



NASAA

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

750 First Street N.E., Suite 1140

Washington, D.C. 20002

202/737-0900

Fax: 202/783-3571

www.nasaa.org

April 24, 2008

Ms. Nancy M. Morris, Secretary  
Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549-1090

VIA EMAIL TO: [rule-comments@sec.gov](mailto:rule-comments@sec.gov)

Re: Release No. 34-57572; File No. SR-FINRA-2008-010  
Notice of Filing of Proposed Rule Change Relating to Amendments to the Codes of  
Arbitration Procedure To Establish New Procedures for Arbitrators To Follow When  
Considering Requests for Expungement Relief

Dear Secretary Morris:

The North American Securities Administrators Association, Inc. ("NASAA")<sup>1</sup> hereby submits the following comments in response to the above-referenced rule proposal ("Proposal") filed by the Financial Industry Regulatory Authority, Inc. ("FINRA"). NASAA's comments here are specifically directed at the Proposal, and are in addition to NASAA's general objections to the mandatory arbitration system, as administered by FINRA.

Since the promulgation of Rule 2130 ("Rule"), adopted in December 2003 by FINRA's predecessor the National Association of Securities Dealers, NASAA has had the occasion to witness the application of the Rule in well over 500 arbitration cases. As a result, NASAA is very familiar with the Rule, its application and misapplication by arbitration panels, and the urgent need for reform of the expungement process. Therefore, we support FINRA's endeavors to effectuate change to the arbitration procedures for expungement relief. However, we do not believe FINRA has gone far enough to ensure the Rule is properly applied or that expungement is an extraordinary remedy, as was intended at the time the Rule was adopted. To this end, NASAA will take this opportunity to comment on the Proposal, and to outline some of our remaining concerns not addressed by the Proposal.

### **Proposal**

We strongly support the Proposal's addition of a hearing requirement specifically on the issue of expungement. NASAA has long advocated that arbitration panels must actually conduct a hearing on a request for expungement relief in order to be able to make a proper "finding," as

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

required by the Rule. Without a hearing on the issue, an informed decision on the appropriateness of expungement is impossible to make. A hearing is especially important where a settlement has been reached by the parties. Unfortunately, it has been a fairly standard practice for arbitration panels to simply adopt a stipulated award in lieu of holding a hearing. NASAA believes that requiring that an arbitration panel actually consider the appropriateness of expungement in the course of a hearing will help ensure the issue of expungement is specifically addressed and considered before the destruction of valuable information from the Central Registration Depository System (“CRD”).

NASAA further supports the Proposal’s requirement that the hearing session be recorded. The ability to obtain a transcript will facilitate state securities agencies’ and other regulators’ ability to review individual waiver requests and confirm that the panel fully considered the expungement request before recommending such relief. It is contrary to our mutual mission of investor protection to simply recommend expungement as a matter of course or as an accommodation to facilitate settlement between the parties. The panels are the gatekeepers for expungement, and cannot carry out this duty without considering the necessary evidence to make a thoughtful recommendation as to the appropriateness of expungement relief.

NASAA equally supports the Proposal’s requirement that the panel consider the terms and conditions of the settlement documents, and the settlement amounts. NASAA has witnessed the expungement process particularly suffer in the context of settlements. Since panels routinely adopt stipulated awards without consideration as to the appropriateness of expungement relief, and often without even receiving or examining the settlement documents, brokers have essentially been able to “buy” expungements through settlement. These settlements often require customers to sign a release or settlement agreement which in turn, prohibits the customers from objecting to the expungement of their customer complaint. As FINRA noted in the proposing release, panels were always expected to examine the settlement for questionable terms and conditions. The Proposal will codify this intention.

As further protection against the misuse of the Rule, NASAA supports those parts of the Proposal that require the panel to indicate on which of the three grounds the panel is recommending expungement, and the Proposal’s further requirement that a written explanation of the reasons for the finding be provided. A simple acknowledgement by the panel of the requirements of the Rule is not sufficient for extraordinary relief. Brokers must be required to prove that the complaint should be expunged and panels must explain how brokers have satisfied this burden. Finally, NASAA supports the Proposal’s requirement that the forum fees for expungement be assessed against the party requesting the expungement relief. Customers should not bear the expense of a broker’s request to expunge information from his or her record. Therefore, the proper allocation of the forum fees lies with the broker.

## **Issues**

While the Proposal makes some progress towards clarifying the process for expungement relief, a number of issues are left unaddressed. The Proposal’s enhancements go largely to the process itself, rather than the substance of expungement relief. The Proposal does not provide guidance as to the proper application of expungement, nor does the Proposal seek to illuminate the actual meaning of each of the standards under the Rule. Without doing so, the arbitrators must navigate blindly through the substance of the Rule. Further guidance and arbitrator training

on the substance of the Rule is crucial. Without such guidance, arbitrators will follow a process with no underlying substantive direction.

The hearing requirement on the issue of expungement is a step in the right direction, but does nothing to prevent the hearing from becoming a one-sided story. Particularly in the context of settled cases, customers have no incentive to participate in an expungement hearing. Therefore, evidence will usually only be presented and heard from the broker requesting expungement. The Panel will not hear testimony or evidence from the customer. Requiring arbitrators to hold a hearing, without providing for a balanced story, does little to prevent inappropriate expungement relief and the resulting destruction of valuable information.

To partially address this issue, NASAA would advocate for the creation of a presumption against expungement. Expungement is, and always was, intended to be an extraordinary remedy. Indeed, FINRA has repeatedly stressed that expungement is not appropriate in all circumstances, and that there remains a significant threat for the abuse of the expungement process.<sup>2</sup> In order to ensure against such abuse, a presumption against this relief should be created. By creating a heightened evidentiary standard for those requesting expungement, expungement will in fact be an extraordinary remedy. This is necessary because, as a practical matter, particularly in the context of settled cases, the claimant and their counsel have no incentive to participate in the expungement hearing. Quite the opposite is true. Claimants would incur additional costs, in the way of attorney's fees and time, in order to participate and would gain no benefit through their participation. And, as noted above, customers are often precluded from objecting to expungement as a condition to the settlement. A presumption against expungement would serve to protect the interests of third parties, investors and regulators alike, in the broker's registration record in the absence of an advocate such as the claimant or their counsel.

NASAA is also concerned about cases where panels exceed their authority in various contexts. First, panels should be instructed that they cannot award relief to third parties not participating in the arbitration. Similarly, where a party has been dismissed from a case, arbitration panels should be instructed that it is beyond their jurisdiction to subsequently take up the issue of expungement on that non-party. It is also beyond the arbitration panel's jurisdiction to attempt to expunge state court proceedings. Finally, NASAA continues to oppose attempts to use the Rule to expunge customer complaint information where there is no underlying arbitration. Such action by arbitration panels is an errant exercise of authority and sets a dangerous precedent. Compromising the accuracy and completeness of the CRD to the detriment of investor protection can not be tolerated. Panels must be reminded of their jurisdictional limits and the narrow circumstances in which to recommend expungement.

FINRA must make further improvements to the expungement process in order to maintain the integrity of the CRD and further our shared mission of investor protection. The CRD, and the information contained therein, is a central component of this mission. We recognize that expungement relief is appropriate in certain circumstances, but it is extraordinary relief. Those seeking such relief and those recommending it should only do so in limited

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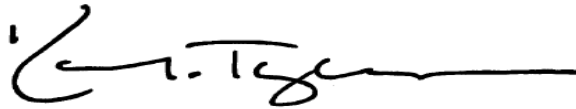
<sup>2</sup> "Expungement of information from the CRD system is an extraordinary remedy, however that is not appropriate in all circumstances. In addition, there is a potential for inappropriate use of the expungement process, particularly where parties have agreed to expunge customer dispute information as a part of a settlement." NTM 01-65.

circumstances. FINRA must take further steps to guard against valuable information about brokers from being destroyed.

We support the Proposal and FINRA's attempts to clarify what has become a murky process. We encourage FINRA to take further steps to provide guidance on the substance of the Rule and to make certain that expungement truly be extraordinary relief that can not be bought. We are happy to provide any assistance going forward.

Thank you for the opportunity to comment on this Proposal. Should you have any questions about our comments, please feel free to contact Melanie Senter Lubin, Chair of the NASAA CRD/IARD Steering Committee at (410) 576-6360 or Bryan J. Lantagne, Chair of the NASAA Arbitration Project Group at (617) 727-3548.

Sincerely,

A handwritten signature in black ink, appearing to read 'K. Tyler', with a long horizontal flourish extending to the right.

Karen Tyler,  
NASAA President and  
North Dakota Securities Commissioner