

FINRA ARBITRATORS STILL GRANTING 90% OF BROKER REQUESTS TO ERASE CUSTOMER COMPLAINTS, BUT A PROMISING NEW RULE WILL ALLOW STATE REGULATORS TO PARTICIPATE

PIABA Foundation Highlights Ongoing Broker Expungement Issues, Announces Expansion of Pro Bono Program to Provide Legal Representation to Aggrieved Investors Opposing Expungements;

New Partnership with the Alabama Securities Commission to Provide Training Program on Arbitration for State Securities Regulators After Major FINRA Rule Change.

WASHINGTON, D.C. – OCTOBER 24, 2023 – Requests for the expungement of customer complaints against their investment brokers were granted at an astonishing rate of 90% according to a new report on FINRA arbitration awards released by two nonprofits, The PIABA Foundation and PIABA (Public Investors Advocate Bar Association). The new study is the third report since 2019 and updates their analysis, which now covers 8 ½ years of arbitration awards issued by FINRA arbitrators in “straight-in” cases, a term to describe a type of expungement request where brokers file arbitrations against their own brokerage firm requesting expungement of customer complaints. Historically, the requests went unopposed because no one was present to challenge the request.

Consistent with its previous reports, the new report reviewed data from January 2019 to August 31, 2023 and found that [expungements were granted approximately 90% of the time](#). Out of 2506 awards issued in that time period, expungements were granted in 2259 “straight-in” cases. Brokerage firms continued their practice of not opposing brokers’ expungement requests in 92% of cases, likely because they have an incentive to erase customer complaints as well.

The study comes roughly a week after [FINRA introduced its new rule](#) that the non-profits groups acknowledge contains significant improvements to the expungement process, including allowing state securities regulators the opportunity to participate in straight-in expungement arbitrations and oppose the requests when appropriate. In order to better understand how state securities regulators can more efficiently and effectively participate, the report analyzed 2,506 expungement awards from January 1, 2019 – August 31, 2023, and determined the home states of the brokers who requested expungement relief. The reason is that state securities regulators commonly defer to the securities regulator in brokers’ home states to make decisions about whether and how to take regulatory action, even though the brokers are often registered in multiple states at the same time. The study found that on average, brokers are simultaneously registered in 16 different states.

The PIABA Foundation applauded FINRA’s rule changes and announced that The PIABA Foundation and PIABA are partnering with the Alabama Securities Commission to offer a new training program for state securities regulators to help facilitate collaboration among states and assist them in effectively participating in FINRA arbitrations. The PIABA Foundation also announced the expansion of its *pro bono* legal program to represent investors in expungement arbitrations.

The study found that the brokers’ home states in approximately 1,301 awards or 54% were California (315), Florida (388), New York (262), New Jersey (179) and Texas (157). The data showed a significant drop off in the average number of straight-in expungement awards between California, Florida, New York, New Jersey and Texas, defined as Tier-1 in the report, and the home states for the rest of the country, labeled as Tier-2- Tier-5 states. The study also provided a geographic map of the United States illustrating the results.

Based on the data, the study concluded that the approach taken by state regulators of relying on the securities regulator in the broker’s home state to decide whether and how to participate in

expungements may not be the most equitable, efficient, or effective approach, especially for the Tier-1 states given that it is extremely likely that the brokers will also be registered in Tiers 2-5 states.

The report also explained that given the steep drop off in awards between Tier-1 states and the rest of the country, it is plausible that if states coordinated and shared the responsibility of participating in straight-in expungements, even if brokers are not in their home state, they could achieve 100% participation in straight-in expungement arbitrations with negligible additional impact on existing state resources.

Given that state securities regulators have not historically participated in FINRA arbitrations, PIABA and The PIABA Foundation remarked that coordination could mitigate some or all of the factors described in the study that may impact the effectiveness of state securities regulator participation in straight-in expungement arbitrations, i.e., (1) solve the limited resources issue; (2) overcome risk of not participating as a result of the short deadline to notify FINRA; (3) increase likelihood of obtaining authority to participate; (4) create a more uniform standard to determine whether to oppose expungement; and (5) more efficiently become familiar with the arbitration process.

Jason Doss, Founding Director, PIABA Foundation, report co-author and Atlanta-based attorney, said: **“PIABA and the Foundation have conducted multiple studies analyzing FINRA’s expungement awards and it is clear that if expungement decisions are going to be in the hands of FINRA’s arbitrators, all parties with an interest in the outcome need to participate to present evidence for and against expungement. We welcome state securities regulators’ participation to the arbitration process because it is their regulatory information that is being erased. We worked hard to clearly identify the root of the problem and now it is time to work even harder to achieve the goal of expungements being granted only in extraordinary circumstances.”**

Joseph Borg, Former Director, Alabama Securities Commission, said: **“The Alabama Securities Commission is honored to be partnering with The PIABA Foundation and PIABA on our new training program for state regulators. FINRA arbitration time windows and deadlines can be short, so it’s important for states to be coordinated and hit the ground running to be as effective as possible. We’re excited to get to work.”**

Joe Peiffer, Incoming President, PIABA (Public Investors Advocate Bar Association), Louisiana-based attorney, said: **“FINRA’s new changes have the potential to solve long-standing problems with FINRA expungements. Effective participation by state securities regulators is crucial to success and we are volunteering to do everything we can to ensure success. The new rules should be a massive improvement for the expungement system that will better serve investors and regulators.”**

Richard Lewins, President, The PIABA Foundation, Texas-based attorney, said: **“Since 2013, The PIABA Foundation and PIABA have shined a light on issues with FINRA’s expungement system. The new rules are the result of the hard work of the attorneys over the years who contributed to this effort, as well as FINRA’s responsiveness. We applaud FINRA for taking constructive criticism in the spirit of cooperation in our common goal of serving investors.”**

The new study points out that state securities regulators may need to adapt to FINRA’s new rules to be able to effectively participate in the proceedings. Here are several factors listed in the report that may impact the effectiveness of state securities regulator participation in straight-in expungement arbitrations:

Limited resources. Under the new expungement rules, each state securities regulator in states where a broker is registered will be given notice within 15 days after the straight-in expungement case is filed

with FINRA. However, given the current demands and limited budgets of state agencies, it is plausible that some states will not have the resources to participate.

Short deadline to notify FINRA. Once notified, state securities regulators or their authorized representatives are required to notify the Director of FINRA Dispute Resolution no later than 30 days after the last answer is due whether it intends to attend and participate in the expungement hearing. It is likely that some state securities regulators (particularly those with limited resources) will not be able to evaluate the merits of the expungement requests in a timely manner and make decisions about whether to oppose the expungement request.

Ability of state regulators to obtain authority to retain an authorized representative. The amended rules contemplate that state securities regulators or their “authorized representative” can participate in straight-in expungements. States widely differ, however, on what steps must be taken to obtain authority from the appropriate state actor to participate in a legal proceeding such as a FINRA arbitration. They also differ on whether and how they can engage a representative, such as outside counsel, to act on their behalf. Some states prohibit hiring outside counsel altogether, while others permit it in limited circumstances. The differences in processes among states may be an impediment to participation and cause further delays in making a decision whether to participate. This could limit the effectiveness of FINRA’s intent to make it easier for states to participate by including the “authorized representative” language in the rule.

Differences in standards applied by state securities regulators in determining whether to oppose expungement. While FINRA Rule 2080 sets forth the basis for when an arbitrator may grant expungement of customer complaints, state securities regulators are not limited by the strict language of the rule about whether to take regulatory action against members of the securities industry. As a result, state regulators may differ in how they evaluate whether to oppose expungement. They may not give the same weight to certain evidence supporting or refuting the customer complaint and may differ in placing a regulatory value on the substance of the complaint. All of this could lead to differing opinions among state securities regulators about whether to participate. This issue is particularly important where a broker is registered in multiple states.

It is important to note that any state where a broker is registered may participate in the expungement process. State participation is not limited to the home state of the brokers seeking expungement and there is no prohibition on more than one state participating in the same straight-in expungement arbitration. State regulators have historically and routinely coordinated activities in licensing, registration, examination, and enforcement matters. A similar approach may be appropriate under the new Rules to mitigate potential concerns as mentioned herein.

Deferring to the home state of the broker to oppose expungement. Every broker must be registered with the securities regulators in each state where the broker intends to do business. As a result, it is common for brokers to be simultaneously registered in multiple states. For example, in deciding whether to take regulatory action against a broker, it is customary for state securities regulators to defer to the home state of the broker about whether the home state would prefer to act. This process could very well lead to delays in decision-making and inconsistent evaluations. Coordinated information or review processes or procedures could potentially mitigate these concerns, as the States have tackled similar issues in the past.

Unfamiliarity with arbitration process. State securities regulators are familiar with court and/or administrative proceedings in carrying out their duties and responsibilities but practicing law in FINRA arbitration will be somewhat foreign to many regulators. The arbitration procedural rules contained in FINRA’s Codes of Arbitration are different in many ways from administrative and court procedures. Many of the legal claims arbitrated before FINRA arbitration are different from those pursued by state securities regulators in enforcement actions. FINRA’s discovery process is more limited than what is available in court, (e.g., depositions are not typically permitted). The documents that are relevant to

prove the claims and defenses asserted in arbitration can be different from what may be relevant to typical actions taken by state securities regulators. Finally, and importantly, arbitrators act as the judge and jury and they may analyze the strength of an investor's complaint differently from the way regulators do. Navigating through a hearing with limited documents and information to oppose expungement will likely entail a learning curve for state regulators' effective participation.

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The PIABA Foundation was formed in 2012. The PIABA Foundation's mission is to promote investor literacy to consumers, in part, by providing educational materials that are designed to prevent investment abuse as well as to raise awareness about the investment-related securities arbitration dispute resolution process. The work of The PIABA Foundation is funded through donations. www.PIABAFoundation.org