CLIENT ALERT
FINRA Seeks SEC Approval of Rules That Would Make It More Difficult to Obtain Expungements

FINRA's expungement process provides a way for registered representatives to remove information about customer complaints and arbitrations from FINRA's Central Registration Depository (CRD) system. The system serves as the central licensing and registration system for the U.S. securities industry. The public can easily access this information through FINRA's BrokerCheck® website, so the information disclosed in the CRD system is extremely important to the reputation of a registered representative and can have a significant impact on his or her business.

In December 2017, FINRA issued Notice to Members 17-42, proposing sweeping changes to the existing process for expunging references to customer complaints and arbitrations, and after a lengthy delay, on September 22, 2020, FINRA requested SEC approval of certain of those proposed changes. Most significantly, FINRA is seeking SEC approval to put in place stricter procedural requirements for granting expungement relief, including requiring unanimous consent of a three-person panel and barring requests if they are not sought within certain time periods. Thus, it will be more difficult to obtain an expungement should these changes become effective. Consequently, registered representatives would be well-advised to seek expungement of meritless complaints and arbitrations reflected on their CRD records before the proposed amendments are enacted.

The expungement process is governed by a layer of rules, primarily FINRA Rules 12805 and 2080. A registered representative sued in arbitration may request the affirmative relief of an expungement recommendation in the Answer to a Statement of Claim. Otherwise, an expungement proceeding may be commenced by filing a claim for expungement with FINRA. FINRA will then assemble a panel to hear the claim. The rules further require that a hearing regarding the merits of the claim be held and, at the conclusion of the hearing, the panel issue a written arbitration award stating the grounds for expungement. Under FINRA Rule 2080, the grounds for expungement set forth in the award must include one or more of the following findings: (1) the claim or allegation by the customer is factually impossible or clearly erroneous, (2) the broker was not involved in the alleged investment-related sales practice violation or other alleged misconduct, and/or (3) the claim or allegation is false. Under the current rules, an expungement request may be heard by a single panelist or three-person panel, and there is a panel selection process that permits the parties to strike a certain number of proposed arbitrators for any reason. If heard by a three-person panel, a ruling...
by the majority of the panel is sufficient to grant expungement relief. Requests for expungement are now subject to the six-year time limit in FINRA Rules 12206 and 13206 (the “Eligibility Rule”), but historically the Eligibility Rule has been applied infrequently and inconsistently to expungement requests, and panels have regularly granted requests that relate to older events. Finally, an expungement request can be made and adjudicated after the conclusion of an underlying arbitration.

The proposed amendments would make obtaining expungement relief more difficult in several respects. Under the proposed amendments, a three-person panel would be required to grant expungement relief, and that relief could be granted only by a unanimous vote. FINRA will randomly select the three arbitrators, and the parties are not permitted to strike an arbitrator, other than for cause. In addition, there are important time limits in the proposed rule changes. Expungement requests will be barred if they are made more than two years after the close of an arbitration or litigation or more than six years after the initial reporting of the customer complaint. In addition, associated persons named as parties in a customer arbitration will be required to request expungement in connection with the underlying arbitration proceeding, or they will forfeit their right to request expungement of the disclosure at a later date. The proposed rule changes will also establish requirements relating to notifying state securities regulators and customers of requests. Obtaining an expungement is already a challenging task. These amendments will make that task even more daunting.

The proposed rules require SEC approval, and if and when the SEC issues that approval is uncertain. If the SEC approves, the rules must be enacted by FINRA within 180 days of the approval. As a precautionary measure, registered representatives should consider seeking expungement relief now, before the proposed amendments are enacted, to maximize their chances of ensuring that any meritless or inaccurate information is permanently deleted from their records and no longer disclosed to the public.

Murphy & McGonigle’s Form U4 and U5 and Expungement practice group advises firms and individuals on making accurate and timely disclosures on Forms U4 and U5 and has decades of experience representing firms and individuals in the expungement of meritless complaints and arbitrations from registered representatives’ CRD records. The firm’s team includes a number of attorneys who have served in senior positions with various financial institutions and government and regulatory agencies, including a former Chief Counsel and Deputy Director of FINRA.