

Client Alert



A report for clients and
friends of the Firm

November 2008

New FINRA Rule Establishes Procedures for Arbitrators Considering Expungement of Customer Dispute Information

On October 30, 2008, the SEC approved a significant rule change to the Financial Industry Regulatory Authority, Inc. ("FINRA") arbitration rules governing expungement of customer complaint information from Central Registration Depository ("CRD") records. Under the new rules, an arbitrator must hold a hearing and adhere to certain other procedural requirements before ordering expungement of information regarding customer disputes. These new procedural requirements will be codified in Rule 12805 of the Code of Arbitration Procedure for Customer Disputes and Rule 13805 of the Code of Arbitration Procedure for Industry Disputes.

The CRD, an online registration and licensing system used by FINRA member firms, regulators and self-regulatory organizations, contains information regarding FINRA members and associated persons, including information about disputes the firm or individual had with customers. A member firm or an associated person can seek to have customer dispute information expunged from the CRD in certain situations, including if it can be shown that the customer dispute information is false, factually impossible or legally erroneous, or the individual was not involved in the conduct described. Under FINRA Rule 2130, a FINRA member or associated person who seeks expungement of customer dispute information must obtain a court order directing expungement or must have a court confirm an arbitration award that contains expungement relief.

While the procedure will not change for member firms or associated persons seeking expungement of customer dispute information under Rule 2130, new Rules 12805 and 13805 change the procedures to be followed by arbitrators. Rules 12805 and 13805 now specify requirements arbitrators must follow prior to issuing an order expunging customer dispute information. Specifically, under new Rules 12805 and 13805, before granting expungement, an arbitrator must: (a) hold a hearing session, either in-person or by telephone, even if a hearing was not requested by the customer; (b) if the case involves a settlement, review the settlement documents and review the monetary consideration given to any party and any other terms and conditions of settlement; (c) indicate the specific grounds on which expungement is being awarded in the order; and (d) assess all forum fees for the hearing session to the party requesting expungement, if the hearing session is solely for the purpose of determining whether or not the expungement should be granted.

These rule changes have been enacted at the prompting of certain state regulatory and investor protection organizations, which argued that the existing rules governing expungement of customer dispute information were inadequate to protect customers. Under the new rules, state securities regulatory organizations are still permitted to intervene in a court proceeding to challenge a proposed expungement.

As a practical matter, member firms and associated persons who desire an order expunging customer dispute information should be aware that seeking such relief could potentially be more time consuming and costly. Whereas prior to the adoption of these rules a hearing on expungement was not mandatory, particularly when the customer did not request a hearing, now a hearing will be required as a matter of course and forum fees will be imposed on the party seeking expungement. Additionally, because of these new procedures, parties who intend to seek expungement of customer dispute information as part of their settlement agreement should expect the settlement to be scrutinized even more closely than in the past.

Notably, new Rules 12805 and 13805 do not affect the process by which language in the CRD may be expunged based on an arbitrator's determination that the language is defamatory in nature.

The date on which Rules 12805 and 13805 will go into effect has not yet been determined.

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