



**FINANCIAL  
SERVICES  
INSTITUTE**

VOICE OF INDEPENDENT  
FINANCIAL SERVICES  
FIRMS AND INDEPENDENT  
FINANCIAL ADVISORS

## VIA ELECTRONIC MAIL

February 5, 2018

Ms. Marcia E. Asquith  
Office of the Corporate Secretary  
The Financial Industry Regulatory Authority, Inc.  
1735 K Street, NW  
Washington, DC 20006-1506

Re: Regulatory Notice 17-42 | Expungement of Customer Dispute Information (Notice)

Dear Ms. Asquith:

On December 6, 2017, the Financial Industry Regulatory Authority, Inc. (FINRA) published its request for public comment on proposed amendments to FINRA's rules governing expungement of customer related dispute information (Proposed Amendments).<sup>1</sup> The Proposed Amendments, which make substantive changes to the expungement process,<sup>2</sup> are part of a series of changes FINRA is considering.<sup>3</sup>

The Financial Services Institute<sup>4</sup> (FSI) appreciates the opportunity to comment on this important proposal. FSI has supported, and continues to support, restrictions on financial advisors' ability to expunge truthful and accurate disparaging information from the Central Registration Depository (CRD) and, consequently, from FINRA's BrokerCheck system. The absence of such restrictions would pose a risk to investors because, among other things, it would make it easier for high-risk or recidivist brokers to move through the industry undetected. It would also impede regulators' ability to execute their oversight responsibilities and would deny investors access to important information.

FSI believes, however, that any restrictions imposed should be unambiguous, reasonable, tied to an articulable regulatory objective, and balanced with financial advisors' needs to eradicate information that is misleading, meaningless, or that has no regulatory or investor protection value.

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<sup>1</sup> See, generally, Regulatory Notice 17-42 (December 6, 2017) (Notice).

<sup>2</sup> See, generally, Notice.

<sup>3</sup> *Id.* at p.1.

<sup>4</sup> The Financial Services Institute (FSI) is an advocacy association comprised of members from the independent financial services industry, and is the only organization advocating solely on behalf of independent financial advisors and independent financial services firms. Since 2004, through advocacy, education and public awareness, FSI has been working to create a healthier regulatory environment for these members so they can provide affordable, objective financial advice to hard-working Main Street Americans.

## **Background on FSI Members**

The independent financial services community has been an important and active part of the lives of American investors for more than 40 years. In the US, there are more than 160,000 independent financial advisors, which account for approximately 52.7 percent of all producing registered representatives.<sup>5</sup> These financial advisors are self-employed independent contractors, rather than employees of the Independent Broker-Dealers (IBD).<sup>6</sup>

FSI's IBD member firms provide business support to independent financial advisors in addition to supervising their business practices and arranging for the execution and clearing of customer transactions. Independent financial advisors are small-business owners and job creators with strong ties to their communities. These financial advisors provide comprehensive and affordable financial services that help millions of individuals, families, small businesses, associations, organizations, and retirement plans. Their services include financial education, planning, implementation, and investment monitoring. Due to their unique business model, FSI member firms and their affiliated financial advisors are especially well positioned to provide Main Street Americans with the affordable financial advice, products, and services necessary to achieve their investment goals.

FSI members make substantial contributions to our nation's economy. According to Oxford Economics, FSI members nationwide generate \$48.3 billion of economic activity. This activity, in turn, supports 482,100 jobs including direct employees, those employed in the FSI supply chain, and those supported in the broader economy. In addition, FSI members contribute nearly \$6.8 billion annually to federal, state, and local government taxes. FSI members account for approximately 8.4% of the total financial services industry contribution to U.S. economic activity.<sup>7</sup>

## **Discussion**

FSI appreciates the opportunity to comment on the Proposed Amendments. As stated above, FSI supports reasonable restrictions on financial advisors' ability to expunge customer dispute information from CRD. To that end, FSI believes that the Proposed Amendments should provide more flexibility with respect to how long an advisor has to initiate an expungement request. Further, FSI is concerned that participants on the Expungement Arbitrator Roster are not required to have securities industry experience and, thus, may fail to appreciate the factual nuances that gave rise to the customer's allegations against the advisor. FSI also has concerns that the arbitrators' standard of review, i.e., that the expunged information has no investor protection or regulatory value, is overly subjective and open to multiple and inconsistent interpretations. Therefore, FSI suggests that the Proposed Amendments eliminate that standard of review. Alternatively, FSI suggests that the Proposed Amendments include specific events that would meet that standard of review. These concerns and recommendations are discussed in greater detail below.

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<sup>5</sup> Cerulli Associates, Advisor Headcount 2016, on file with author.

<sup>6</sup> The use of the term "financial advisor" or "advisor" in this letter is a reference to an individual who is a registered representative of a broker-dealer, an investment adviser representative of a registered investment adviser firm, or a dual registrant. The use of the term "investment adviser" or "adviser" in this letter is a reference to a firm or individual registered with the SEC or state securities division as an investment adviser.

<sup>7</sup> Oxford Economics for the Financial Services Institute, The Economic Impact of FSI's Members (2016).

## I. FSI's Comments

### A. Introduction & Background

CRD has several important functions. First, investors rely on CRD information, made available to them through FINRA's BrokerCheck, to assist them in deciding whether to do business with a particular financial advisor.<sup>8</sup> Regulators use CRD to execute regulatory oversight and, at times, to identify industry trends.<sup>9</sup> Broker dealers use CRD information as a basis for its hiring decisions.<sup>10</sup> For those reasons, information contained in CRD, if it is inaccurate or confusing, may cause regulators to misidentify trends and, important to FSI's advisor members, may directly result in advisors losing clients, new business opportunities or employment opportunities.

Notably, in addition to collecting information regarding fully adjudicated customer-related matters, CRD also contains other customer dispute information, such as customer claims that have been settled. It is important to keep in the mind that every settlement is not tantamount to admission of guilt. In fact, financial advisors frequently agree to settle claims as part of an overall settlement agreed to by the broker dealer they are associated with at the time of the alleged misconduct. Financial advisors also, individually, decide to settle an action, even ones they believe are without merit, to avoid the cost and expense associated with arbitration or litigation or due to the unpredictable nature of the same.

In these cases, the financial advisor may not have engaged in any wrongdoing. This is why the need to balance investor protection and regulatory value, with advisors' rights, becomes so important. Hence, in implementing its series of changes to the expungement to the process, FINRA should consider these financial advisors; and not only the high risk, recidivist, or other advisors who pose an inherent threat to investor protection.

### B. Financial Advisors Should Have Three Years to Bring Expungement Proceedings

Financial advisors may seek to have customer dispute information removed from CRD, pursuant to FINRA Rule 2080, if the claim, allegation or information is factually impossible, clearly erroneous, false or the financial advisor "was not involved in the alleged investment related sales practice violation, forgery, theft, misappropriation or conversion of funds."<sup>11</sup> Thus, there are limitations on the circumstances in which expungement may be appropriate. This aligns with FINRA's philosophy that "expungement of customer dispute information is an extraordinary measure."<sup>12</sup>

The Proposed Amendments would require that expungement requests be made at the conclusion of a case.<sup>13</sup> If the matter concludes by means other than an award (i.e., the matter is settled), the Proposed Amendments would require financial advisors to make expungement requests within one-year of FINRA closing the arbitration or, if there was no arbitration, within one

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<sup>8</sup> See FINRA Office of Dispute Resolution Arbitrator's Guide, at p. 72 available at <http://www.finra.org/sites/default/files/arbitrators-ref-guide.pdf>.

<sup>9</sup> *Id.*

<sup>10</sup> *Id.*

<sup>11</sup> See FINRA Rule 2080 (b)(1) (A) – (C).

<sup>12</sup> See Notice at p. 4.

<sup>13</sup> See Proposed Rule 13800(f).

year of the information being reported to CRD.<sup>14</sup> According to the Notice, these time limitations are designed to ensure that information regarding the underlying allegations would still be available and that customers would be more likely to participate in the expungement proceedings.<sup>15</sup> FSI agrees there should be some time limitations imposed, but suggests three years as a more reasonable alternative.

Broker dealers are required to maintain books and records related to their business for time periods prescribed by FINRA rules and by rules promulgated by the US Securities and Exchange Commission. Thus, it is unlikely that a longer delay would substantially impair access to pertinent information. Also, in the event that the arbitrators determine that, after the three-year period, there is not sufficient available information to rule in the advisor's favor, the arbitrators may simply rule against the advisor.

With respect to customers' participation in expungement proceedings, that participation is at the customer's discretion. There is no guarantee that the one-year limitation, versus a three-year limitation (or longer), would make customers want to expend the time and financial resources necessary to attend the expungement proceedings. On the other hand, the one-year limitation undoubtedly impacts financial advisors by imposing additional hurdles to the expungement process. It also inserts imbalance in the system since the Code of Arbitration Procedures gives customers six years to bring claims.<sup>16</sup>

Advisors should not be unfairly prejudiced based upon the mere chance that a customer may decide he or she wants to appear at the proceeding. This is particularly true since there are no additional factors, other than the customer's desire to do so, that would impede the customer from attending the proceeding three years later. Nonetheless, this additional time would give financial advisors the opportunity to, among other things, assess how the information will impact the advisor's ability to do business, retain appropriate legal representation, and work with the advisor's attorney to determine litigation strategy. At times, the impact on the advisor's ability to do business may not be immediately apparent.

C. Qualifications for Arbitrators to Appear on the Expungement Arbitrator Roster Should be Broadened to Include Persons Who Have Worked in the Securities Industry in a Registered Capacity

Three public chairpersons chosen from an Expungement Arbitrator Roster (Roster) would decide certain expungement cases. Selection is random.<sup>17</sup> To be included on the Roster, public chairpersons must receive enhanced training, be licensed attorneys, and have five-years' experience either in litigation, state or federal securities regulation, serving as a judge, in administrative law or serving as a securities regulator.<sup>18</sup> FINRA believes that these requirements will help it "maintain the integrity of its CRD records and ensure that expungement is only granted in appropriate circumstances."<sup>19</sup> Based on these requirements, and the random selection process, it

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<sup>14</sup> See Proposed Rule 13805(a)(3).

<sup>15</sup> See Notice at p. 7.

<sup>16</sup> See Sec. 12206, FINRA Code of Arbitration.

<sup>17</sup> See Proposed Rule 13806 (b)(1)

<sup>18</sup> See Proposed Rule 13806 (b)(2).

<sup>19</sup> See Notice at p. 10.

is possible to have a panel consisting of three licensed attorneys, who are trained in expungements, but who lack any meaningful securities industry experience.<sup>20</sup>

FSI is concerned that while these persons may understand the importance of maintaining public records, they may not understand the securities industry. Without this understanding, it may be difficult to appreciate whether information has regulatory significance or investor protection value. FSI, therefore, suggests that industry participants who have worked as a general securities principal for a least five consecutive years, in the prior seven-year period, be eligible for inclusion on the Roster. Persons meeting those requirements would be eligible for inclusion regardless of whether they are attorneys, providing however, that they do not have any disciplinary history. While this would, in certain cases, mean that the panel would be semi-public, as noted, this person would be able to speak to, and access, the integrity of the underlying facts.

FSI also suggests that, at least one person on each three-person panel be required to have securities industry experience either as general securities principal that meets the qualifications outlined above; or as an attorney who has the requisite five years' experience in state or federal securities regulation or as a securities regulator. This will help ensure that one person on the panel not only understands the general importance of maintaining records, but also understands the factual nuances that gave rise to the customer dispute, as well as whether the information has regulatory and investor protection value.

D. The Proposed "No Investor Protection or Regulatory Value" Standard Is Subjective and Ambiguous

Under the Proposed Amendments, arbitrators must agree unanimously and in the arbitration award:

1. include findings that one or more of the grounds for expungement set forth in Rule 2080 (b)(1)<sup>21</sup> apply;
2. provide a written explanation for its determination that the grounds apply; and
3. determine that "the customer dispute information has no investor protection or regulatory value."<sup>22</sup>

Perhaps, this requires clarification; however, it appears that this is a multi-part test requiring that arbitrators both determine that: (i) one of the enumerated grounds in Rule 2080(b)(1) apply; and (ii) independently, determine that the information has no investor protection or regulatory value. Thus, conceivably, even in the presence of one of the grounds set forth in 2080(b)(1), arbitrators may deny a request for expungement if the information has investor protection or regulatory value. This is confusing as it is difficult to imagine a scenario where information that is false, clearly erroneous, factually impossible or did not involve the advisor, would have regulatory or investor protection value.

To the extent that the investor protection or regulatory value standard, was meant to be an independent standard of review, while FSI unequivocally supports this as a *concept*; it is concerned that, as a rule-based standard of review, it is subjective, ambiguous and open to

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<sup>20</sup> *Id.*

<sup>21</sup> The available defenses under FINRA Rule 2080 (b)(1) are that the claim, allegation or information is factually impossible, clearly erroneous or false or that the registered person was not involved in the conduct.

<sup>22</sup> See Proposed Rule

multiple and inconsistent interpretations. More specifically, the grounds set forth in Rule 2080(b)(1) (e.g., the information is demonstrably false, clearly erroneous, impossible, etc.), creates an objective standard of review that can be easily understood by financial advisors and applied by arbitrators. Conversely, whether information has value is subjective, ambiguous and, consequently, renders that review process patently unpredictable. This would likely lead to various rulings based on facts that are the same, or substantially similar. Thus, FSI suggests that language be eliminated, or that FINRA consider including supplementary material in the rule clarifying how that portion of the standard or review should be applied.

## II. Disclosure by Unnamed Parties

Firms are required to report, as customer complaints, allegations of sales practice violations made in arbitration claims and civil lawsuits against financial advisors who are not named as parties in those proceedings. This, often, results in a lack of due process for the unnamed advisor as it results in the unnamed financial advisor with a negative mark on his Form U-4 even though the advisor did not have the opportunity to participate in the arbitration. Also, without the advisor having been present to offer his narrative of the events, with respect to the advisor, the arbitration panel is left with a one-sided presentation of the facts. Hence, any regulatory value of disclosing these on the Form U-4 is greatly diminished. Thus, FSI suggests that FINRA no longer require advisors to disclose arbitration, settlements in which the advisor was not named.

### Conclusion

We are committed to constructive engagement in the regulatory process and welcome the opportunity to work with FINRA on this and other important regulatory efforts.

Thank you for considering FSI's comments. Should you have any questions, please contact me at (202) 393-0022.

Respectfully submitted,

A handwritten signature in blue ink that reads "Robin Traxler". The signature is written in a cursive, flowing style with a long horizontal line extending to the right.

Vice President, Regulatory Affairs & Associate General Counsel