

# FINRA Proposal Creates Urgency for Brokers Seeking Expungement of Customer Complaints

With the SEC's approval of arguably the most sweeping changes ever to FINRA expungement rules, brokers will soon be faced with even greater difficulty when seeking to expunge their records of career-damaging customer complaints.

*The Legal Intelligencer*

May 5, 2023

By Samuel E. Cohen and Ryan P. Friel

A proposal from the Financial Industry Regulatory Authority (FINRA) designed to make it more difficult for securities brokers to expunge customer disputes from their publicly available records received approval from the U.S. Securities and Exchange Commission (SEC) on April 12.

Over the last two decades, FINRA, the securities industry self-regulatory organization whose motto is "Investor Protection, Market Integrity," has incrementally restricted the rules related to the expungement of customer complaints made against brokers. During that time the expungement process has become more cumbersome, costly and limited. Now, with the SEC's approval of arguably the most sweeping changes ever to FINRA expungement rules, brokers will soon be faced with even greater difficulty when seeking to expunge their records of career-damaging customer complaints.

## FINRA BrokerCheck

FINRA has many tools at its disposal to accomplish its mission. Perhaps the most accessible for retail investors and the general public alike is BrokerCheck, a free

website that anyone may use to research the professional backgrounds of brokers and brokerage firms. The information on BrokerCheck comes from the online registration and licensing databases called Central Registration Depository (CRD), a database maintained by FINRA since 2007 for all firms and individuals involved in the U.S. securities industry. BrokerCheck provides a summary of brokers' licensing credentials, including exams they have passed; securities industry employment history; and disclosures regarding criminal, civil, regulatory and customer complaint history. In total, BrokerCheck contains information on approximately 625,000 registered brokers. Notably, customer complaints must be disclosed on BrokerCheck regardless of the merit of the complaint.

## The Evolution of FINRA Expungement Rules

Disclosures on BrokerCheck, particularly those related to customer complaints, can have devastating professional consequences for a broker. FINRA encourages investors to use BrokerCheck before establishing a relationship with a broker and to monitor it on a going-forward basis. Any disclosure,

however minor, can drastically affect a broker's ability to maintain clients and generate new business. In 2004, FINRA enacted Rule 2080 which provides the following three grounds upon which brokers can expunge their CRD record:

- The claim, allegation or information is factually impossible or clearly erroneous;
- The registered person was not involved in the alleged investment-related sales practice violation, forgery, theft, misappropriation, or conversion of funds; or
- The claim, allegation or information is false.

See FINRA Rule 2080(b)(1)(A)-(C). While brokers were able to expunge their records prior to 2004, Rule 2080 for the first time provided arbitrators with specific, stringent grounds upon which to recommend expungement requests. Absent proof of at least one of the three grounds in Rule 2080, expungement requests must be denied.

In 2014, FINRA raised the bar on expungements again. At that time, disclosures were increasing in response to a 2009 rule amendment which required firms to report allegations of sales practice violations made against a broker in an arbitration or litigation even where the broker was not a named party in the case. In essence, FINRA began requiring broker-dealers to determine whether their broker was implicated, either expressly or impliedly, in a complaint and then report it. This change increased the number of disclosures being reported, oftentimes unfairly because the complaint and basis allegations become publicly available regardless of merit.

With the increase in reporting of customer complaints, broker expungement requests grew as well. In response, FINRA issued guidance for arbitrators that advised that expungement relief is an “extraordinary remedy that should be recommended only under appropriate circumstances.” In addition, arbitrators should grant requests for expungement only when a disclosure had no “regulatory value.” In other words, FINRA’s guidance recommended a more holistic arbitrator analysis to determine whether expungement was in the best interest of the investing public who would be prevented from seeing an expunged complaint.

Even after heightening the standard for expungements, only a few years later in 2017, FINRA proposed extensive changes to the customer dispute expungement process to make it incrementally more difficult and costly for brokers to rid their disclosure reports of potentially unwarranted customer complaints. Those changes were implemented in 2020 and applied a minimum process fee and member surcharge to “straight-in” expungement requests which are not part of an arbitration claim brought by a customer, but occur when a broker files an arbitration case against their current or former brokerage firm requesting the expungement of a customer complaint. The amendment also added minimum hearing session fees to expungement-only hearings. Such changes significantly increased the cost of filing an expungement, thereby making it an untenable proposition for many brokers. For example, minimum filing fees charged to brokers for expungements increased from \$50 to \$1,575 and hearing session fees increased from \$50 to \$1,125. In addition, fees charged by FINRA to broker-dealers in expungement proceedings,

which are frequently charged back to brokers, were set at \$3,750. In total, the fees payable to FINRA for expungements increased thousands of dollars in 2020. Such changes had an obvious chilling effect on expungements with an approximate 95% decrease in the filing of “straight-in” expungements from Q3 to Q4 2020.

### **New, Forthcoming Changes Target ‘Straight-In’ Requests**

On April 12, new FINRA expungement rules were approved by the SEC that will make it even more difficult for brokers to clear their records of potentially unwarranted customer complaints. In particular, FINRA appears to be targeting “straight-in” requests since they are granted at a higher rate than other types of expungement petitions, often-times years after the disclosure and without notice to the complaining customer or to state regulators. The pending changes include the following:

- Requiring unanimous decisions among three-person arbitration panels in order to issue awards granting expungements.
- Notifying customers of the time, date and place of any prehearing conferences and the expungement hearing, and establishing customers’ rights to attend or be represented at such hearings.
- Requiring more detailed expungement awards explaining arbitrators’ rationale. Imposing time limits wherein a broker must file a “straight-in” expungement. Specifically, such expungements must be

filed within three years after the date the customer complaint was initially reported in the CRD system or within two years after the close of the customer-initiated arbitration or civil litigation associated with the customer dispute information.

- Requiring notification of state regulators within 15 days of filing a “straight-in” expungement request so as to allow state regulators to participate as a non-party in the expungement hearing.

While the SEC has approved the changes, FINRA has not announced when they will go into effect. However, the message is clear: FINRA is continuing to seek out ways to purportedly strengthen its BrokerCheck system by making expungements more restrictive and burdensome, if not impossible in the case of older complaints. Brokers must act now before they potentially lose the opportunity to rid their professional records of older customer complaints that would otherwise meet the standards for expungement, forever.



---

*Samuel E. Cohen chairs the securities and investments professional liability practice group in the Philadelphia office of Marshall Dennehey Warner Coleman & Goggin. Ryan P. Friel is an associate within the group. Both attorneys represent FINRA member broker-dealer firms, registered representatives and registered investment advisers in arbitration, state and federal court, regulatory matters and expungement proceedings.*

*They may be reached, respectively, at [secohen@mdwgc.com](mailto:secohen@mdwgc.com) and [rpfriel@mdwgc.com](mailto:rpfriel@mdwgc.com).*