

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–88945; File No. SR–FINRA–2020–005]

### Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Order Approving a Proposed Rule Change To Amend the FINRA Code of Arbitration Procedure for Customer Disputes and the FINRA Code of Arbitration Procedure for Industry Disputes To Apply Minimum Fees To Requests for Expungement of Customer Dispute Information

May 26, 2020.

#### I. Introduction

On February 7, 2020, Financial Industry Regulatory Authority, Inc. (“FINRA”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Exchange Act”) <sup>1</sup> and Rule 19b–4 thereunder,<sup>2</sup> a proposed rule change to amend FINRA’s Code of Arbitration Procedure for Customer Disputes and Code of Arbitration Procedure for Industry Disputes (collectively, the “Codes”) to apply minimum fees to requests for the expungement of customer dispute information.

The proposed rule change was published for comment in the **Federal Register** on February 26, 2020.<sup>3</sup> The public comment period closed on March 18, 2020. The Commission received seven comment letters in response to the Notice.<sup>4</sup> On April 2, 2020, FINRA extended the time period in which the Commission must approve the proposed

rule change, disapprove the proposed rule change, or institute proceedings to determine whether to approve or disapprove the proposed rule change to May 26, 2020. On May 18, 2020, FINRA responded to the comment letters received in response to the Notice.<sup>5</sup> This order approves the proposed rule change.

#### II. Description of the Proposed Rule Change <sup>6</sup>

##### A. Background

##### 1. Customer Dispute Information in the Central Registration Depository

Information regarding customer disputes involving associated persons is contained in the Central Registration Depository (“CRD”) system, the central licensing and registration system used by the U.S. securities industry and its regulators. The concept for CRD, as well as the policies pursuant to which FINRA operates CRD, were developed by FINRA jointly with NASAA.<sup>7</sup>

In general, the information in the CRD system is submitted by broker-dealers, associated persons, and regulators in response to questions on the uniform registration forms.<sup>8</sup> Among other things, these forms collect administrative, regulatory, criminal history, and disciplinary information about associated persons, including customer complaints, arbitration claims and court filings made by customers (*i.e.*, “customer dispute information”). FINRA, state and other regulators use this information in connection with their licensing and regulatory activities, and broker-dealers use this information to help them make employment decisions.

Pursuant to rules approved by the SEC, FINRA makes specified current CRD information publicly available through BrokerCheck.<sup>9</sup> According to FINRA, BrokerCheck is part of its effort to help investors make informed choices about the broker-dealers and associated persons with which they may conduct business.<sup>10</sup> BrokerCheck maintains information on the approximately 3,600 registered broker-dealers and 628,000 associated persons. BrokerCheck also provides the public with access to information about formerly registered broker-dealers and associated persons.<sup>11</sup>

According to FINRA, the regulatory framework governing the CRD system and BrokerCheck has long contemplated the possibility of expunging certain customer dispute information from these systems in limited circumstances, such as where the allegations made about the associated person are factually impossible or clearly erroneous.<sup>12</sup> FINRA believes the expungement framework seeks to balance the important benefits of disclosing information about customer disputes to regulators and investors with the goal of protecting associated persons from the publication of false allegations against them.<sup>13</sup>

A broker-dealer or associated person can seek expungement of customer dispute information by going through the FINRA arbitration process or directly to court (without first going through arbitration). Regardless of whether expungement of customer dispute information is sought directly through a court or through arbitration, FINRA Rule 2080 (Obtaining an Order of Expungement of Customer Dispute Information from the Central Registration Depository (CRD) System), requires a member firm or associated person seeking expungement to obtain an order of a court of competent jurisdiction directing such expungement

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b–4.

<sup>3</sup> See Exchange Act Release No. 88251 (Feb. 20, 2020), 85 FR 11165 (Feb 26, 2020) (File No. SR–FINRA–2020–005) (“Notice”).

<sup>4</sup> See Letter from Steven B. Caruso, Maddox Hargett Caruso, P.C., dated Feb. 21, 2020 (“Caruso Letter”); letter from Samuel Edwards, President, Public Investors Arbitration Bar Association (“PIABA”), dated Mar. 18, 2020 (“PIABA Letter”); letter from Christopher Gerold, President & Chief, New Jersey Bureau of Securities, North American Securities Administrators Association (“NASAA”), dated Mar. 18, 2020 (“NASAA Letter”); letter from Dochtor D. Kennedy, President & Founder, AdvisorLaw LLC, dated Mar. 18, 2020 (“AdvisorLaw Letter”); letter from Christine Lazaro, Director of the Securities Arbitration Clinic and Professor of Clinical Legal Education, Christina Buru, Legal Intern, Gia Fernicola, Legal Intern, and Lauren K. Peterson, Legal Intern, Securities Arbitration Clinic, St. John’s University School of Law, dated Mar. 18, 2020 (“SJU Letter”); letter from Robin M. Traxler, Esq., Senior Vice President, Policy & Deputy General Counsel, Financial Services Institute (“FSI”), dated Mar. 18, 2020 (“FSI Letter”); and letter from Richard P. Ryder, Esq., President, Securities Arbitration Commenter, Inc. (“SAC”), dated Mar. 26, 2020 (“SAC Letter”). Comment letters are available on the Commission’s website at <https://www.sec.gov>.

<sup>5</sup> See Letter from Mignon McLemore, Assistant General Counsel, Office of General Counsel, FINRA, to Vanessa Countryman, Secretary, U.S. Securities and Exchange Commission, dated May 18, 2020 (“FINRA Letter”). The FINRA Letter is available on FINRA’s website at <http://www.finra.org>, at the principal office of FINRA, on the Commission’s website at <https://www.sec.gov/comments/sr-finra-2020-005/srfinra2020005-7214393-216896.pdf>, and at the Commission’s Public Reference Room.

<sup>6</sup> The subsequent description of the proposed rule change is substantially excerpted from FINRA’s description in the Notice. See Notice, 85 FR at 11165–73.

<sup>7</sup> See Notice at 11165 and n. 4. NASAA and state regulators remain involved with the ongoing development and implementation of CRD. See Notice at n. 4.

<sup>8</sup> The uniform registration forms are Form BD (Uniform Application for Broker-Dealer Registration), Form BDW (Uniform Request for Broker-Dealer Withdrawal), Form BR (Uniform Branch Office Registration Form), Form U4 (Uniform Application for Securities Industry Registration or Transfer), Form U5 (Uniform Termination Notice for Securities Industry Registration), and Form U6 (Uniform Disciplinary Action Reporting Form).

<sup>9</sup> There is a limited amount of information in the CRD system that FINRA does not display in BrokerCheck, including personal or confidential information. A detailed description of the information made available through BrokerCheck is available at <http://www.finra.org/investors/about-brokercheck>.

<sup>10</sup> See Notice at 11165.

<sup>11</sup> Formerly registered associated persons, although no longer in the securities industry in a registered capacity, may work in other investment-related industries or may seek to attain other positions of trust with potential investors. BrokerCheck provides information on more than 16,800 formerly registered broker-dealers and 567,000 formerly registered associated persons. An associated person’s records are available in BrokerCheck for 10 years after the associated person leaves the industry, and associated persons who are the subject of disciplinary actions and certain other events remain on BrokerCheck permanently.

<sup>12</sup> See Notice at 11166.

<sup>13</sup> *Id.*

or confirming an award containing expungement relief. FINRA will expunge customer dispute information only after the court orders it to execute the expungement.<sup>14</sup>

## 2. Current Fee Structure in FINRA Arbitration

Under the Codes, if a customer files a claim in arbitration against an associated person and a member firm, the customer is assessed a filing fee based on the claim amount.<sup>15</sup> The member firm is assessed a member surcharge and a process fee based on the claim amount.<sup>16</sup> The member firm is assessed only one surcharge and one process fee per arbitration.<sup>17</sup> When the associated person answers the claim,<sup>18</sup> the associated person is not assessed a fee if he or she does not add a claim to the answer.<sup>19</sup>

<sup>14</sup> FINRA Rule 2080 also requires that FINRA member firms or associated persons seeking a court order or confirmation of the arbitration award containing expungement relief name FINRA as a party. FINRA may, however, waive the requirement to name it as a party if it determines that the award containing expungement relief is based on affirmative judicial or arbitral findings that: (1) The claim, allegation or information is factually impossible or clearly erroneous; (2) the associated person was not involved in the alleged investment-related sales practice violation, forgery, theft, misappropriation or conversion of funds; or (3) the claim, allegation, or information is false. In addition, FINRA stated it has sole discretion “under extraordinary circumstances” to waive the requirement if the request for expungement relief and accompanying award are meritorious and expungement would not have a material adverse effect on investor protection, the integrity of the CRD system, or regulatory requirements. See Notice at n. 2; see also FINRA Rule 2080.

<sup>15</sup> Customers, associated persons, and other non-members who file a claim, counterclaim, cross claim or third party claim must pay a filing fee. See FINRA Rule 12900(a)(1); see also FINRA Rule 13900(a)(1).

<sup>16</sup> A member surcharge is assessed against a member firm if, for example, the member firm files an arbitration claim, is named as a respondent in a claim, or employed, at the time the dispute arose, an associated person who is named as a respondent; the amount of the surcharge is based on the amount of the claim. See FINRA Rules 12901(a)(1)(B) and 12901(a)(1)(C) and FINRA Rules 13901(a)(2) and 13901(a)(3).

Further, each member firm that is a party to an arbitration claim in which more than \$25,000 is in dispute, or that is non-monetary or not specified, is required to pay a process fee based on the amount or nature of the claim. If an associated person of a member firm is a party, the member firm that employed the associated person at the time the dispute arose is charged the process fee. See FINRA Rules 12903(a) and (b) and FINRA Rules 13903(a) and (b).

<sup>17</sup> Under the Codes, no member firm is assessed more than a single surcharge or process fee in any arbitration. See FINRA Rules 12901(a)(4) and 12903(b) and FINRA Rules 13901(d) and 13903(b).

<sup>18</sup> The respondent must answer the statement of claim within 45 days and may include other claims and remedies requested. See FINRA Rules 12303(a) and (b) and FINRA Rules 13303(a) and (b).

<sup>19</sup> For example, an associated person is permitted to file a claim against the claimant requesting relief.

If the parties do not settle the arbitration, the panel will hold at least one hearing to decide the customer arbitration and, at the conclusion of the hearing(s), issue an award. In the award, the panel will allocate the fees incurred by the parties during the arbitration, including each party’s portion of the hearing session fees,<sup>20</sup> which are also based on the amount of the customer’s claim.<sup>21</sup> If the parties settle, the panel will not issue an award.

### a. Current Fee Structure for Expungement Requests Made During a Customer Arbitration

Currently, even if the associated person’s answer to a customer’s claim includes a request for expungement, the associated person is not assessed a filing fee. The member firm, having been assessed the surcharge and process fee for the customer arbitration, will not incur additional charges because of the expungement request. If the customer’s claim closes by award after a hearing,<sup>22</sup> the panel will decide the customer’s claim and the expungement request (assuming the associated person pursues the request during the arbitration), and allocate the hearing session fees among the parties.

If the customer arbitration does not close by award after a hearing (e.g., settles) and the associated person or requesting party, if it is an on-behalf-of request,<sup>23</sup> continues to pursue the

Such counterclaim would require the associated person to pay a filing fee. See FINRA Rule 12303(d); see also FINRA Rule 13303(d).

<sup>20</sup> Parties are charged hearing session fees for each hearing session, based on the customer’s

claim amount. In the award, the panel determines the amount of each hearing session fee that each party is required to pay. See FINRA Rules 12902 and 13902.

<sup>21</sup> FINRA makes all arbitration awards publicly available. See

<https://www.finra.org/arbitration-mediation/arbitration-awards>.

<sup>22</sup> The term “hearing” means the hearing on the merits of an arbitration under Rule 12600.

See FINRA Rule 12100(o).

<sup>23</sup> In 2009, the Commission approved amendments to Forms U4 and U5 to require, among other things, the reporting of allegations of sales practice violations made against unnamed persons. See Exchange Act Release No. 59916 (May 13, 2009), 74 FR 23750 (May 20, 2009) (Order Approving SR-FINRA-2009-008). Specifically,

Forms U4 and U5 were amended to add questions to elicit whether the applicant or registered person, though not named as a respondent or defendant in a customer-initiated arbitration, was either mentioned in or could be reasonably identified from the body of the arbitration claim as a registered person who was involved in one or more of the alleged sales practice violations. A party (typically, the firm) named in a customer arbitration may request expungement on-behalf-of an associated person who is a subject of, but not named in, the arbitration. Such on-behalf-of requests occur in customer-initiated arbitrations only.

expungement request, the panel from the customer arbitration will hold a separate expungement-only hearing to decide the expungement request. The hearing session fee for the expungement-only hearing will be based on the amount of the customer’s claim. Under the Codes, fees for hearing sessions held solely to decide an expungement request must be charged to the party or parties requesting expungement.<sup>24</sup>

### b. Current Fee Structure for an Expungement Requests Made in a Separate Arbitration (“Straight-In Request”)

An associated person may request expungement by filing a straight-in request rather than requesting expungement during a customer arbitration. The straight-in request may be filed against a former or current firm or the customer.<sup>25</sup> Any claim that does not request a dollar amount is considered a non-monetary or not specified claim (“nonmonetary claim”) under the Codes. An expungement request is a non-monetary claim; thus, under the Codes, the associated person must pay a \$1,575 filing fee, and the member firm named as a respondent or that employed the associated person at the time the dispute arose must pay a \$3,750 process fee.<sup>26</sup> A member firm named as a respondent or that employed the associated person at the time the dispute arose is also assessed a surcharge of \$1,900.<sup>27</sup> These claims are decided by a three-person panel, unless the parties agree in writing to one arbitrator.<sup>28</sup> Further, the per-hearing session fee for a nonmonetary claim is \$1,125, and is assessed against the party requesting expungement.

### c. FINRA’s Concerns With Fees for Certain Expungement Requests

As discussed above, an expungement request is a non-monetary claim, and FINRA believes that the parties requesting expungement should pay the fees associated with such requests under the Codes.<sup>29</sup> FINRA is concerned, however, that member firms and associated persons are engaging in

<sup>24</sup> See FINRA Rules 12805(d) and 13805(d).

<sup>25</sup> FINRA notes, however, that straight-in requests filed against the customer are rare.

See Notice at n. 19.

<sup>26</sup> See *supra* note 16. Some associated persons have independent contractor, rather than employment, relationships with their firms. In these circumstances, FINRA assesses applicable member surcharge or process fees against the firm at which the associated person was associated at the time the dispute arose.

<sup>27</sup> See *supra* note 16; see also *supra* note 17.

<sup>28</sup> See FINRA Rules 12401(c) and 13401(c).

<sup>29</sup> See Notice at 11167.

practices to avoid fees applicable to expungement requests, particularly expungement requests made as straight-in requests.<sup>30</sup> FINRA cited as an example associated persons who file a straight-in request adding a small monetary claim (typically, one dollar) to the expungement request with the intent of reducing the fees assessed against the associated person and qualify for an arbitration heard by a single arbitrator.<sup>31</sup> Further, FINRA stated that claims for small damages also reduce the member fees that the forum assesses against member firms when an arbitration claim is filed. Thus, adding a claim for one dollar in a straight-in request against a member firm reduces the fees that normally would be assessed to the associated person requesting expungement and member firm from \$9,475 to \$300.<sup>32</sup> FINRA noted that, often, the associated person will subsequently drop the claim for one dollar.<sup>33</sup> Adding a small damages claim also changes the default panel composition to a single arbitrator rather than a three-person panel.<sup>34</sup>

#### B. Proposed Amendments

As stated in the Notice, FINRA is proposing to amend the Codes to apply a minimum filing fee for all expungement requests to help ensure

<sup>30</sup> *Id.*

<sup>31</sup> Whether the claimant specifies damages, and the amount specified, determines the fees assessed in arbitration cases and whether a single arbitrator or a three-person panel will decide the case. See FINRA Rules 12401 and 13401. If the amount of the claim is \$50,000 or less, exclusive of interest and expenses, the panel will consist of one arbitrator and the claim is subject to the simplified arbitration procedures under Rule 12800. If the amount of the claim is more than \$50,000, but less than \$100,000, exclusive of interest and expenses, the panel will consist of one arbitrator unless the parties agree in writing to three arbitrators. If the amount of a claim is more than \$100,000, exclusive of interest and expenses, or is non-monetary, or if the claim does not request money damages, the panel will consist of three arbitrators, unless the parties agree in writing to one arbitrator.

<sup>32</sup> FINRA cited another example of an associated person filing a straight-in request against a member firm. If the associated person does not add a monetary claim, and assuming one prehearing conference and one hearing session on the merits, the associated person is assessed a filing fee of \$1,575 and a hearing session fee of \$2,250 (\$1,125 for the prehearing conference and \$1,125 for the hearing session on the merits). In addition, the respondent member firm is assessed a member surcharge of \$1,900 and a process fee of \$3,750. If the associated person adds a one dollar claim to the request, assuming one prehearing conference and one hearing session on the merits, the associated person is assessed a filing fee of \$50 and a hearing session fee of \$100 (\$50 for the prehearing conference and \$50 for the hearing session on the merits). The member firm is also assessed a member surcharge of \$150 but no process fee. See Notice at n. 24.

<sup>33</sup> See Notice at 11167.

<sup>34</sup> See *supra* note 31.

that parties requesting expungement pay the fees intended for such requests under the Codes, that the fees charged when expungement is requested are more consistent, and that more expungement requests are heard by a three-person panel.<sup>35</sup> Specifically, the same fees would apply to an expungement request irrespective of whether the request is made as part of the customer arbitration or the associated person files a straight-in request, or the requesting party adds a small damages claim.<sup>36</sup> The proposed rule change would also apply a minimum process fee and member surcharge to straight-in requests, as well as a minimum hearing session fee to expungement-only hearings held after a customer arbitration<sup>37</sup> or in connection with a straight-in request.<sup>38</sup>

#### 1. Proposed Filing Fee

Under the proposed rule change, an associated person, or requesting party if it is an on-behalf-of request,<sup>39</sup> would be required to pay the filing fee for a non-monetary claim for an expungement request made during a customer arbitration<sup>40</sup> or filed as a straight-in request.<sup>41</sup> If the associated person or requesting party adds a monetary claim to the expungement request, the filing fee would be the fee for a non-monetary claim or the applicable filing fee based

<sup>35</sup> See Notice at 11167.

<sup>36</sup> *Id.*

<sup>37</sup> As an example, FINRA provided that under the current expungement process, if the customer arbitration settles, but an associated person seeks to pursue a request for expungement made during the customer arbitration, the panel from the customer arbitration will hold a separate expungement-only hearing to decide the expungement request and issue an award setting forth its decision on the expungement request. Under the proposed rule change, the associated person requesting expungement would be required to pay the minimum hearing session fee for this separate expungement-only hearing. See Notice at n. 26.

<sup>38</sup> The proposed rule change would apply to all members, including members that are funding portals or have elected to be treated as capital acquisition brokers (“CABs”), given that the funding portal and CAB rule sets incorporate the impacted FINRA rules by reference.

<sup>39</sup> See *supra* note 23.

<sup>40</sup> Under the proposed rule change, an associated person who requests expungement of customer dispute information during an industry arbitration would also be required to pay the filing fee for a non-monetary claim. FINRA notes, however, that these requests are rare. See Notice at n. 29.

<sup>41</sup> If the requesting party chooses to seek expungement in the customer arbitration, but later determines not to pursue the request and then files a straight-in request for expungement of the same customer dispute information, the requesting party would be required to pay the filing fee applicable to the straight-in request, notwithstanding the previous payment of the filing fee applicable to the expungement request during the customer arbitration.

on the claim amount, whichever is greater.<sup>42</sup>

As discussed above, under the Codes, an expungement request that does not include a claim for damages is a non-monetary claim that is currently assessed a \$1,575 filing fee and triggers review by a three-person panel. FINRA believes that all parties requesting expungement should pay the same minimum filing fee, and that parties should not be able to avoid the fee (or a three-person panel) simply by adding a small claim amount.

Accordingly, FINRA is proposing to impose the filing fee for all non-monetary claims as the minimum filing fee for expungement requests. Furthermore, FINRA is proposing to impose this minimum filing fee to expungement requests in customer arbitrations as well as to straight-in requests.<sup>43</sup>

FINRA also believes that the proposed minimum filing fee is commensurate with the additional steps that arbitrators should take when deciding an expungement request during a customer arbitration or in connection with a straight-in request.<sup>44</sup> Regardless of whether expungement is decided during a customer arbitration or separately, FINRA Rules 12805 and 13805 require the panel to hold one or more recorded hearing sessions regarding the appropriateness of expungement, to review settlement documents in cases involving settlements and consider the amount of payments made to any party and any other terms and conditions of the settlement, and to make a determination as to whether any of the Rule 2080 grounds for expungement have been established.

#### 2. Proposed Member Surcharge for Straight-in Requests

The proposed rule change would apply a minimum member surcharge when an associated person files a

<sup>42</sup> See Proposed Rules 12900(a)(3) and 13900(a)(3). An associated person could add a monetary or non-monetary claim to the expungement request. FINRA notes, however, that it is rare that significant dollar claims accompany expungement requests.

<sup>43</sup> Under the Codes, the Director of Dispute Resolution Services (“Director”) may defer payment of all or part of an associated person’s filing fee on a showing of financial hardship. See FINRA Rules 12900(a)(1) and 13900(a)(1). The proposed rule change would make clear that this provision applies to expungement requests. Information on how to request an arbitration fee waiver is available at <https://www.finra.org/arbitrationmediation/arbitration-fee-waivers>. In addition, in the award, the panel may order a party to reimburse another party for all or part of any filing fee paid. See FINRA Rules 12900(d) and 13900(d).

<sup>44</sup> See Notice at 11167–68.

straight-in request against either a customer or a member firm.<sup>45</sup>

Under the proposed rule change, if an associated person files a straight-in request against a member firm, that firm would be assessed the member surcharge for a non-monetary claim under the Codes (currently \$1,900). The proposed member surcharge is consistent with what a member firm should pay today for a straight-in request without an additional small monetary claim filed against a member firm.<sup>46</sup>

The proposed rule change would also provide that, for straight-in requests filed against a customer, each member firm that employed the associated person at the time the customer dispute arose would be assessed the member surcharge for a non-monetary claim under the Codes (currently \$1,900).<sup>47</sup>

Under the Proposal, if the associated person adds a separate claim for damages to the straight-in request against the customer or member firm, the member surcharge would be the non-monetary member surcharge or the applicable surcharge under the Codes, whichever is greater. Under the Proposal, the surcharge would be due when the Director serves the Claim Notification Letter or the initial statement of claim under the Codes.<sup>48</sup>

### 3. Proposed Hearing Session Fees

The proposed rule change would apply the hearing session fee for a non-monetary claim heard by three arbitrators to each hearing session in which the sole topic is the determination of a request for expungement relief.<sup>49</sup> Thus, the proposed hearing session fee would apply to straight-in requests, and when a customer arbitration does not close by award after a hearing (*e.g.*, settles) and there is a separate hearing session held after the customer arbitration to decide an expungement request that was made

<sup>45</sup> See proposed Rule 13901(c). If the associated person files the straight-in request against another associated person, each member firm that employed the respondent associated person at the time the dispute arose would be assessed the member surcharge for a non-monetary claim under the Codes. See FINRA Rule 13901(a)(3) and proposed Rule 13901(c).

<sup>46</sup> Consistent with how the member surcharge is assessed today, under the proposal, FINRA would not assess a member firm more than a single surcharge in any arbitration. See *also supra* note 17.

<sup>47</sup> See proposed Rule 12901(a)(3).

<sup>48</sup> See proposed Rules 12901(a)(5) and 13901(e).

<sup>49</sup> FINRA notes that the proposed \$1,125 hearing session fee for expungement hearings would apply if a party requests expungement as part of a Simplified Arbitration and no hearings are held to decide the underlying customer claim, regardless of whether a single arbitrator or a panel hears the Simplified Arbitration.

during the customer arbitration.<sup>50</sup> If the requesting party adds a monetary claim to the expungement request, the hearing session fee would be the greater of the fee for a non-monetary claim with three arbitrators or the applicable hearing session fee under the Codes based on the claim amount.<sup>51</sup> In addition, consistent with the Codes today, the hearing session fee would be assessed against the party requesting expungement.<sup>52</sup>

### 4. Proposed Process Fees for Straight-In Requests

The proposed rule change would apply a minimum process fee when an associated person files a straight-in request against either a customer or member firm. Under the proposed rule change, if an associated person files a straight-in request against a member firm, that firm would be assessed the process fee for a non-monetary claim under the Codes (currently \$3,750).<sup>53</sup>

The proposed rule change would also clarify that, for straight-in requests filed against a customer, the member firm that employed the associated person at the time the customer dispute arose would be assessed the process fee for a non-monetary claim under the Codes (currently \$3,750).<sup>54</sup>

If the associated person adds a separate claim for damages to the straight-in request against the customer or member firm, the process fee would be the non-monetary process fee or the applicable process fee under the Codes, whichever is greater.<sup>55</sup> The proposed process fee is consistent with what member firms should pay today for straight-in requests without an additional small monetary claim filed against a customer or member firm.

FINRA will announce the effective date of the proposed rule change in a *Regulatory Notice* to be published no

<sup>50</sup> See proposed Rules 12900(a)(3) and 13900(a)(3); see *also supra* note 37. If an associated person requests expungement during a customer arbitration, the customer arbitration closes by award after a hearing, and the arbitrator or panel decides the expungement request during the customer arbitration, the hearing session fee would be based on the amount of the customer's claim.

<sup>51</sup> See proposed Rules 12902(a)(5) and 13902(a)(4).

<sup>52</sup> *Id.*

<sup>53</sup> See proposed Rule 13903(c). Under the Proposal, if the associated person files the straight-in request against another associated person, the firm that employed the respondent associated person at the time the dispute arose would be assessed the process fee for a non-monetary claim under the Codes. See proposed Rules 13903(b) and 13903(c).

<sup>54</sup> See proposed Rule 12903(c).

<sup>55</sup> Consistent with how the process fee is assessed today, under the proposal, FINRA would not assess a member more than one process fee in any arbitration. See *also supra* note 17.

later than 60 days following Commission approval. The effective date will be no later than 60 days following publication of the *Regulatory Notice* announcing Commission approval of the proposed rule change.

### III. Comment Summary

As noted above, the Commission received seven comment letters on the proposed rule change.<sup>56</sup> One commenter fully supported the Proposal;<sup>57</sup> three commenters supported the Proposal but urged FINRA to make further changes;<sup>58</sup> two commenters were critical of the Proposal;<sup>59</sup> and one commenter supported the Proposal but sought clarification of its scope.<sup>60</sup>

#### *Supportive of Proposal*

In one commenter's view, the proposed rule changes "would be a fair, equitable and reasonable approach that would expedite and facilitate the efficiency of the arbitration forum as well as the investor protection attributes that are all too often compromised through the improper application of the expungement process."<sup>61</sup> This commenter believes that the changes "should be approved by the SEC on an expedited basis."<sup>62</sup> A second commenter was "[g]enerally . . . supportive of the proposed rule changes," noting that "[i]t is wholly unfair to allow some brokers to evade the expungement fees imposed by the Codes by claiming fictitious nominal damages."<sup>63</sup>

#### *Proposal Is Beneficial but Insufficient*

One commenter was supportive of the Proposal but stated that expungement requests should be decided by a three-person panel in all instances.<sup>64</sup> Another commenter also supported the proposal "as a general matter," but "strongly urge[d] the Commission to require FINRA to enhance the proposal by requiring unanimous decisions by three-person arbitration panels," noting that "[a] divided panel indicates that there is doubt that the broker has met the higher burden attendant to eligibility for extraordinary relief, and thus should not merit an expungement recommendation."<sup>65</sup> This commenter also argued that "further expungement reform is required to improve a failed

<sup>56</sup> See *supra* note 4.

<sup>57</sup> See Caruso Letter.

<sup>58</sup> See SJU Letter, PIABA Letter, NASAA Letter.

<sup>59</sup> See FSI Letter, AdvisorLaw Letter.

<sup>60</sup> See SAC Letter.

<sup>61</sup> Caruso Letter.

<sup>62</sup> *Id.*

<sup>63</sup> SJU Letter.

<sup>64</sup> See *id.*

<sup>65</sup> NASAA Letter.

system,” and urged FINRA to “continue to close gaps in the existing process and to initiate steps towards more meaningful expungement reform.”<sup>66</sup> This commenter was concerned that, “[i]n light of expungement’s evolution from an extraordinary remedy into routinely granted relief, the integrity of the data on the CRD and IARD systems is suffering.”<sup>67</sup>

A third commenter supported the proposed minimum fees, stating that “the practice of adding a small monetary claim to a request for expungement in a ‘straight in’ expungement request” is an “egregious abuse of the process” that has “become the norm.” This commenter also favored requiring three-person panels, stating that “rather than hoping that the new rules ‘should’ result in more expungement requests [being] heard before three-person arbitration panels, FINRA should require this under the revised arbitration rules.”<sup>68</sup>

In response, FINRA noted that while it believes that “most expungement requests, particularly straight-in requests, should be decided by a three-person panel,” it has determined not to revise this Proposal to require a three-person panel to decide expungement requests, or to require the unanimous consent of a three-person panel to decide expungement requests.<sup>69</sup> FINRA stated that it believes “it is appropriate that this Proposal focus only on applying minimum fees to requests for expungement of customer dispute information, to help ensure that parties requesting expungement pay the fees intended for such requests under the Codes and that the fees charged when expungement is requested are more consistent.”<sup>70</sup> At the same time, however, FINRA recognized the concerns raised by the commenters regarding the current expungement framework, and stated that it is separately developing other proposed changes to the framework, including codifying as rules the Notice to Arbitrators and Parties on Expanded Expungement Guidance (“Guidance”),<sup>71</sup> and establishing a roster of arbitrators with additional training and experience from which a three-person panel would be selected to decide straight-in requests and expungement requests in settled customer arbitrations.<sup>72</sup>

<sup>66</sup> *Id.*

<sup>67</sup> *Id.*

<sup>68</sup> PIABA Letter.

<sup>69</sup> FINRA Letter.

<sup>70</sup> *Id.*

<sup>71</sup> See <https://www.finra.org/arbitrationmediation/notice-arbitrators-and-parties-expandedexpungement-guidance>.

<sup>72</sup> See FINRA Letter.

### Critical of Proposal

One commenter argued that the Proposal “will result in member firms bearing the increased costs associated with Straight-in Requests for expungement even though member firms do not have control over whether the associated person files a request for expungement,” and even though “an associated person’s interest, and not necessarily a member firm’s interest, is primarily served” by a straight-in request for expungement.<sup>73</sup> This commenter recommended amending the Proposal to provide for a refund of the member firm surcharge and process fees where an associated person’s straight-in request for expungement is denied, or on the member firm’s showing of financial hardship.<sup>74</sup>

FINRA responded that the member surcharge and process fee are charged to member firms using the arbitration forum to help cover the costs of administering the forum.<sup>75</sup> FINRA noted further that the proposed member surcharge and process fee are consistent with what a member firm should pay today for a non-monetary claim, and what member firms currently pay for a straight-in request without an additional small monetary claim filed against a member firm.<sup>76</sup> FINRA stated that it has “determined not to revise the Proposal to refund the member surcharge or process fee if a panel denies an associated person’s straight-in request, or to waive these fees on a member firm’s showing of financial hardship.”<sup>77</sup> FINRA noted, however, that the Codes permit the Director to refund or waive the member surcharge under extraordinary circumstances, and to refund the member surcharge if the panel denies all of a customer’s claims against the member firm or associated person, and allocates all hearing session fees assessed against the customer.<sup>78</sup> Thus, the Codes currently permit the Director to refund or waive the member surcharge in certain circumstances, although they do not currently permit the waiver or refund of the process fee; this would not change under the Proposal.<sup>79</sup>

FINRA also noted that, consistent with the current fee structure under the Codes, it believes that “member firms, rather than associated persons or customers, should continue to bear the larger share of the costs of

<sup>73</sup> FSI Letter.

<sup>74</sup> *See id.*

<sup>75</sup> *See* FINRA Letter.

<sup>76</sup> *See id.*

<sup>77</sup> FINRA Letter.

<sup>78</sup> *See id.*

<sup>79</sup> *See id.*

expungement.”<sup>80</sup> However, FINRA states that it “intends to monitor the impact of the fees on parties and consider if additional changes are warranted.”<sup>81</sup>

Another commenter sought to explain the practice of claiming nominal damages, stating that the purpose and intent “was never to ‘reduce fees,’” but rather to “ensure that the Director does not impose egregious forum fees,” as the Director is authorized to assess hearing session fees for non-monetary claims that exceed those for monetary claims.<sup>82</sup> In response, FINRA underscored that the Proposal is “intended to help ensure that parties requesting expungement pay the fees associated with expungement requests by amending the Codes to apply minimum fees for all expungement requests, regardless of whether the requesting party adds a small damages claim to the request,” and to “add consistency to the fees charged across all expungement requests.”<sup>83</sup> FINRA notes that the proposed minimum fees would result in the same filing and hearing session fees being assessed for an expungement claim in the absence of the addition of a small damages claim.<sup>84</sup> Moreover, FINRA noted that the proposed minimum fees for expungement requests (a non-monetary claim) would be the same as those fees applicable to any non-monetary claim under the Codes.<sup>85</sup>

This commenter also believes that FINRA’s economic impact analysis is flawed in that it: Lacks a full accounting of FINRA’s costs in connection with expungement claims; incorrectly assumes that all expungement claims are limited to two hearings (one pre-hearing conference and one hearing on the merits); and fails to account for the

<sup>80</sup> FINRA Letter.

<sup>81</sup> *Id.* The commenter also urged FINRA to consider eliminating the requirement that member firms disclose on CRD customer complaints against their associated persons, even when the associated person is not named as a party. In response, FINRA noted that, as these concerns relate to the requirements to report information in the CRD system and its publication through BrokerCheck, rather than the application of fees related to requests to expunge customer dispute information already submitted in the CRD system and publicly available through BrokerCheck, FINRA would not address those concerns as part of this Proposal. *See* FINRA Letter.

<sup>82</sup> *See* AdvisorLaw Letter.

<sup>83</sup> FINRA Letter.

<sup>84</sup> *See id.*

<sup>85</sup> *Id.* The Commission also notes that the Director also has authority to defer the payment of all or part of an associated person’s filing fee on a showing of financial hardship, and the Codes currently permit the Director to refund or waive the member surcharge in certain circumstances. *See* Notice at 11173

fact that a portion of filing fees are refundable.<sup>86</sup>

In response, FINRA reiterated that the cost and revenue information detailed in its original economic analysis accurately demonstrates “the impact that the practice of adding a small damages claim to an expungement request has had on the forum.”<sup>87</sup> FINRA explained that the assumption of one prehearing conference and one hearing session on the merits “is based on the median number of prehearing conferences (one) and hearing sessions on the merits (one) associated with straight-in requests that were filed and closed during the sample period.”<sup>88</sup> FINRA believes that this assumption is consistent with evidence provided by the commenter, which noted in its letter that the majority (78.8%) of claims in its sample were concluded with one prehearing conference and one hearing on the merits.<sup>89</sup> Finally, FINRA responded that because the Proposal only addresses the assessment of fees,

<sup>86</sup> See AdvisorLaw Letter.

The commenter also criticized FINRA’s economic impact analysis by claiming that FINRA understated the level of BrokerCheck usage. *Id.* In response, FINRA stated that in 2017, it began using a different service provider to monitor BrokerCheck web traffic, and that differences in the monitoring methodology explain why the usage numbers from 2016 and earlier that are cited in the Notice are higher than the numbers from 2017 to the present. See FINRA Letter. The commenter also argued that FINRA’s economic analysis relies on a study that overstates the predictive value of information currently in BrokerCheck. See AdvisorLaw Letter. In response, FINRA noted that the Proposal cites a second study with a different empirical methodology, and that this study also finds that past disciplinary and other regulatory events associated with a member firm or individual can be predictive of similar future events. FINRA believes “the inferences from the [challenged study] are, therefore, consistent with other, similar studies using different sets of assumptions.” FINRA Letter. Moreover, the commenter also suggested that the Proposal would discourage the removal of “factually impossible or clearly erroneous” allegations from the CRD system, compromising the integrity of the information therein, and raised concerns regarding the requirements to report information in the CRD system, and the accuracy and completeness of that information. See AdvisorLaw Letter. In response, FINRA noted that these concerns relate to the requirements to report information in the CRD system and its publication through BrokerCheck and not the application of fees related to requests to expunge customer dispute information already submitted in the CRD system and publicly available through BrokerCheck. Accordingly, FINRA did not address these concerns as part of this Proposal. See FINRA Letter.

<sup>87</sup> FINRA Letter.

<sup>88</sup> *Id.*

<sup>89</sup> See FINRA Letter (acknowledging that “additional fees would have been assessed for cases with a greater number of pre-hearing conferences or a greater number of hearing sessions on the merits,” but “continues to believe that the use of the assumption results in a reasonable estimate for the additional fees that would have been assessed during the sample period.” See also AdvisorLaw Letter.

the collection of fees (which includes crediting the refundable portion of the filing fees) is outside the scope of the Proposal.<sup>90</sup>

The commenter also argued that FINRA fails to fully support its contention that straight-in expungement requests should be heard by a three-person panel, and stated that it is unclear whether the parties to a straight-in request would be allowed to continue to agree to adjudication by a single arbitrator.<sup>91</sup> In response, FINRA clarified that the Proposal would not require a three-person panel to decide expungement requests, and that it would not change the parties’ ability to request a single arbitrator.<sup>92</sup>

Finally, the commenter argues that the Proposal is inconsistent with the Exchange Act, and more specifically that it is not consistent with Sections 15(A)(b)(5) and 15(A)(b)(6) of the Exchange Act because it does not purport to address actual fraud, and because it will lead to false information in the CRD, which is not in the interests of investors or the public.<sup>93</sup>

FINRA responded that it believes that the Proposal is consistent with the provisions of Section 15A(b)(5) which requires, among other things, that FINRA rules provide for the equitable allocation of reasonable dues, fees and other charges among members and issuers and other persons using any facility or system that FINRA operates or controls, and Section 15A(b)(6), which requires, among other things, that FINRA rules be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest.<sup>94</sup>

Specifically, FINRA stated that “[t]he Proposal is intended to close gaps in the fee structure that have emerged in the existing expungement process, such as where parties add small dollar claims to their expungement requests to

significantly lower the fees associated with expungement requests.”<sup>95</sup> As a result, FINRA believes that the Proposal will apply fees consistently to all parties requesting expungement, consistent with what is intended under the existing fee structure in the Codes.<sup>96</sup> In addition, FINRA stated that “as an expungement request is a separate relief request that an arbitrator or panel must consider and decide, the filing fees and related member and forum fees should reflect the general complexity of these requests, as well as the time and effort needed to administer, consider and decide them.”<sup>97</sup> By consistently applying the fees to all parties requesting expungement, FINRA believes the Proposal will help ensure that the fees for expungement requests are assessed, and that the costs borne by the forum to administer expungement requests are allocated, as intended, to those requesting expungement under the Codes.<sup>98</sup>

FINRA also stated that, to the extent that the Proposal results in more expungement requests being heard by a three-person panel, particularly for straight-in requests that often do not include customer participation and can be complex to resolve, the Proposal would help ensure a complete factual record to support the arbitrators’ decision, regardless of whether the arbitrators grant or deny the expungement request.<sup>99</sup> FINRA believes that this, in turn, will help protect investors and the public interest by helping to ensure the accuracy and integrity of information in the CRD system.<sup>100</sup>

Finally, FINRA stated that it disagrees with the commenter’s suggestion that customers who choose to participate in expungement hearings, even though they are not a party to the arbitration, should be assessed fees under the Proposal.<sup>101</sup> FINRA believes that “such fees could have a chilling effect on customer participation and would be

<sup>90</sup> See FINRA Letter. Notwithstanding its position that the collection of fees is outside the scope of the proposal, FINRA offered additional information regarding the portion of the fees that is refundable. Specifically, FINRA stated that every filing fee contains a refundable portion and non-refundable portion. FINRA provided an illustration of how the proposal would impact the allocation of these two portions of the filing fee. In addition, FINRA clarified that the “refundable” portion is generally not refunded but rather used to offset expenses for which the party paying the hearing session fee would otherwise be responsible at the end of a claim (*e.g.*, to offset hearing session fees assessed against the party who paid the filing fee in the award).

<sup>91</sup> See AdvisorLaw Letter.

<sup>92</sup> See FINRA Letter.

<sup>93</sup> See Advisor Law Letter.

<sup>94</sup> See FINRA Letter.

<sup>95</sup> FINRA Letter. In response to the comment that the Proposal “singles out” expungement fees, FINRA notes that the Proposal only singles out those fees in order to help ensure that expungement requests are subject to the same minimum filing fee as other non-monetary claims. See FINRA Letter.

<sup>96</sup> See FINRA Letter.

<sup>97</sup> FINRA Letter.

<sup>98</sup> See *id.*

<sup>99</sup> *Id.* FINRA also stated that it is separately developing other proposed changes to the expungement framework, which would include establishing a roster of arbitrators with additional training and experience from which a three-person panel would be selected to decide straight-in requests and expungement requests in settled customer arbitrations. See *supra* notes 74–75 and accompanying text.

<sup>100</sup> See FINRA Letter.

<sup>101</sup> *Id.*

inconsistent with FINRA's long-held position of encouraging customer participation in expungement hearings."<sup>102</sup> FINRA asserted that "[c]ustomer participation during an expungement hearing provides the panel with important information and perspective that it might not otherwise receive."<sup>103</sup> Therefore, FINRA "seeks to encourage customer participation in expungement hearings, even if the customer is not a party."<sup>104</sup>

#### *Proposal Requires Clarification*

As noted above, one commenter was concerned that the Proposal does not distinguish between expungement requests relating to customer disputes, and requests from associated persons to expunge allegations that relate to regulatory, policy, or behavioral matters that did not directly impact customers, and which are alleged to be "defamatory in nature."<sup>105</sup> This commenter noted that the expungement of these "defamatory" claims has historically been treated differently than the expungement of customer dispute information, and suggested that FINRA clarify whether or not they are included in the Proposal.<sup>106</sup> In response, FINRA clarified that the Proposal applies only to requests to expunge customer dispute information, and not to other types of expungement claims.<sup>107</sup>

#### **IV. Discussion and Commission Findings**

After careful review of the Proposal, the comment letters, and FINRA's response, the Commission finds that the Proposal is consistent with the requirements of the Exchange Act and the rules and regulations thereunder that are applicable to a national securities association.<sup>108</sup> Specifically, the Commission finds that the proposed rule change is consistent with Section 15A(b)(6) of the Exchange Act,<sup>109</sup> which requires, among other things, that FINRA rules be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest, and Section 15A(b)(5) of the Exchange Act, which requires, among other things, that FINRA rules provide for the

equitable allocation of reasonable dues, fees and other charges among members and issuers and other persons using any facility or system that FINRA operates or controls.

#### *Proposed Minimum Filing Fee*

The Proposal would require an associated person, or requesting party if it is an on-behalf-of request, to pay the current filing fee for a non-monetary claim for an expungement request made during a customer arbitration or filed as a straight-in request. If the associated person or requesting party adds a monetary claim, the filing fee would be the fee for a non-monetary claim or the applicable filing fee based on the claim amount, whichever is greater.<sup>110</sup>

The Commission believes that applying a minimum filing fee to all requests for expungement of customer dispute information will help ensure that the fees are equitably allocated because the parties requesting expungement will pay the fees intended for such requests under FINRA's Codes. Specifically, the Commission agrees that the proposed minimum filing fee will help eliminate the inconsistent allocation of fees that results when parties add small dollar claims to their expungement requests to avoid the fees otherwise applicable to expungement requests. The Commission also believes that the Proposal will help ensure that the fees charged when expungement is requested are consistent, irrespective of whether the request is made as a straight-in request or during a customer arbitration, or whether damages are included in the request; and that it will help ensure that parties requesting expungement pay the fees intended for such requests. For these reasons, the Commission believes the Proposal will help provide for the equitable allocation of reasonable dues and fees against those who would either file or be a party to an expungement request.

With respect to associated persons who would otherwise make a small damages claim in order to avoid the applicable fees, while the Commission acknowledges that the proposed rule changes will result in costs that are currently being avoided, the effect of the proposal is simply to apply the applicable fees that were intended for such requests under FINRA's Codes. This will help provide for the equitable allocation of reasonable dues and fees against those who would file or be a party to an expungement request.

The Commission acknowledges that Proposal would increase costs for member firms and associated persons

who include a request for expungement in the answer to a customer's claim. However, the Commission also believes that these increased costs are consistent with the Exchange Act, because they will help ensure that the fees charged when expungement is requested are consistent across associated persons and member firms, regardless of whether the request for expungement is made during a customer arbitration or as a straight-in request, and that requests for expungement made during a customer arbitration are treated consistently with other types of claims. The Commission believes that this will provide for the equitable allocation of reasonable dues and fees against those who would file an expungement request.

The Commission notes also that the amount of the filing fees applicable to these requests is not the subject of the Proposal, which is instead addressing the equitable application of the existing filing fees applicable to non-monetary claims. Further, as FINRA notes, the Director may defer payment of all or part of an associated person's filing fee on a showing of financial hardship.<sup>111</sup>

#### *Proposed Minimum Member Surcharge and Process Fee for Straight-In Requests*

The Proposal would apply a minimum member surcharge and process fee when an associated person files a straight-in request against either a customer or a member firm. If an associated person files a straight-in request against a member firm, that firm would be assessed the member surcharge for a non-monetary claim under the Codes (currently \$1,900) and the process fee for a non-monetary claim under the Codes (currently \$3,750). These fees are consistent with what a member firm would pay today for a straight-in request without an additional small monetary claim filed against a member firm. For straight-in requests filed against a customer, the member firm that employed the associated person at the time the customer dispute arose would be assessed the member surcharge and process fee.<sup>112</sup> If the associated person adds a separate claim for damages to the straight-in request against the customer or member firm, the member surcharge would be the non-monetary member surcharge and process fee or the applicable surcharge and process fee under the Codes, whichever is greater.<sup>113</sup>

<sup>111</sup> See Notice at 11173.

<sup>112</sup> FINRA notes, however, that straight-in requests filed against the customer are rare. See Notice at n. 19.

<sup>113</sup> See Notice at 11168.

<sup>102</sup> FINRA Letter.

<sup>103</sup> *Id.*

<sup>104</sup> *Id.*

<sup>105</sup> SAC Letter.

<sup>106</sup> *Id.*

<sup>107</sup> FINRA Letter.

<sup>108</sup> In approving this rule change, the Commission has considered the rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

<sup>109</sup> 15 U.S.C. 78o-3(b)(6).

<sup>110</sup> See Notice at 11167.

The Commission agrees with FINRA that applying a minimum member surcharge and process fee to requests for expungement of customer dispute information will help ensure that member firms pay the fees intended for such requests under FINRA's Codes, and will help ensure that the fees charged when expungement is requested are consistent across member firms. As is the case with filing fees, the practice of adding small dollar claims to an expungement request significantly lowers the applicable member surcharge and process fee in a way not intended when those provisions of the FINRA Codes were adopted. The Commission acknowledges that, for member firms who are parties to requests that would otherwise include small dollar claims, the Proposal will increase costs. However, the Commission agrees with FINRA that eliminating this practice by applying the member surcharge and process fee consistently will help provide for the equitable allocation of reasonable dues and fees against those members who would be parties to an expungement request.

The Commission also acknowledges the concern expressed by a commenter that the Proposal "will result in member firms bearing the increased costs associated with Straight-in Requests for expungement even though member firms do not have control over whether the associated person files a request for expungement," and that "an associated person's interest, and not necessarily a member firm's interest, is primarily served" by a straight-in request for expungement.<sup>114</sup> However, the Commission observes that the requirement that member firms bear some of the costs associated with straight-in requests for expungement, even where member firms do not have control over whether the associated person files a request for expungement, is not part of the Proposal, but instead is an existing requirement under FINRA's Codes. The Proposal would not change FINRA's rules with respect to member firms bearing some of the costs associated with straight-in requests for expungement, but rather, would eliminate the ability of associated persons and member firms to avoid paying the full amount intended for such requests under FINRA's Codes.<sup>115</sup>

<sup>114</sup> FSI Letter.

<sup>115</sup> Similarly, the Commission acknowledges that one commenter suggested that customers who choose to participate in expungement hearings, even though they are not a party to the arbitration, be assessed fees under the Proposal. See AdvisorLaw Letter. The Commission observes that this is outside the scope of the Proposal. Additionally, the Commission agrees with FINRA

that, under FINRA's Codes, the Director can waive or refund the member surcharge under extraordinary circumstances.<sup>116</sup> In addition, under the Codes, the Director can refund the member surcharge if the panel denies all of a customer's claims against the member firm or associated person and allocates all fees assessed pursuant to Rule 12902(a) against the customer.<sup>117</sup> FINRA notes also in its response that these waivers and refunds would continue to be available under the Proposal, and that it intends to monitor the impact of the fees on parties and consider if additional changes are warranted.<sup>118</sup>

#### *Proposed Minimum Hearing Session Fee*

The Proposal would apply the hearing session fee for a non-monetary claim heard by three arbitrators to each hearing session in which the sole topic is the determination of a request for expungement relief. This fee would apply to straight-in requests, and when a customer arbitration does not close by award after a hearing (e.g., settles) and there is a separate hearing session held after the customer arbitration to decide an expungement request that was made during the customer arbitration. If the requesting party adds a monetary claim to the expungement request, the hearing session fee would be the greater of the fee for a non-monetary claim with three arbitrators or the applicable hearing session fee under the Codes based on the claim amount.<sup>119</sup>

The Commission agrees with FINRA that applying a hearing session fee to requests for expungement of customer dispute information will help ensure that parties requesting expungement pay the fees intended for such requests under FINRA's Codes, and will help ensure that the fees charged when expungement is requested are consistent. As with the filing fees, member surcharge, and process fee, the practice of adding small dollar claims to an expungement request significantly lowers the applicable hearing session fee.

that customer participation during an expungement hearing provides the panel with important information and perspective that it might not otherwise receive, and that such fees could have a chilling effect on customer participation.

<sup>116</sup> See FINRA Letter.

<sup>117</sup> *Id.*

<sup>118</sup> *Id.*

<sup>119</sup> See Notice at 11168. This is consistent with the current fee structure, which provides that whether the claimant specifies damages, and the amount specified, determines the fees assessed in arbitration cases and whether a single arbitrator or a three-person panel will decide the case. See FINRA Rules 12401 and 13401.

#### *Other Issues Related to Minimum Fees for the Expungement of Customer Dispute Information*

The Commission notes the concern, expressed by one commenter, that the proposed minimum fees may deter some member firms and associated persons from making meritorious expungement requests that they would have otherwise made.<sup>120</sup> As a result, the Commission agrees that the minimum fees may impact certain associated persons and member firms more than others.<sup>121</sup> However, the Commission agrees with FINRA that the proposed rule change will not result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Exchange Act. As discussed above, some associated persons and member firms avoid paying the intended fees under the Codes by adding a small damages claim to their expungement requests, thus receiving a benefit not intended under the Codes. The Commission notes that these small damages claims do not necessarily reflect an actual claim against the member firm;<sup>122</sup> and, in fact, associated persons who file such monetary claims often drop them during the proceedings.<sup>123</sup> Therefore, the Commission agrees with another commenter who noted that it is "unfair to allow some brokers to evade the expungement fees imposed by the Codes by claiming . . . nominal damages."<sup>124</sup>

The Commission acknowledges the concerns of commenters who argue that the proposal should do more to reform the expungement process, including by requiring expungement requests to be decided by a three-person panel.<sup>125</sup> However, the Commission notes that FINRA has represented that it is separately developing other proposed changes to the current expungement framework, including codifying as rules the Guidance<sup>126</sup> and establishing a roster of arbitrators with additional training and experience from which a three-person panel would be selected to decide straight-in requests and expungement requests in settled customer arbitrations.<sup>127</sup> FINRA also states that it welcomes a continued dialogue with the commenters on these

<sup>120</sup> See AdvisorLaw Letter.

<sup>121</sup> See Notice at 11173.

<sup>122</sup> See AdvisorLaw Letter.

<sup>123</sup> See Notice at 11167.

<sup>124</sup> SJU Letter.

<sup>125</sup> See PIABA Letter, NASAA Letter, SJU Letter.

<sup>126</sup> See *supra* note 74.

<sup>127</sup> See FINRA Letter.

and other proposed changes to the expungement framework.<sup>128</sup>

#### *Reliability of FINRA's Analysis*

FINRA supports the Proposal with data regarding BrokerCheck usage and the predictive value of information therein, as well as an economic impact analysis that includes information on the costs of expungement hearings, the number of hearings in which a small claim for damages was made, and the shortfall between the total amount of fees assessed and the amount that would have been assessed if the fees for non-monetary claims were applied consistently. As set out in more detail above, one commenter criticized various aspects of FINRA's data and analysis.<sup>129</sup>

The Commission notes that the purpose of the Proposal is to help ensure that those who would either file or be a party to an expungement request pay the existing fees as required by the Codes. The fees established by the Proposal are not new; rather, they are the same fees currently applicable to non-monetary claims, applied on a more consistent basis to all, rather than some, expungement requests. Therefore, the question of whether the amount of the fees applicable to non-monetary claims is appropriate is beyond the scope of the Proposal. As noted above, the Commission believes that eliminating the practice of claiming nominal damages to avoid the existing fees, and applying the fees consistently to parties requesting expungement, is consistent with Section 15A(b)(5) of the Exchange Act, which requires, among other things, that FINRA rules provide for the equitable allocation of reasonable dues, fees and other charges among members and issuers and other persons using any facility or system that FINRA operates or controls.

FINRA provided cost and revenue information, which demonstrate the negative impact that the practice of adding a small damages claim to an expungement request has had on the forum.<sup>130</sup> The Commission emphasizes that the fees established by the Proposal are not new,<sup>131</sup> and that the question of whether the amount of the fees is appropriate is beyond the scope of the Proposal. However, the Commission also notes that FINRA provides evidence that there is a shortfall between the cost of a typical

expungement request and the fees assessed where parties claim a small amount in damages to reduce the applicable fees, which supports a regulatory need for the Proposal.<sup>132</sup> FINRA also provides sufficient evidence that the disparity in fees that would be assessed under the Proposal's more consistent approach and the fees currently assessed is significant.<sup>133</sup> Commenters generally did not challenge this evidence.<sup>134</sup>

One commenter also questioned the reliability of FINRA's data regarding BrokerCheck usage.<sup>135</sup> As noted above, FINRA clarified in its response that in 2017, it began using a different service provider to monitor BrokerCheck web traffic, and that differences in the monitoring methodology explain why

<sup>132</sup> Specifically, FINRA explains that the costs to administer a straight-in request can include chairperson honoraria, travel expenses, conference room rental, and other costs to administer the forum. FINRA states that the cost of chairperson honoraria alone for a typical straight-in request is \$725—more than double the total amount of the fees typically assessed for a straight-in request where a small damages claim is added (\$300). See Notice at 11170.

<sup>133</sup> For example, FINRA notes that, for a sample period of January 2016–June 2019, 76% of straight-in requests for expungement included a small damages claim. FINRA also provides an estimate of the total amount of fees not assessed during the sample period as a result of: (1) Filings made during the customer arbitration that were not subject to a filing fee (\$2.4 million) and (2) straight-in expungement requests that included a small damages claim (\$7.3 million). See Notice at 11170.

<sup>134</sup> In calculating the overall shortfall in fees assessed, FINRA assumed that each straight-in expungement request would result in one prehearing conference and one hearing session on the merits. One commenter questioned this assumption. See AdvisorLaw Letter. FINRA responded that the assumption is based on the median number of prehearing conferences (one) and hearing sessions on the merits (one) associated with straight-in requests that were filed and closed during the sample period. See FINRA Letter. FINRA also stated that this assumption is consistent with evidence provided by the commenter, which noted in its letter that the majority (78.8%) of claims in its sample were concluded with one prehearing conference and one hearing on the merits. *Id.* The Commission does not believe that the exact amount of the shortfall is necessary to determine whether the Proposal is consistent with the Exchange Act; rather, the relevant consideration is whether the fees are currently assessed inconsistently across members and associated persons.

The commenter also asserted that the Proposal fails to account for the fact that a portion of filing fees are refundable. See AdvisorLaw Letter. FINRA responds that because the Proposal only addresses the assessment of fees, the collection of fees (which includes crediting the refundable portion of the filing fees) is outside the scope of the Proposal. See FINRA Letter. However, FINRA also offers additional information regarding the portion of the fees that is refundable. *Id.* As noted above, the Commission does not believe that the exact amount of the shortfall is necessary to determine whether the Proposal is consistent with the Exchange Act; rather, the relevant consideration is whether the fees are currently assessed inconsistently across member firms and associated persons.

<sup>135</sup> See AdvisorLaw Letter.

the numbers from 2016 and earlier seem to indicate higher usage than the numbers from 2017 to the present.<sup>136</sup> The Commission believes that this explanation is reasonable, and that regardless, the specific number of unique users of BrokerCheck is not relevant to the application of the fees related to requests to expunge customer information already mentioned in the CRD system and publicly available through BrokerCheck, and is not necessary to the Commission's analysis of whether or not the Proposal is consistent with the Exchange Act.

The commenter also argued that FINRA's 2015 study overstates the predictive value of information currently in BrokerCheck because it excludes certain types of claims from its analysis.<sup>137</sup> In response, FINRA notes that the Proposal cites another study with a different empirical methodology that also finds past disciplinary and other regulatory events associated with a member firm or individual can be predictive of similar future events.<sup>138</sup> The Commission notes that the two studies cited by FINRA provide support for the contention that past disciplinary and other regulatory events associated with a firm or individual can be predictive of similar future events; the Commission also notes that the commenter does not point to any studies reaching a different conclusion. Regardless, the Commission believes that the utility of BrokerCheck as a tool for predicting future misconduct is not relevant to the application of the fees related to requests to expunge customer information already mentioned in the CRD system and publicly available through BrokerCheck, and is not necessary to the Commission's analysis of whether or not the Proposal is consistent with the Exchange Act.

Thus, for the reasons described above, the Commission believes that the Proposal, as filed with the Commission, is consistent with Sections 15(A)(b)(5) and 15(A)(b)(6) of the Exchange Act.

## V. Conclusion

*It is therefore ordered* pursuant to Section 19(b)(2) of the Exchange Act<sup>139</sup> that the proposal (SR-FINRA-2020-005) be, and hereby is, approved.

<sup>136</sup> See FINRA Letter.

<sup>137</sup> See AdvisorLaw Letter.

<sup>138</sup> See FINRA Letter.

<sup>139</sup> 15 U.S.C. 78s(b)(2).

<sup>128</sup> *Id.*

<sup>129</sup> See AdvisorLaw Letter.

<sup>130</sup> See FINRA Letter.

<sup>131</sup> While none of these fees is a new forum fee, some fees, such as the filing fee, will be assessed more uniformly regardless of when the expungement request is made. See sections II.A.2.a and II.B.1 above.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>140</sup>

**J. Matthew DeLesDernier,**  
Assistant Secretary.

[FR Doc. 2020-11650 Filed 5-29-20; 8:45 am]

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-88944; File No. SR-ICC-2020-005]

### Self-Regulatory Organizations; ICE Clear Credit LLC; Order Approving Proposed Rule Change Relating to the ICC Clearing Participant Default Management Procedures

May 26, 2020.

#### I. Introduction

On April 3, 2020, ICE Clear Credit LLC (“ICC”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to revise the ICC Clearing Participant (“CP”) Default Management Procedures (“Default Management Procedures”). The proposed rule change was published for comment in the *Federal Register* on April 15, 2020.<sup>3</sup> The Commission did not receive comments regarding the proposed rule change. For the reasons discussed below, the Commission is approving the proposed rule change.

#### II. Description of the Proposed Rule Change

The proposed rule change would make amendments to the Default Management Procedures related to (i) the personnel involved in the default management process, including personnel at ICC and representatives of CPs; (ii) actions taken as part of the default management process; (iii) the development and execution of default management tests; and (iv) the correction of typographical and drafting errors.<sup>4</sup>

#### A. Personnel Involved in the Default Management Process

As mentioned above, the proposed rule change would make changes related to the personnel involved in the default management process, including personnel at ICC and representatives of CPs.

First, the proposed rule change would amend the list of defined terms in Section 2 to update the definition of the term “ICC Management”. Under the proposed rule change, ICC Management would consist of the General Counsel, Chief Risk Officer, Chief Operating Officer, Chief Compliance Officer, Head of Corporate Development, and Head of Technology. The Default Management Procedures assign certain responsibilities to, and require certain notifications to, the individuals comprising ICC Management.

Second, the proposed rule change would revise the personnel at each CP for which ICC maintains contact information related to the default management process. Currently, ICC is required to maintain contact information for the Chief Executive Officer (“CEO”), Chief Financial Officer (“CFO”), and General Counsel of each CP, as well as other role-based contacts that are specific to the default management process. The proposed rule change would remove this and instead require ICC to maintain contact information for the most senior person in charge of the CDS business and the most senior person responsible for providing compliance oversight for the CDS business. The Default Management Procedures would refer to these personnel as the CP’s “CP Default Contacts.” Accordingly, the proposed rule change would replace, throughout the Default Management Procedures, references to a CP’s CEO, CFO, and General Counsel, with the term CP Default Contacts.

#### B. Actions Taken as Part of the Default Management Process

In addition to changes related to the personnel involved in the default management process, the proposed rule change would make changes related to certain actions taken as part of the default management process. First, the proposed rule change would amend Subsection 6.1.1, which describes certain actions that ICC’s President must take before a CP is declared in default. Currently, ICC’s President must notify ICE’s Head of Enterprise Risk Management and ICE’s CFO of a CP’s possible default. The proposed rule change would instead require that ICC’s

president notify ICE’s Global Head of Clearing, rather than the ICE CFO.

Next, the proposed rule change would amend Subsection 6.1.5, which describes certain actions that ICC’s CCO must take before a CP is declared in default. Currently, Subsection 6.1.5 requires that ICC’s CCO draft certain notifications and email those notifications to ICC Management for review and approval prior to sending the notifications. The proposed rule change would instead require that ICC’s CCO email the notifications to the Close-Out Team, rather than ICC Management, for review and approval. The Close-Out Team is responsible for overseeing the default management process and includes ICC Management, the most senior member of the ICC Treasury Department, and the ICC Risk Oversight Officer. Thus, under this proposed change, ICC’s CCO would still send the notifications to ICC Management for review and approval, because ICC Management is part of the Close-Out Team, but would also send the notifications to the most senior member of the ICC Treasury Department and the ICC Risk Oversight Officer, who are the other members of the Close-Out Team.

Next, the proposed rule change would amend Subsection 6.4, which describes certain actions that ICC’s President must take after a CP is declared in default. Currently, Subsection 6.4 requires that ICC’s President call or email the Chairman of the Risk Committee to inform the Chairman of the declaration of default and that ICC’s President confirm with ICC’s CCO that the Chairman has been notified. The proposed rule change would expand this to require that the President inform the Risk Committee (not just the Chairman) and ICC’s Board, and furthermore, that the President confirm with ICC’s CCO that the Risk Committee and Board have been notified.

The proposed rule change would also amend Subsection 8.6 to clarify that ICC could only take certain actions relating to direct liquidation if ICC obtains Board approval. Currently, Subsection 8.6 describes the actions that ICC would take to liquidate a defaulting CP’s portfolio by direct transactions, rather than a default auction. Subsection 8.6 currently provides that if the Close-Out Team does not receive Board approval, ICC may not execute direct liquidation trades that would consume the Guaranty Fund resources of non-Defaulting CPs and provides a list of certain actions that ICC would take otherwise. The proposed rule change would clarify this point by specifying that the list of actions ICC would take are actions that

<sup>140</sup> 17 CFR 200.30-3(a)(12).

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> Self-Regulatory Organizations; ICE Clear Credit LLC; Notice of Filing of Proposed Rule Change Relating to the ICC Clearing Participant Default Management Procedures; Exchange Act Release No. 88614 (April 9, 2020); 85 FR 21052 (April 15, 2020) (SR-ICC-2020-005) (“Notice”).

<sup>4</sup> Capitalized terms not otherwise defined herein have the meanings assigned to them in the ICC Rules and Default Management Procedures, as applicable.