in the DRS arbitration forum.



be imposed by the proposed rule change, however, if associated persons would have filed a straight-in request after the close of the non-simplified customer arbitration regardless of the proposed restrictions.

The additional costs for an associated person to file and resolve a straight-in request after the close of a non-simplified customer arbitration (that closes other than by award or by award without a hearing) may reduce the likelihood that parties settle a customer arbitration or the amount for which parties settle. For example, associated persons may factor the cost to resolve a separate straight-in request into the decision to settle or arbitrate. In addition, even if the parties settle the dispute, associated persons may consider the cost to file and resolve a separate straight-in request when determining the amount at which they are willing to settle. The customers to an arbitration which does not settle may incur additional costs to instead arbitrate the claim.<sup>233</sup>

iii. Expungement Requests by Unnamed Persons in Non-Simplified Customer Arbitrations and by Named and Unnamed Persons in Simplified Customer Arbitrations

The proposed rule change would not require an unnamed person in a non-simplified customer arbitration, an associated person named in a simplified customer arbitration, or an unnamed person in a simplified customer arbitration to request expungement of the customer

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<sup>233</sup> FINRA notes, however, that the determination regarding whether to settle a customer arbitration can depend on a number of factors, including the parties' respective estimates of the additional costs they would incur to continue the customer arbitration, the value that the associated person places on expungement, the associated person's estimate of the likelihood that the associated person could obtain expungement in the customer arbitration compared to in a straight-in request, and the estimated cost to pursue the straight-in request. Other proposed amendments may similarly factor into the decision to settle, such as the potential for customer or state securities regulator attendance and participation in expungement hearings in straight-in requests.

dispute information during the arbitration.<sup>234</sup> Instead, like today, these associated persons may wait until after the conclusion of the arbitration to request expungement as a straight-in request.<sup>235</sup> During the sample period, unnamed persons in non-simplified customer arbitrations, associated persons named in simplified customer arbitrations, and unnamed persons in simplified customer arbitrations sought to expunge 2,724 of the 4,346 disclosures that associated persons sought to expunge in a customer arbitration that closed.

The option to wait until after the customer arbitration has concluded to request expungement is not a new benefit created by the proposed rule change, but is instead currently permitted under the Codes. FINRA believes that an unnamed person in a non-simplified customer arbitration, an associated person named to a simplified customer arbitration, or an unnamed person in a simplified customer arbitration should have the option to seek expungement as a straight-in request and have their request decided by a panel from the Special Arbitrator Roster.

Associated persons (or parties on behalf of unnamed persons) who are not required and choose not to request expungement during a customer arbitration may incur additional costs to file and resolve a straight-in request. The member firms with which the associated persons were associated at the time the customer dispute arose would also incur additional costs. Any incremental costs from not filing an expungement request during a customer arbitration, however, are not imposed by the proposed rule change. Instead, they are borne at the discretion

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<sup>234</sup> See proposed Rules 12805(a)(2)(A), 12800(d)(1)(A), and 12800(d)(2)(A). Unnamed persons would also be prohibited from intervening in a non-simplified or simplified customer arbitration and requesting expungement. See proposed Rules 12805(a)(2)(E)(iii)(a) and 12800(d)(2)(D).

<sup>235</sup> The requirement to wait until after the close of the customer arbitration would help ensure that the panel from the Special Arbitrator Roster is aware of the outcome of the customer arbitration when deciding the request.

of the parties who make the determination of when to request expungement, and are similar to the costs they incur under the Codes today.

The proposed time limits to request expungement during a customer arbitration may impose costs on associated persons (or parties on behalf of unnamed persons) who are not required but choose to request expungement.<sup>236</sup> Associated persons who are not able to have their expungement request decided during a customer arbitration (e.g., because the case settles) and instead file a straight-in request as a result of the proposed time limits would incur a delay in receiving a decision on the expungement request. Similar to today, associated persons would incur the legal and forum fees associated with the request, and the member firms with which the associated persons were associated at the time the customer dispute arose would also incur legal and forum fees associated with the straight-in request.

### C. Time Limits for Filing Straight-in Requests

For customer dispute information reported to the CRD system after the effective date of the proposed rule change, the proposed rule change would require an associated person to file a straight-in request within two years of a customer arbitration or civil litigation closing, or, if there is no customer arbitration or civil litigation, within three years from the initial reporting of the customer complaint to the CRD system.<sup>237</sup>

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<sup>236</sup> Under the proposed rule change, a party on-behalf-of an unnamed person would be required to request expungement during a non-simplified arbitration no later than 60 days before the first scheduled hearing, and a named associated person or a party on-behalf-of an unnamed person would be required to request expungement during a simplified arbitration within 30 days of the date that FINRA provides notice of arbitrator appointment. See proposed Rules 12805(a)(2)(C)(iii) and 12800(d)(1)(B)(i).

<sup>237</sup> See proposed Rules 13805(a)(2)(A)(iv) and 13805(a)(2)(A)(v). The proposed rule change would also impose a two-year time limit for requests to expunge customer dispute information that arose from a customer arbitration or civil litigation that closed on or prior to the effective date of the proposed rule change, or, if no customer arbitration or civil litigation, a three-year time limit to request expungement of customer dispute

The proposed time limits may better facilitate customer attendance and participation in the proceedings and the likelihood that the panel from the Special Arbitrator Roster receives testimony and other evidence relevant to deciding an expungement request. In addition, the time limits would help ensure that the expungement hearing is held close in time to the customer arbitration or civil litigation, or the events that led to the customer dispute information disclosure, and foreclose the option of an associated person to choose the timing of a straight-in request to potentially reduce the likelihood of customer attendance and participation. Similar to the other amendments proposed herein, an increase in customer attendance and participation may provide a panel from the Special Arbitrator Roster with additional information to decide an expungement request and help ensure the accuracy of the customer dispute information contained in the CRD system and displayed through BrokerCheck.

The proposed time limits, however, may constrain an associated person from filing a straight-in request. Associated persons who would otherwise delay the filing of a straight-in request may incur additional costs to file a straight-in request within the required time limits. Similar to the costs which may result from the proposed time limits to request expungement during a customer arbitration, associated persons who become constrained to file a straight-in request within the proposed time limits may incur indirect costs (as described above).

The proposed time limits to file a straight-in request may also constrain an associated person from seeking expungement of multiple customer dispute information disclosures in the same straight-in request (i.e., in the same arbitration). Associated persons who may become

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information arising from a customer complaint initially reported to the CRD system on or prior to the effective date of the proposed rule change. See proposed Rules 13805(a)(2)(B)(i) and 13805(a)(2)(B)(ii). These time limits would run from the effective date of the proposed rule change.

constrained include those waiting for additional customers to make complaints or for a customer arbitration or civil litigation to close. The disclosures associated persons may want to include in the same straight-in request may relate to the provision of similar investment advice or services or market events resulting in multiple customer losses.

Associated persons who become constrained from seeking to expunge multiple customer dispute information disclosures in the same straight-in request because of the proposed time limits and who still seek expungement of all customer dispute information disclosures would be required to file the requests in more than one arbitration. These associated persons would incur additional legal and forum fees for each additional arbitration. The member firm at which the individual was associated at the time the customer disputes arose would also incur additional legal and forum fees for each additional arbitration. Associated persons who seek to expunge customer dispute information disclosures from a longer time period may be more likely to become constrained and incur these additional costs than associated persons who seek to expunge customer dispute information disclosures from a shorter time period.

Associated persons who are waiting until the close of a customer arbitration or civil litigation to seek to expunge multiple customer dispute information disclosures in the same arbitration may consider the anticipated costs to file an additional straight-in request when offering a settlement amount to customers. Associated persons could offer a higher settlement amount reflective of these anticipated costs, and customers may similarly seek to negotiate a higher settlement amount.<sup>238</sup>

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<sup>238</sup> Other factors may influence the decision of parties to settle or arbitrate the dispute. See supra note 233.

Finally, the three-year time limit may increase the likelihood that an associated person seeks expungement of a customer complaint only for the customer then to file a related claim in arbitration. If the associated person were to seek expungement of a customer dispute information disclosure associated with the subsequent customer arbitration, either during the customer arbitration or as a straight-in request, then the associated person would incur the additional costs of the second request. If the associated person seeks expungement as a straight-in request, then the member firm with which the associated person was associated at the time the customer dispute arose would also incur costs associated with the request.

#### D. Time Limits for Filing Straight-in Requests – Quantitative Description

As discussed as part of the Economic Baseline, 6,476 customer dispute information disclosures were sought to be expunged in straight-in requests during the sample period. The following estimates demonstrate that for the majority of these straight-in requests, the request would not have been permitted under the proposed time limits and associated persons would not have been able to include more than one customer dispute information disclosure in the same straight-in request. The estimates, however, do not account for the potential change in the behavior of associated persons—associated persons would have incentive under the proposed amendments to file the straight-in requests within the proposed time limits or otherwise lose the ability to file a request in the forum.<sup>239</sup>

Among the 6,476 customer dispute information disclosures that associated persons sought to expunge in straight-in requests, 2,135 of the disclosures related to a previous (non-

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<sup>239</sup> The following estimates also do not account for the number of straight-in requests of customer dispute information arising from a previous (non-simplified or simplified) customer arbitration which, under the proposed rule change, would have been decided as part of the customer arbitration.

simplified or simplified) customer arbitration (of the same underlying dispute). Six-hundred ten of the disclosures (29 percent) were sought to be expunged in straight-in requests filed within the two-year time limit and would have been permitted under the proposed rule change. The remaining 4,341 of the 6,476 disclosures did not relate to a previous (non-simplified or simplified) customer arbitration (of the same underlying dispute). Seven-hundred ninety-eight of the disclosures (18 percent) were sought to be expunged in straight-in requests within three years from the initial reporting of the disclosure to the CRD system and would have been permitted under the proposed rule change.

As discussed above, the expungement of more than one customer dispute information disclosure can be sought in a single arbitration, and the proposed time limits may limit the ability of an associated person to seek expungement of multiple customer dispute information disclosures in the same straight-in request. The 6,476 customer dispute information disclosures sought to be expunged in straight-in requests were made in 3,177 arbitrations. Associated persons included more than one customer dispute information disclosure in 1,384 of the 3,177 straight-in requests (44 percent). In total, associated persons sought the expungement of 4,683 customer dispute information disclosures (72 percent of the 6,476 customer dispute disclosures) in the 1,384 straight-in requests.

Under the proposed time limits, associated persons would not have been able to include all of the customer dispute information disclosures in at least 614 of the 1,384 straight-in requests (44 percent). In 556 of the 614 straight-in requests (91 percent), the associated person included at least one customer dispute information disclosure that was six years or longer from its respective time limit start date. Also, in 374 of the 614 straight-in requests (61 percent), the

associated person would not have been able to include in the same straight-in request one or more customer dispute information disclosures that related to a customer arbitration.

#### E. Arbitrators or Panels Deciding Expungement Requests

The proposed rule change would require that the panel from a non-simplified customer arbitration decide expungement requests during the arbitration if the arbitration closes by award after a hearing.<sup>240</sup> In addition, the proposed rule change would require the arbitrator from a simplified customer arbitration to decide an expungement request if it is requested—at a full hearing, in a separate expungement-only hearing after the simplified arbitration closes if the arbitration is decided “on the papers,” or in a special proceeding.<sup>241</sup> The proposed rule change would also require that a randomly selected three-person arbitration panel from the Special Arbitrator Roster decide straight-in requests.<sup>242</sup> Finally, the proposed rule change would require that a three-person arbitration panel unanimously agree to issue an award containing expungement relief.<sup>243</sup>

The proposed rule change may place a panel in a better position to determine whether to award expungement of customer dispute information, and thereby help ensure the accuracy of the customer dispute information contained in the CRD system. In general, the panel that decides a request would either hear the full merits of the customer arbitration or have additional training and qualifications when they may receive information only from the party requesting expungement. Panels from the Special Arbitrator Roster would also be able to request any

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<sup>240</sup> See proposed Rules 12805(a)(1)(D)(i) and 12805(a)(2)(E)(i).

<sup>241</sup> See proposed Rules 12800(e)(1)(A) and 12800(e)(1)(B)(ii).

<sup>242</sup> See proposed Rule 13806(b)(1).

<sup>243</sup> See proposed Rules 12805(c)(8)(A)(i) and 13805(c)(9)(A)(i).



evidence that they deem relevant from the associated person and member firm at which the associated person was associated at the time the customer dispute arose.

As discussed above, straight-in requests where customers typically do not attend or participate in the expungement hearing often lack appreciable opposition. A panel from the Special Arbitrator Roster, with three arbitrators to ask questions, request evidence, and serve generally as fact finders in the absence of customer input, may help ensure that a complete factual record is created to support a decision and the decision reflects the merits of the request.

The proposed rule change would also reduce the potential influence of associated persons and member firms on the selection of the panel that decides a straight-in request. First, parties to the straight-in request would not be permitted to strike or rank any arbitrators randomly selected to create a panel from the Special Arbitrator Roster, thereby limiting the ability of an associated person and member firm with which the associated person was associated at the time the customer dispute arose to together select arbitrators who are more likely to award expungement. To the extent that the associated person and the member firm's interests are aligned and both seek to increase the likelihood that an award containing expungement relief is issued, they would together be expected to select arbitrators who may be more likely to award expungement.<sup>244</sup>

Second, an associated person would not be permitted to withdraw a request and seek expungement of the same customer dispute information in a subsequent arbitration.<sup>245</sup>

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<sup>244</sup> Honigsberg and Jacob also find evidence that suggests parties can use previous expungement decisions to determine the potential likelihood that an arbitrator will award expungement. See supra note 223.

<sup>245</sup> See proposed Rules 12805(a)(2)(A), Rules 12805(a)(1)(D)(i) and 12805(a)(2)(E)(i). The inability to withdraw a request also includes the requirement that a case be closed with prejudice if an associated person withdraws a straight-in request after a panel from the Special Arbitrator Roster is appointed. See proposed Rule 13805(a)(4). In the sample period, an associated person withdrew 292 of the 5,810 straight-in requests (five percent)

Associated persons may exercise this option if they believe that they have a higher probability of obtaining an expungement award with a different arbitrator or panel in another arbitration, and in particular if the associated person files a straight-in request against the member firm with which the individual was associated at the time the customer dispute arose.

Among the expungement requests during the sample period, FINRA has identified 282 attempts to expunge a previously withdrawn or denied request to expunge.<sup>246</sup> Both the initial request and the subsequent request were made during the sample period. Additional subsequent expungement requests may have been filed during the sample period if the initial expungement request was made prior to the sample period (i.e., before January 2016). These 282 attempts can therefore be considered a lower bound for the number of these requests during the sample period.

Under the proposed rule change, the grounds under which a panel may award expungement would not change.<sup>247</sup> The proposed rule change, however, would likely increase

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filed in cases that closed. The 292 straight-in requests include 240 requests where a panel was appointed.

<sup>246</sup> The 282 subsequent requests include 261 previous requests that were withdrawn or otherwise not pursued by the associated person or party that filed the request, 17 previous requests by a named person that were denied, one previous request on behalf of an unnamed person that was denied, and three previous requests determined by the panel to be ineligible for arbitration. A panel issued an award containing expungement relief in 167 of the 282 subsequent expungement requests (59 percent) and denied 20 requests (seven percent). One of the awards containing expungement relief relates to the previous request on behalf of the unnamed person that was denied. Another of the awards containing expungement relief relates to the previous request that was deficient and therefore not decided. Forty-three subsequent expungement requests were withdrawn or deficient and, therefore, not decided. Finally, 52 subsequent expungement requests were still pending as of the end of the sample period. In 115 of the 282 subsequent expungement requests, the associated person was an unnamed party in the first arbitration. A similar measure in the Discussion Paper describes 193 attempts to expunge the same customer dispute information in more than one arbitration. See supra note 13. The measure described herein reflects an updated methodology.

<sup>247</sup> See supra note 31 and accompanying text; see also proposed Rules 12805(c)(8)(A)(i) and 13805(c)(9)(A)(i). The proposed rule change would also instruct the panel not to consider the decision of the customer or authorized representative not to attend or

the number of expungement requests decided by a three-person panel and would require that the panel decide unanimously whether to issue an award containing expungement relief. FINRA expects that the unanimity requirement would tend to reduce the number of awards containing expungement relief with less or less certain merit.

F. Arbitrators or Panels Deciding Expungement Requests – Quantitative Description

As discussed as part of the Economic Baseline, 10,156 of the 11,619 customer dispute information disclosures sought to be expunged during the sample period were filed in an arbitration that closed. Among the 10,156 disclosures, 9,030 (89 percent) would have required a panel from the Special Arbitrator Roster. The 9,030 disclosures include 5,088 disclosures sought to be expunged during a non-simplified customer arbitration that closed by award without a hearing or other than by award, and 3,942 sought to be expunged in a straight-in request that did not relate to a previous (non-simplified or simplified) customer arbitration.

A panel from a (non-simplified or simplified) customer arbitration would have been required to make a decision on the requests to expunge 1,025 of the 10,156 customer dispute information disclosures (10 percent). The 1,025 disclosures include 499 disclosures that were requested to be expunged during a non-simplified customer arbitration that closed by award after a hearing, 400 requested to be expunged during a simplified customer arbitration, and 126 requested to be expunged in a straight-in request to expunge customer dispute information arising from a previous non-simplified customer arbitration that closed by award after a hearing.

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participate in an expungement hearing as material to the determination of whether expungement is appropriate. This may help ensure expungement decisions are based on the merits of the request. See proposed Rules 12805(c)(8)(C) and 13805(c)(9)(C).

Finally, a panel from the Special Arbitrator Roster, or an arbitrator from a simplified customer arbitration, would have been required to make the decision with respect to the remaining 101 disclosures that associated persons sought to expunge in a straight-in request and that related to customer dispute information arising from a previous simplified customer arbitration. The panel that would have decided the request is dependent on whether an associated person, or a party on-behalf-of an associated person, would have requested expungement during the simplified arbitration.

A three-person panel made expungement decisions in 1,051 customer or industry arbitrations. The panel decision was unanimous in 1,030 of the 1,051 arbitrations (98 percent), but not unanimous in 21 arbitrations (2 percent). In 11 of the 21 arbitrations, or one percent of the 1,051 arbitrations, one of the three arbitrators opposed an expungement decision awarding expungement. These 11 awards would not have been permitted under the proposed rule change. Since unanimous agreement is not currently required, however, current data on unanimous agreement may not reflect the extent to which unanimity would occur once it is required. The extent to which decisions may differ under the proposed rule change is therefore not known.

#### G. Attendance and Participation in Expungement Hearings

As discussed above, the proposed rule change may facilitate customer attendance and participation by restricting when a named associated person, or a party on-behalf-of an unnamed person, may request expungement. Other proposed amendments may facilitate the attendance and participation of customers or authorized representatives of states securities regulators in expungement hearings. Attendance and participation by customers or authorized representatives may increase the likelihood that a panel reviews a more complete factual record when deciding a

request, and ultimately help ensure the accuracy of the customer dispute information contained in the CRD system.

The proposed rule change would provide customers the option to attend and participate in an expungement hearing using whichever method is convenient for them (*i.e.*, by telephone, by video conference or in person).<sup>248</sup> The proposed rule change would also codify elements of the Guidance that require associated persons to notify a customer of a straight-in request,<sup>249</sup> and for the panel to permit the customer to testify, cross-examine the associated person and other witnesses, present evidence at the hearing and make opening and closing arguments.<sup>250</sup>

An authorized representative of state securities regulators would similarly be permitted to attend and participate in prehearing conferences and expungement hearings in straight-in requests.<sup>251</sup> If an authorized representative presents additional information at the expungement

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<sup>248</sup> See proposed Rules 12805(c)(3)(B) and 13805(c)(3)(B).

<sup>249</sup> See proposed Rule 13805(b)(1)(A)(i) through (iii). The proposed rule change would also require the associated person to file with the panel all documents provided to the customers. This would help ensure that customers have knowledge of the straight-in request, and are not dissuaded from attending or participating in the expungement hearing as a result of the notification from the associated person. See proposed Rule 13805(b)(1)(A)(iv). The Director would also provide the notified customers with access to documents relevant to the expungement request filed in the arbitration, which may help in their preparation for the expungement hearing. See proposed Rule 13805(b)(1)(B)(ii).

<sup>250</sup> Other amendments to the proposed rule change would also help encourage customer attendance and participation in simplified customer arbitrations and straight-in requests. For example, the proposed rule change would allow customers to be represented at an expungement hearing and thereby mitigate any potential concern they may have regarding a direct confrontation with the associated person. See proposed Rules 12805(c)(4) and 13805(c)(4). In addition, the proposed rule change provides that the Director would notify the customer of the time and place of any prehearing conferences and the expungement hearing of a straight-in request. See proposed Rule 13805(b)(1)(B)(i).

<sup>251</sup> See proposed Rule 13805(c)(6). The proposed rule change also provides that FINRA would notify state securities regulators within 15 days of receiving a request for expungement. See proposed Rules 12805(b) and 13805(b)(2). State securities regulators would therefore have the time to review and decide whether to oppose a straight-in

hearing, including information that may not otherwise be available, the panel may receive a more complete factual record on which to base their decision. The magnitude of these effects would increase with the likelihood the authorized representative attends, participates and presents new evidence, such as when concerns arise regarding the merits of an expungement request.

Customers and authorized representatives of state securities regulators may incur costs to attend and participate in the expungement hearings. These costs, however, would be optional and at their own discretion. Associated persons may factor in the potential for customer and state securities regulator attendance and participation in a straight-in request when deciding whether to settle a non-simplified customer arbitration.<sup>252</sup>

The proposed rule change would require an associated person (or the party requesting expungement on behalf of an unnamed person) to appear by video conference or in-person at an expungement hearing.<sup>253</sup> This requirement would help the panel assess the associated person's credibility and allow them to ask questions of an associated person and observe their responses. An associated person would also be permitted to cross-examine and seek information from customers who testify.<sup>254</sup> This may provide associated persons with the opportunity to substantiate their arguments in support of their expungement request.

Associated persons may incur costs to appear at an expungement hearing. The costs include the time and expense to appear, and other direct and indirect costs (e.g., opportunity

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request, or review and decide whether to oppose confirmation in court of an award from a customer arbitration containing expungement relief.

<sup>252</sup> See supra Item II.A.1.II.F., “Attendance and Participation of an Authorized Representative of State Securities Regulators in Straight-in Requests,” and accompanying text.

<sup>253</sup> See proposed Rules 12805(c)(2) and 13805(c)(2).

<sup>254</sup> See proposed Rules 12805(c)(5)(B) and 13805(c)(5)(B).

costs) associated with the associated person's appearance. The costs would depend on the method of appearance (i.e., by video conference or in-person), which, under the proposed rule change, would be determined by the panel. Associated persons who appear in-person would incur the time and expense to travel to and from the hearing location. Associated persons who live further away from the hearing location, or are less able to travel, would incur greater costs to appear in-person. Associated persons who instead appear by video conference would not incur travel costs. These associated persons, however, may perceive that they are less able to provide effective testimony. These perceived costs may be mitigated by the ability of parties to file a motion seeking to appear in-person.

#### H. Impact on Business and Professional Opportunities

As a result of the proposed rule change, associated persons may determine that the additional costs to seek expungement relief are higher than the anticipated benefits. In addition, although the proposed rule change is intended to help ensure arbitrators award expungement when appropriate as it relates to the merits of the request, the likelihood that an associated person receives an award containing expungement relief may decrease because of the likely increase in the number of three-person panels deciding expungement requests and the requirement that such decisions be unanimous. This may lead associated persons not to seek expungement, including in some instances when expungement is likely to be awarded.

Associated persons who are not able to seek expungement of customer dispute information from the CRD system, or are delayed in doing so, may experience a loss of business and professional opportunities. The loss of business and professional opportunities by one associated person, however, may be the gain of another. Associated persons who may benefit in this regard include those who still determine that the additional costs to seek expungement relief

under the proposed rule change is less than the anticipated benefits and continue to seek expungement of customer dispute information, and other associated persons who do not have similar disclosures.

An associated person may seek expungement of customer dispute information in a direct-to-court expungement case. The proposed rule change may result in associated persons seeking expungement in more direct-to-court expungement cases. For some associated persons, the anticipated costs to first go through arbitration under the proposed rule change may be greater than the similar costs to seek expungement in a direct-to-court expungement case. Associated persons who would otherwise first go through arbitration because of the proposed rule change may incur additional costs relative to today to seek expungement relief.

The number of associated persons who would instead seek expungement in a direct-to-court expungement case is dependent not only on the additional costs under the proposed rule change, but the costs an associated person would expect to incur in court to initiate an expungement proceeding. This information is generally not publicly available, and accordingly the potential effect of the proposed rule change on direct-to-court expungement cases is not measured and is uncertain.

#### I. Other Economic Effects

Finally, the proposed rule change may have other marginal economic effects. First, the prohibition of a subsequent expungement request would decrease the potential inefficient allocation of resources resulting from a subsequent request that would have resulted in the same decision (i.e., denial) as the first. The resources of the forum allocated to the additional



expungement request could instead be used for other claims or requests that were not previously adjudicated or for other purposes.<sup>255</sup>

Second, the proposed rule change may increase the efficiency of the forum by requiring that a party provide certain information when filing an expungement request. The information includes identification of the customer dispute information that is the subject of the request, and whether expungement of the same customer dispute information was previously requested and, if so, how it was decided. This would increase the efficiency of the forum by enabling FINRA to identify and track a request through the expungement process, and by alerting arbitrators and FINRA to another expungement request of the same customer dispute information. The efficiency of the forum would also increase by requiring an unnamed person to consent to an on-behalf-of expungement request in writing. This would help ensure that an unnamed person is aware of the request and prevent another expungement request by the unnamed person of the same customer dispute information.

In addition, the proposed rule change may affect the value of the customer dispute information to describe the conduct of associated persons. The change in the value of the information depends on the merit of the disclosures that would have otherwise been expunged. The merit of these disclosures also depends on many factors which are difficult to predict. These factors include the incentive of parties to file an expungement request under the proposed rule change, the decisions by the panel to issue an award containing expungement relief dependent on the information that becomes available, and the merit of the customer dispute information that would have otherwise been sought to be expunged. The effect of the proposed rule change on

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<sup>255</sup> The resources relate to the specific costs to administer the claim, as well as the overall attendant costs to administer the forum.

the extent to which the customer dispute information available in the CRD system accurately describes the conduct of associated persons is, therefore, uncertain.

#### 4. Alternatives Considered

Alternatives to the proposed rule change include amendments that were proposed in Regulatory Notice 17-42 and the 2020 Rule Filing.<sup>256</sup> For example, an alternative to the proposed rule change, which was proposed in the 2020 Rule Filing, could be to limit when a party can file an expungement request during a non-simplified customer arbitration to 30 days before the first scheduled hearing session. Thirty days may reduce the likelihood that an associated person files an expungement request based on more limited information about whether the request would be successful. Thirty days, however, may not provide associated persons adequate time to address any filing deficiencies before the request is served on the other parties. In addition, customers would have less time to consider the request before the first scheduled hearing session.

Another alternative to the proposed rule change could be to include different time limits for an associated person to file a straight-in request. In the Notice, FINRA proposed a one-year time limit for associated persons to file a straight-in request after the close of a customer arbitration or, if no arbitration or civil litigation, after the initial reporting of the customer complaint to the CRD system.<sup>257</sup> In the 2020 Rule Filing, FINRA proposed a two-year time limit for associated persons to file a straight-in request after the close of a customer case, or, if no

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<sup>256</sup> See supra notes 9 and 11.

<sup>257</sup> See supra note 9.

arbitration or civil litigation, a six-year time limit for associated persons to file a straight-in request after the initial reporting of the customer complaint.<sup>258</sup>

In general, shorter (longer) time limits may further facilitate (impede) customer attendance and participation in the proceedings and the likelihood that the panel from the Special Arbitrator Roster receives evidence and testimony from the customer to consider when deciding an expungement request. Shorter (longer) time limits, however, may further (less) constrain an associated person from filing a straight-in request or including more than one expungement request in the same straight-in request.

For example, the percentage of associated persons who would not have been able to include all customer dispute information disclosures in the same straight-in request would be lower if the proposed rule change imposed a six-year rather than three-year time limit on requesting expungement of customer complaints.<sup>259</sup> As discussed above, FINRA believes that the proposed time limits would facilitate customer attendance and participation while providing associated persons sufficient opportunity to file a straight-in request.

Other alternatives relate to the panel's decision to issue an award containing expungement relief. In the 2020 Rule Filing, FINRA proposed allowing a majority decision by a three-person panel, not a unanimous decision (as proposed herein), to issue an award containing

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<sup>258</sup> See supra note 11.

<sup>259</sup> Under these alternative time limits, associated persons would not have been able to include all expungement requests in at least 426 of the 1,384 arbitrations (31 percent). This estimate is 13 percent less than the similar calculation but with the time limits proposed herein (44 percent). See supra Item II.B.3.D., "Time Limits for Filing Straight-in Requests – Quantitative Description." As mentioned above, these estimates do not account for the potential change in the behavior of associated persons as a result of the proposed rule change. The estimates also do not account for the number of straight-in requests of customer dispute information arising from a previous customer arbitration which, under the proposed rule change, may have been decided as part of the customer arbitration.

expungement relief.<sup>260</sup> A majority decision would be consistent with what is required for other three-person panel decisions in customer and industry arbitrations. FINRA determined, however, that a unanimous decision by a three-person panel would better help protect the integrity of the information in the CRD system.

In the Notice, FINRA proposed that a panel find that the customer dispute information has “no investor protection or regulatory value” in order to issue an award containing expungement relief.<sup>261</sup> This alternative may increase the difficulty for an associated person to receive an expungement award, and may cause associated persons not to seek expungement where expungement is likely (or unlikely) to be awarded. In addition, some commenters to the Notice raised concerns that the standard may, if codified, create confusion among arbitrators and the potential for inconsistent application among different arbitrators and panels. After considering the concerns, FINRA determined not to propose that the panel must find “no investor protection or regulatory value” to issue an award containing expungement relief.

Finally, other alternatives relate to the appearance of parties at expungement hearings. The proposed rule change could have allowed an associated person to appear at an expungement hearing by telephone, as an alternative to appearance in person or by video conference.

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<sup>260</sup> See supra note 11.

<sup>261</sup> See supra note 9. In its Order approving NASD Rule 2130 (now FINRA Rule 2080), which describes the current findings that arbitrators must make to issue an award containing expungement relief, the SEC stated that “it believes the proposal strikes the appropriate balance between permitting members and associated persons to remove information from the CRD system that holds no regulatory value, while at the same time preserving information on the CRD system that is valuable to investors and regulators.” See Securities Exchange Act Release No. 48933 (December 16, 2003) 68 FR 74667, 74672 (December 24, 2003) (Order Approving File No. SR-NASD-2002-168).

Although associated persons may incur fewer costs to appear by telephone, FINRA believes appearance by telephone may reduce the ability of arbitrators to assess the credibility of associated persons when deciding an expungement request.

The proposed rule change could have provided a mechanism for an authorized representative of state securities regulators to attend and participate in expungement hearings when expungement is requested during a customer arbitration (simplified or non-simplified). FINRA determined not to propose allowing an authorized representative to attend or participate in a customer arbitration in which expungement is requested because such attendance and participation could delay or disrupt the customer's case and would be less impactful. Unlike many straight-in requests, customer cases are opposed and the panel would have the benefit of hearing the customer's evidence on the merits.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

In December 2017, FINRA published Regulatory Notice 17-42, requesting comment on proposed amendments to the current expungement process.<sup>262</sup> FINRA received 70 comments in response to the Notice. FINRA responded to these comments in the 2020 Rule Filing, which it filed with the Commission on September 22, 2020.<sup>263</sup>

The 2020 Rule Filing proposed several significant enhancements to the current expungement process, including:

- establishing time limits within which associated persons may file straight-in requests;

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<sup>262</sup> See supra note 9.

<sup>263</sup> See Securities Exchange Act Release No. 90000 (September 25, 2020), 85 FR 62142 (October 1, 2020) (Notice of Filing of File No. SR-FINRA-2020-030).

- providing state securities regulators with notification of expungement requests at the time of filing of the requests;
- requiring that all straight-in requests be decided by a three-person panel, randomly selected from a roster of experienced public arbitrators with enhanced expungement training;
- prohibiting parties to straight-in requests from (1) agreeing to fewer than three arbitrators to review their expungement requests, (2) striking any of the selected arbitrators, (3) stipulating to an arbitrator's removal or (4) stipulating to the use of pre-selected arbitrators;
- requiring an associated person named in a customer arbitration to request expungement during the customer arbitration;
- preventing an associated person from getting "two bites at the apple" by conditioning and limiting the ability of a party to a customer arbitration to file an on-behalf-of request and precluding an associated person from requesting expungement of customer dispute information if a panel or a court previously denied a request to expunge the same customer dispute information;
- prohibiting an associated person who withdraws an expungement request from refiling the same request at a later date;
- facilitating customer attendance and participation in straight-in requests by notifying customers of the time, date and place of any prehearing conferences and the expungement hearing, and making clear that customers are entitled to appear with representation at prehearing conferences and the expungement hearing;

- providing customers who seek to attend and participate in straight-in requests with access to all relevant documents filed in the arbitration;
- specifically authorizing the panel to request any documentary, testimonial or other evidence that it deems relevant from the broker-dealer firm or associated person seeking expungement;
- requiring that the associated person requesting expungement appear personally at the expungement hearing; and
- requiring that the panel deciding the expungement request provide enough detail in the award to explain its rationale for including expungement relief in the award.

The Commission ultimately received 19 comments from 13 commenters in connection with the 2020 Rule Filing. The SEC received eight comment letters in response to the initial 2020 Rule Filing.<sup>264</sup> On December 18, 2020, FINRA responded to the comments and filed

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<sup>264</sup> Letter from Steven B. Caruso, Maddox Hargett & Caruso, P.C., to Vanessa Countryman, Secretary, SEC, dated September 28, 2020; letter from Benjamin P. Edwards, Associate Professor of Law, University of Nevada, Las Vegas, William S. Boyd School of Law, to J. Matthew DeLesDernier, Assistant Secretary, SEC, dated October 12, 2020 (“Edwards 1”); letter from Dochter D. Kennedy, President & Founder, AdvisorLaw, LLC, to J. Matthew DeLesDernier, Assistant Secretary, SEC, dated October 22, 2020 (“AdvisorLaw”); letter from Lisa Hopkins, President, NASAA, to Vanessa Countryman, Secretary, SEC, dated October 22, 2020 (“NASAA 1”); letter from Amanda Skrelja, Paige Guarino, William Lapadula, and Zachary Dukoff, Legal Interns & Elissa Germaine, Supervising Attorney, John Jay Legal Services, Inc., Elizabeth Haub School of Law, PACE University, to J. Matthew DeLesDernier, Assistant Secretary, SEC, dated October 22, 2020; letter from Kevin M. Carroll, Managing Director and Associate General Counsel, SIFMA, to Vanessa A. Countryman, Secretary, SEC, dated October 22, 2020; letter from Ruben Huertero, Legal Intern & Christine Lazaro, Director of the Securities Arbitration Clinic and Professor of Clinical Legal Education, St. John’s University School of Law, to Vanessa Countryman, Secretary, SEC, dated October 22, 2020; and letter from David P. Meyer, President, Public Investors Advocate Bar Association, to Brent J. Fields, Secretary, SEC, dated October 23, 2020 (“PIABA 1”). The comment letters are available at <https://www.sec.gov/comments/sr-finra-2020-030/srfinra2020030.htm>.

Partial Amendment No. 1.<sup>265</sup> On December 28, 2020, the SEC published a notice and order in the Federal Register to solicit comments on the 2020 Rule Filing and to institute proceedings to determine whether to approve or disapprove the proposed rule change as modified by Partial Amendment No. 1.<sup>266</sup> The SEC received nine comment letters in response to the Order.<sup>267</sup> On April 9, 2021 FINRA filed its response to the comments on the Order and Partial Amendment No. 2.<sup>268</sup> On May 18, 2021, FINRA filed a third response to comments.<sup>269</sup>

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<sup>265</sup> Letter from Mignon McLemore, Assistant General Counsel, FINRA to Vanessa Countryman, Secretary, SEC, dated December 18, 2020, <https://www.sec.gov/comments/sr-finra-2020-030/srfinra2020030-8163215-226938.pdf>.

<sup>266</sup> See Securities Exchange Act Release No. 90734 (December 18, 2020), 85 FR 84396 (December 28, 2020) (Order Instituting Proceedings to Determine Whether to Approve or Disapprove File No. SR-FINRA-2020-030) (“Order”).

<sup>267</sup> Letter from Julius Z. Frager, to SEC, dated January 7, 2021; letter from Professor Lisa Miller, CEO, Lex Law Corporation, to Vanessa Countryman, Secretary, SEC, dated January 7, 2021; letter from Lisa Hopkins, President, NASAA, to Vanessa Countryman, Secretary, SEC, dated January 18, 2021 (“NASAA 2”); letter from Benjamin P. Edwards, Associate Professor of Law, University of Nevada, Las Vegas, William S. Boyd School of Law, to J. Matthew DeLesDernier, Assistant Secretary, SEC, dated January 19, 2021; letter from Jason R. Doss, President & Celiza Brangança, Vice-President, the PIABA Foundation, Inc., to J. Matthew DeLesDernier, Assistant Secretary, SEC, dated January 19, 2021 (“PIABA Foundation”) (PIABA Foundation is a separate entity from PIABA); letter from Kevin M. Carroll, Managing Director and Associate General Counsel, SIFMA, to Vanessa A. Countryman, Secretary, SEC, dated January 19, 2021; letter from Lisa Hopkins, President, NASAA, to Vanessa Countryman, Secretary, SEC, dated January 28, 2021; letter from Barbara Roper, Director of Investor Protection, Consumer Federation of America, to Vanessa A. Countryman, Secretary, SEC, dated February 1, 2021; and letter from David P. Meyer, President, PIABA, to J. Matthew DeLesDernier, Assistant Secretary, SEC, dated February 2, 2021 (“PIABA 2”). The comment letters are available at <https://www.sec.gov/comments/sr-finra-2020-030/srfinra2020030.htm>.

<sup>268</sup> Letter from Mignon McLemore, Associate General Counsel, FINRA to Vanessa Countryman, Secretary, SEC, dated April 9, 2021, <https://www.sec.gov/comments/sr-finra-2020-030/srfinra2020030-8658196-235191.pdf>.

<sup>269</sup> Letter from Mignon McLemore, Associate General Counsel, FINRA to Vanessa Countryman, Secretary, SEC, dated May 18, 2021 (“Response”), <https://www.sec.gov/comments/sr-finra-2020-030/srfinra2020030-8811356-238001.pdf>. Following the Response and prior to the deadline for Commission action on the 2020 Rule Filing, the SEC received one additional comment letter. See letter from David P. Meyer, President, PIABA, Jason R. Doss, President, PIABA Foundation & Lisa



In general, the commenters on the 2020 Rule Filing suggested that the proposed changes to the expungement process would be beneficial. However, most of the commenters recommended alternative approaches or modifications to further protect the information in the CRD system and address the fact that many straight-in requests are unopposed. The commenters' recommendations generally focused on replacing the current expungement process with an administrative process; allowing state securities regulators to participate in expungement hearings in the DRS arbitration forum; embedding an independent advocate into the expungement process in the DRS arbitration forum; requiring that associated persons meet a higher standard to obtain an expungement award; requiring a unanimous decision of the arbitrators to award expungement; providing financial incentives to encourage customer participation in expungement proceedings; shortening the time limits within which associated persons may request expungement; and requiring that the associated person appear at the expungement hearing in person. Some commenters, in contrast, suggested that the proposed time limits were arbitrarily short; that the arbitrators should be required to provide an explanation when denying expungement; or that the arbitrators should not be limited to awarding expungement on the grounds set forth in FINRA Rule 2080(b)(1).

On May 28, 2021, following discussions with SEC staff, FINRA withdrew the 2020 Rule Filing and Partial Amendments Nos. 1 and 2 in order to consider whether modifications to the proposal would be appropriate in response to concerns raised by the commenters and SEC staff.<sup>270</sup>

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Brangança, Vice-President, PIABA Foundation, to J. Matthew DeLesDernier, Assistant Secretary, SEC, dated May 19, 2021 (“PIABA 3”).

<sup>270</sup> Withdrawal of Proposed Rule Change (May 28, 2021), <https://www.finra.org/sites/default/files/2021-05/SR-FINRA-2020-030-Withdrawal.pdf>. Following FINRA's withdrawal of the 2020 Rule Filing, the SEC received two additional

While the proposed rule change retains many of the significant enhancements proposed in the 2020 Rule Filing, the proposed rule change makes several key additional changes that would materially mitigate a number of the concerns with the current expungement process identified above and by commenters on the 2020 Rule Filing. These additional enhancements include: (1) providing a mechanism for state securities regulators to attend and participate in expungement hearings in straight-in requests;<sup>271</sup> (2) requiring that arbitrators unanimously agree to issue an award containing expungement relief based on one or more grounds specified in the rule;<sup>272</sup> (3)

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comment letters. See letter from Kevin M. Carroll, Managing Director and Associate General Counsel, SIFMA, to Vanessa A. Countryman, Secretary, SEC, dated May 6, 2022 and letter from Anonymous, to J. Matthew DeLesDernier, Assistant Secretary, SEC, dated July 19, 2021.

<sup>271</sup> In the 2020 Rule Filing, FINRA did not provide a mechanism for state securities regulators to attend and participate in expungement hearings. NASAA 1 stated that the 2020 Rule Filing “fail[ed] to provide a pathway to contest the expungement relief during the arbitration should a state determine it is appropriate to do so.” NASAA 2 also stated that notification would “allow NASAA members additional time to evaluate the request and determine the appropriate regulatory response, including but not limited to investigations, enforcement actions, or intervention in subsequent court proceedings seeking to confirm an award.” In addition, PIABA 2 and the PIABA Foundation stated that the 2020 Rule Filing “should provide state securities regulators with notice of the expungement request at the time that the petition for expungement is filed and give them a meaningful opportunity to participate in the arbitration proceeding—either by permitting them to intervene in the arbitrations directly or permitting them to participate indirectly through” an independent advocate. See also PIABA 3 (stating that “state securities regulators and customers [should] have a meaningful opportunity to participate in these expungement proceedings directly or through an advocate so that, when appropriate, evidence opposing expungement can be presented to arbitrators.”).

<sup>272</sup> Consistent with arbitration cases generally, the 2020 Rule Filing would have required a majority decision of the arbitrators to award expungement. See FINRA Rules 12904(a) and 13904(a). PIABA 1 and NASAA 1 suggested that a majority decision was inconsistent with expungement being an extraordinary remedy, that it undercut the goal of helping to preserve valuable information in the CRD system, and that a divided panel decision would indicate that there is doubt that the associated person has met this high burden. Similarly, Edwards 1 stated that allowing majority decisions “insufficiently protects the public’s vital interest in information” and “fails to communicate that expungement should only be recommended in truly extraordinary cases.”

shortening the time period for requesting expungement of a customer complaint from six years to three years after the date a customer complaint is initially reported in the CRD system;<sup>273</sup> and (4) requiring an associated person who is seeking expungement to appear at the expungement hearing in person or by video conference to further enhance the ability of the arbitrator or panel to assess the credibility of the associated person.<sup>274</sup> Each of the proposed changes is discussed in detail above under Item II.A.1.II.

### III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

- (A) by order approve or disapprove such proposed rule change, or

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<sup>273</sup> In the 2020 Rule Filing, FINRA proposed time limits to request expungement in straight-in requests: (1) within two years of the close of a customer arbitration or civil litigation that gave rise to the customer dispute information and (2) within six years of the date a customer complaint was initially reported in the CRD system. PIABA 1 and NASAA 1 supported a shorter one-year time limit for all expungement requests. PIABA 1 stated that the longer time provided in the 2020 Rule Filing would “degrade the quality of evidence for a panel to consider in making an expungement determination and decrease the likelihood that the customer will participate in the hearing.” PIABA 1 also stated that firms do not “need six years to complete investigations of customer complaints and close them in the CRD system (emphasis in original).” Contra AdvisorLaw (stating that the proposed limitations in the 2020 Rule Filing were “arbitrary” and that “the accuracy of the information contained within the CRD system has no relationship to the age of that information”).

<sup>274</sup> The 2020 Rule Filing would have allowed the arbitrators to determine whether the associated person would appear at the expungement hearing by telephone, in person or by video conference. NASAA 1 commented that the associated person should appear in person and that they should not be able to appear “by telephone or, as a matter of course, videoconference.”

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

#### IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

##### Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-FINRA-2022-024 on the subject line.

##### Paper Comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-FINRA-2022-024. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F

Street, NE, Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 p.m. Copies of such filing also will be available for inspection and copying at the principal office of FINRA. All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-FINRA-2022-024 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>275</sup>

J. Matthew DeLesDernier,  
Deputy Secretary.

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<sup>275</sup> 17 CFR 200.30-3(a)(12).