

JLG LEGAL TIP FINRA EXPUNGEMENT PART II - JUNE 2017

Legal Risk Management Tip June 2017

Background

In the [April 2017 Legal Risk Management Tip, *What You Need to Know About Expungement*](#), we focused on FINRA expungement as it pertains to customer complaints. Pursuant to Rules 2080 and 2081 and in Arbitrator Rules 12805 and 13805, in order to have a customer complaint removed from the CRD system and your BrokerCheck report, one must demonstrate that:

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

Through a FINRA arbitration procedure, the claimant must demonstrate, and the Arbitrators must affirmatively find and document, at least one of the three grounds listed above in an Award Information Sheet, which the Arbitrators complete and submit to FINRA. This finding allows FINRA to waive its right to oppose the expungement. If one or more of those grounds is not specifically included in the award, FINRA will oppose the expungement.

In addition to customer complaints, there are other reasons why a claimant could have grounds for expungement. This month's legal tip will go through these considerations and provide guidance on such variations and procedures to consider.

1. Expungement as Part of a Settlement

Some situations may present themselves for expunging certain information contained on Form U4. One of the most common situations arises when a dispute has been settled and, as part of the settlement, there is a request for expungement. This, however, is not enough to get an expungement. The expungement must be done in a separate action, and the granting of expungement must be signed by at least two of three Arbitrators.

Moreover, just because a broker prevails in arbitration does not necessarily mean that there are appropriate grounds for granting expungement. Arbitrators must still find and document at least one of the three grounds referenced above in order to recommend expungement.

2. Dismissal of Actions and Recommendation for Expungement by Arbitrators

There may be times when the Arbitrators dismiss a broker early in the arbitration and they recommend expungement. Here, the panel can order a new case be opened to address the expungement request. This would be done before the same panel. In order for the expungement to be granted, there still must be findings that one of the three expungement criteria exists and is documented in the Award Information Sheet.

3. What Cannot Be Expunged

There are several disclosure events that cannot be expunged. These include: Civil Judicial Actions, Criminal Matters (that include charges and convictions for any felony and for those misdemeanors that the U-4 and U-5 ask about; fraud, wrongful taking of property or bribery), Financial Matters, official investigations or regulatory actions. However, once a broker satisfies a judgement or a lien, it can be removed from BrokerCheck, but not from CRD.

4. Intra-Industry Disputes and Defamation Considerations

These rules, however, do not apply to intra-industry disputes unless the information to be expunged involves customer dispute information. If, for example, a firm uses "failure to meet production standards" as the reason for termination on the Form U-5, a broker may request expungement as to the reason for termination. This request does not involve customer information, so the arbitrators can recommend expungement without addressing the three guidelines. Nevertheless, before FINRA would expunge this, it would have to be confirmed in court.

Should the Arbitrators determine that the Form U-5 disclosures are defamatory in nature, FINRA will expunge the specific information without a court order. Parties requesting expungement for defamatory reasons must present evidence to the arbitrators that the information in the broker's CRD is defamatory in nature and portrays the broker in a negative light. It should be noted that in court the absolute defense to defamation is truth. If the entry is in fact true, there is no defamation. The arbitrators, though, are not required to find or state explicitly in the award that all elements of defamation have been satisfied under governing law have been met.

Final Thoughts

As we have explored, expungement is a process. Before you go forward on this journey, it is extremely important for you to confer with counsel to evaluate both the merits of moving ahead and the associated costs - not to mention likelihood - of achieving expungement.

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