

July 24, 2014

Securities and Exchange Commission Approves FINRA Rule 2081 Prohibiting Member Firms and Associated Persons from Conditioning Settlement on Customer's Agreement not to Oppose Request for Expungement

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Introduction

On July 22, 2014, the Securities and Exchange Commission ("SEC") approved the Financial Industry Regulatory Authority's ("FINRA") proposed Rule 2081 barring broker-dealers and registered representatives from seeking to condition settlement of a customer dispute on the customer's not opposing a request for expungement of the matter from the Central Registration Depository ("CRD") records. SEC Release No. 34-72649. In approving the new rule, however, the SEC noted its concerns about the high proportion of cases in which arbitrators grant requests for expungement and the concomitant loss of public availability of the expunged information. The SEC expressly encouraged FINRA to determine whether additional rulemaking is necessary to ensure that expungement "is treated as an extraordinary remedy" that is available only where the information in question "has no meaningful investor protection or regulatory value." SEC Release No. 34-72649 at 14.

The SEC's Approval Of FINRA Rule 2081

FINRA Rule 2081, as approved by the SEC, provides that "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." FINRA Rule 2081. As contemplated by FINRA, this prohibition "would apply to both written and oral agreements" along with "agreements entered into during the course of settlement negotiations, as well as to any agreements entered into separate from such negotiations." SEC Release No. 34-72649 at 6.

The SEC determined that proposed Rule 2081 is consistent with Section 15A(b)(6) of the Securities Exchange Act of 1934 in that "prohibiting member firms and associated persons from conditioning or seeking to condition settlement of a dispute with a customer on, or otherwise compensating the customer for, the customer's agreement to consent to, or not to oppose, the firm's or associated person's request to expunge information regarding customer disputes and arbitration claims from the CRD should help assure that accurate and complete customer dispute information remains available to the investing public, regulators and broker-dealers." SEC Release No. 34-72649 at 11-12. The SEC found that "despite the very narrow permissible grounds and procedural protections designed to assure expungement is an extraordinary remedy..., arbitrators appear to grant expungement relief in a very high percentage of settled cases." *Id.* at 12-13. The SEC found further that "[t]he completeness of information in the CRD, including accurate customer dispute information, is critical for the protection of investors and effective regulatory oversight." *Id.* at 13. In the SEC's view, Rule 2081's "application to both written and oral agreements, as well as any agreement separate from the negotiations, and the prohibition from compensating the customer following settlement for not opposing an expungement request are important aspects of the proposed rule change." *Id.* The SEC concluded that "by eliminating the ability of parties to a customer dispute to bargain for expungement relief as a condition to a settlement agreement or otherwise," Rule 2081 should "help assure that negotiated customer consents or non-objections do not unduly influence the judicial or arbitral decision that expungement is appropriate" as well as "enhance the integrity of information in the CRD to the benefit of the investing public and regulators." *Id.*

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In approving Rule 2081, however, the SEC cautioned FINRA that the new rule should not be the last word on the subject of expungement and that FINRA should continue to consider making improvements to the expungement process. In this regard, even though “the proposed rule change is a constructive step to help assure that the expungement of customer dispute information is an extraordinary remedy that is permitted only in the appropriate narrow circumstances contemplated by FINRA rules,” the SEC nonetheless remains concerned about “the high number of cases where arbitrators grant brokers’ expungement requests.” SEC Release No. 34-72649 at 14. The SEC observed that “[w]hen information is expunged from the CRD, it is no longer available to regulators, broker-dealers, or the investing public” and that “[b]oth regulators and the investing public are disadvantaged when factual information is removed from the CRD.” *Id.* The SEC concluded its order approving Rule 2081 by “encourag[ing] FINRA to conduct a comprehensive review of its expungement rules and procedures to determine whether additional rulemaking is necessary or appropriate to assure that expungement *in fact is treated as an extraordinary remedy that is permitted only where the information to be expunged has no meaningful investor protection or regulatory value.*” *Id.* (emphasis added).

FINRA intends to announce the effective date of Rule 2081 in a regulatory notice to be published in the near future. February 23, 2014 FINRA News Release.

Conclusion

SEC Release No. 34-72649 makes clear the SEC’s view that Rule 2081 is good as far as it goes but that it may not go far enough. Despite an arbitration panel’s express finding in accordance with FINRA Rule 2080 that the claim or allegation is factually impossible, clearly erroneous or false or that the associated person was not involved in the alleged wrongdoing, the SEC remains concerned that there may be some salutary purpose that would be served by retaining such information in the associated person’s CRD records. In other words, the SEC does not appear to be convinced that information concerning a claim or allegation which is factually impossible or clearly erroneous or false or as to which the associated person was not involved in the alleged wrongdoing “has no meaningful investor protection or regulatory value.” SEC Release No. 34-72649 at 14. The SEC thus clearly expects FINRA to consider the possibility of additional rule changes to ensure that regulators and investors are not “disadvantaged” by the expungement of such customer dispute information from the CRD. ■

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