

WHAT IS THE VALUE OF ONE'S PERSONAL REPUTATION? YOUR OPPORTUNITY TO OBTAIN AN EXPUNGEMENT MAY BE RUNNING OUT

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The legendary basketball coach, John Wooden, once said: "Be more concerned with your character than your reputation. Your character is what you really are while your reputation is merely what others think you are." Unfortunately, in today's technological world, particularly where FINRA requires that financial advisors' websites direct clients to FINRA's BrokerCheck system, a derogatory and meritless disclosure puts your reputation into question. In the eyes of a customer, a single "black mark" immediately renders you untrustworthy without the opportunity to impress upon the client your true character. Indeed, there are more than 600,000 financial advisors in our country; why would anyone work with someone of questionable integrity when there are so many other options available?

FINRA's website states that BrokerCheck:

1. Helps investors make informed choices about brokers and brokerage firms and provides easy access to investment adviser information; and
2. Gives you a snapshot of a broker's employment history, licensing information and regulatory actions, arbitrations and complaints.

Instead of acknowledging that customers will (and do) make meritless claims, FINRA requires brokers to immediately report any customer complaint on their public record. Practically, this creates a "guilty until proven innocent" scenario as brokers must immediately disclose the complaint on their CRD regardless of any merit and then traverse the exceedingly cumbersome path of expungement to have the blemish removed. There is no simple "he/she made a mistake" path that will result in permanent removal of the complaint. Without taking affirmative legal action, a customer complaint will remain on a broker's public record indefinitely for all to see.

How Did We Get Here: A History of FINRA Expungement

Prior to July 30, 2014, broker-dealers and registered representatives could seek an expungement agreement in connection with a settlement. If a customer filed an informal or formal complaint, a settlement frequently would state that the customer agreed not to oppose a request to expunge the information from FINRA's BrokerCheck system. The result, according to the Public Investors Arbitration Bar Association ("PIABA"), which analyzed expungements granted between 2012-2014 where the parties resolved their dispute, was that nearly 90% of expungement requests were granted.

In response to these findings, FINRA issued a Notice to Arbitrators and Parties on Expanded Expungement Guidance ("Expanded Guidelines") educating arbitrators on the "extraordinary" nature of expungement and instructing them to "consider the importance of maintaining the integrity of the information in the CRD system". FINRA specifically stated, "[e]nsuring that CRD information is accurate and meaningful is essential to investors, who may rely on the information when making decisions about brokers with whom they may conduct business; to regulators, who rely on the information to fulfill their regulatory responsibilities; and to prospective broker-dealer employers, who rely on the information when making hiring decisions."

FINRA also implemented Rule 2081 on July 30, 2014. It provides:

2081. Prohibited Conditions Relating to Expungement of Customer Disputes

No member 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.

Thus, with FINRA's Expanded Guidelines and Rule 2081, FINRA emphasized to arbitrators that expungement is an extraordinary remedy that should be granted only when it has no meaningful investor protection or regulatory value.

With that history in mind, below you will find how the expungement process unfolds in today's climate.

Beginning the Expungement Process: Filing a Claim

Whether informal or formal, a customer complaint can only be removed from a broker's BrokerCheck Report through a formal FINRA Arbitration. There are two ways to do this: (1) file an arbitration claim against the customer; or (2) file an arbitration claim

against the broker-dealer that filed the disclosure¹. From the outset, it is important to note that the expungement process does not occur overnight. Regardless of which route you choose, you should expect the process to take six months or more from beginning to end.

1. Filing An Arbitration Claim Against The Customer

Although it shows you mean business, filing an arbitration claim against a customer can easily backfire. Regulators do not look favorably on suing customers. Beyond that, it can aggravate an otherwise complacent customer (perhaps a customer that is headstrong and unwilling to admit a mistake), resulting in more pushback and inflammatory comments that could dissuade arbitrators from empathizing with the broker and granting the expungement request. Further, while not determinative, common sense tells us that the chances of obtaining an expungement increase significantly if the customer is not opposing the request. Therefore, naming the customer in a FINRA arbitration claim could decrease the chances of success.

2. Filing An Arbitration Claim Against The Reporting Broker-Dealer

What's becoming the more common avenue in obtaining expungement relief is to file an arbitration claim against the reporting broker-dealer. Indeed, since FINRA Rule 2081 was implemented, 193 arbitration claims have been filed by registered representatives against their current or former firm. Of those 193 cases, 166 (i.e., 86%) were granted.² Further, filing a claim against the broker-dealer grants the parties more control over the arbitration process, including arbitrator selection and hearing schedules. The caveat – if you are naming your current broker-dealer, you will want to check with the compliance department to make sure the firm is on board. While it is in both the firm's and the representative's best interests to have unwarranted disclosures removed, some firms can be quirky about being named in a lawsuit. Additionally, you should be prepared for the possibility that the broker-dealer (whether current or former) may request that you pay all associated forum fees.

Notably, FINRA's Expanded Guidelines instruct Arbitrators to order the broker to provide a copy of the expungement request to the customer(s) involved in the underlying complaint. FINRA does not, however, provide any guidance on when such notification must take place. Thus, as long as notification is made prior to the hearing with enough time for the customer(s) to elect to participate, you will likely have satisfied this requirement. More often than not, customers are less likely to object when they are not a named party and there is nothing in it for them one way or another.

¹ The member firm that was involved in the Form U4 or U5 disclosure is in a unique position to know all of the facts and circumstances surrounding the customer complaint, as well as any formal response and resolution.

² Statistics obtained from Capital Forensics, Inc.

Presenting Your Side of the Story: The Hearing

An expungement hearing, usually done telephonically, may be opposed or unopposed by the customer. As previously stated, an unopposed hearing allows the broker to present his/her narrative story without interference from the customer. An unopposed hearing can proceed one of two ways. In one scenario, the broker or their attorney can present the broker's story to the arbitration panel and provide time at the end for any questions. Another way is for the attorney to conduct a direct examination of the broker, leaving room at the end for any questions or clarification from the panel. Both methods are effective and allow the broker to lead the hearing in the most favorable direction.

In cases where a customer indicates that he/she will oppose an expungement request, the broker must seriously consider the ramifications and potential outcome. Although opposition does not mean the expungement request will be denied, the time and expense associated with an arbitration hearing will increase. In such circumstances, a formal, in-person hearing with testimony and witnesses may be required.

Whether opposed or unopposed, you will need to persuade the Panel to grant expungement under one of three limited grounds provided in FINRA Rule 2080:

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

The Arbitration Award will need to include one of these explanations if expungement is granted.

It's Not Over Until it's Over: Confirming the Arbitration Award

Assuming the expungement hearing goes well and a panel recommends expungement, you are not yet finished. FINRA requires brokers to obtain confirmation of the Arbitration Award from a court of competent jurisdiction. As a result, you will need to file a petition to confirm the arbitration award in the appropriate court and obtain a judgment directing FINRA to remove the matter from your CRD record.

FINRA Rule 2080, however, requires a broker to name FINRA as a party unless it waives the obligation to be named. For expediency purposes, this is always a good route. Thus, before filing a petition with a court, you should submit a formal request to FINRA asking that it waive its obligation to be named as a party. FINRA will only waive

this right if the expungement relief granted is based on one of the three above-mentioned criteria. In other words, the arbitration panel must have expressly found that (1) the claim was factually impossible or clearly erroneous, (2) the broker was not involved in the misconduct, or (3) the claim was false. Any one of these criteria will suffice.

After the petition is filed and the judge confirms the arbitration award, the only thing left to do is submit the court's Order to FINRA and request the removal of the customer dispute from your record. The black mark will be permanently removed.

That Sounds Pretty Straightforward. What's the Catch?

The expungement process, although tedious and time-consuming, appears to be straightforward: if a customer files a meritless claim, I just have to go through the expungement process to remove it from my public record. Sorry, FINRA doesn't see this as an easy process, and it certainly does not want brokers to view it as such.

As previously explained, FINRA's Expanded Guidelines memorialize FINRA's position that expungement is an "extraordinary remedy" that should be granted only under "appropriate circumstances". FINRA believes that a customer complaint should only be expunged when "it has no meaningful investor protection or regulatory value". What does this mean? FINRA has already planted the seed in arbitrators' minds that expungement should be granted sparingly. In other words, even where a customer does not oppose an expungement request, the arbitrators are instructed to remain cautious and only grant an expungement under very limited circumstances.

So Where Do We Go From Here?

In the past three years, 86% of expungement requests have been granted by FINRA arbitrators.³ This should provide some hope, but FINRA has also noticed the high percentage of expungement requests and seeks to severely restrict, and even outright prohibit, the ability to obtain an expungement.

On December 6, 2017, FINRA issued Regulatory Notice 17-42 wherein it requested comments on proposed amendments to the Code of Arbitration relating to expungement requests. By FINRA's own admission, it intends to establish rules that further restrict how and when registered representatives can seek expungement of a customer complaint. The difference this time, however, is that FINRA intends to make it more costly and incredibly burdensome (and in some instances, impossible) for anyone to obtain expungement.

³ Statistics obtained from Capital Forensics, Inc.

The most relevant and important proposals are as follows:

| Current Rule | Proposed Rule |
|--|---|
| An associated person may participate in an expungement hearing in person, telephonically, or via videoconference. | An associated person may only attend an expungement hearing in person or via videoconference. |
| Depending on when the expungement request is initiated, a one-person or three-person panel may preside over the proceedings. | A three-person panel will always decide an expungement request. |
| In cases overseen by a three-person panel, a majority must grant expungement under FINRA Rule 2080(b)(1). | A three-person panel must unanimously grant expungement under FINRA Rule 2080(b)(1) and find that “the customer dispute information has no investor protection or regulatory value”. |
| An associated person named in an arbitration claim may request expungement during the underlying proceedings or initiate a separate arbitration claim within six years from the underlying complaint. | An associated person who is a named party to a customer arbitration claim must request expungement during the underlying customer case or forfeit their right to request such. |
| If an associated person is not a named party in a customer arbitration, he/she can file an arbitration claim requesting expungement of the underlying case within six years from the underlying complaint. | If an associated person is not a named party in a customer arbitration, he/she must file an arbitration claim requesting expungement within one year after the member firm initially reports the customer complaint to the CRD. |
| An associated person may name either the member firm or customer in their request for expungement. | An associated person is required to name the firm at which he or she was associated at the time of the events giving rise to the customer claim – the associated person may not name the customer. |

Clearly, FINRA intends to burden the expungement process in the near future. Only time will tell when and to what extent the proposed rules will be enacted. But one thing is clear, FINRA’s recent intentions make it apparent that now is the time to act if expungement is sought. Indeed, FINRA is an equitable forum and notwithstanding its efforts to deter arbitrators from granting expungement requests, the costs associated with obtaining an expungement are miniscule in comparison to the amount of revenue

lost due to an undeserved black mark on your record. Expungement ensures your reputation stays intact so your clients and potential clients will get the opportunity to meet you and assess your true character.

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