



Alerts

SEC Approves FINRA Rule Changes That Make Expungement of Customer Complaints More Difficult

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Hinshaw Alert

Recently, the Securities and Exchange Commission (SEC) approved the Financial Industry Regulatory Authority's (FINRA) latest attempt to make expungement of customer disputes harder. The latest changes will make successful expungement more difficult, but FINRA has not yet announced when the new expungement rules will go into effect.

Existing Expungement Rules

I. Existing Standard of Proof

FINRA Rule 2080 requires that the movant prove that customer complaints can be expunged only if the Associated Person (AP) can show one of three things: (i) claims, allegations, or information is factually impossible or clearly erroneous; (ii) claimant was not involved in the alleged investment-related sales practice violation; or (iii) the claims, allegations, or information is false.

II. Two-Step Process for Expungement Arbitrations

For the vast majority of existing expungement attempts, the AP must obtain a decision from an arbitration panel ordering expungement. That decision must be confirmed in a court of competent jurisdiction for the material to be removed from the records of the Central Registration Depository (CRD).

Criticism of Existing Expungement Rules

In some quarters, the existing expungement rules were harshly criticized primarily because even very dated events were being successfully expunged and because complaining customers rarely participated in expungement hearings.

Rule Changes Applicable to All Expungements After Implementation

- No longer allowing APs to appear by telephone. They must appear in person or by video conference under the new rules.
- Requiring the arbitration panel to provide greater detail in its award to explain the rationale for including expungement.

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- Barring an AP who withdraws an expungement request from re-filing the request at a later date to prevent "arbitrator shopping."
- Requiring the arbitration panel to be unanimous in finding for expungement under the existing standards listed in FINRA Rule 2080.
- Specifically authorizing the panel to request testimonial, documentary or other evidence that it deems relevant from the party seeking expungement.
- Precluding APs from expunging customer dispute information if a court or prior arbitration panel considered the merits of expungement and denied to grant such relief.
- Explicitly allowing complaining customer attendance by telephone at a hearing on expungement, notification of the customer who initiated the dispute of the date, time, and location of the expungement hearing. Specifically delineating that customers can attend, participate in the expungement hearing, and be represented by counsel if they choose as well as providing the customer with all of the documents filed as part of the arbitration.

Amendments Applicable to Expungements Not Affiliated With an Existing Ongoing Dispute or So-Called "Straight In" Expungement

Lessening the time that APs have to file an expungement request to the following: within two years after the close of the customer litigation or arbitration associated with the customer dispute or within three years after the date the customer complaint was initially reported on the CRD system.

FINRA notification of applicable state securities regulators within fifteen days of receiving a "straight in" expungement request. These state regulators may participate in the expungement arbitration by filing written submissions and otherwise acting as a litigant. For example, the regulator could cross examine the AP's witnesses at a hearing and participate in the Pre-Hearing Conference.

Requiring a "straight in" expungement request to be filed against the broker-dealer where the AP worked when the dispute arose. Currently, APs may name their current broker-dealer even if the client dispute seeking to expunge did not occur there.

APs will no longer be able to rank and strike arbitrators in "straight in" expungements. FINRA will randomly choose arbitrators from a special panel of public arbitrators with experience in arbitration. Industry arbitrators will not be included in expungement arbitrations after implementation.