

**THE PIABA FOUNDATION**

**2019 STUDY ON FINRA EXPUNGEMENTS**

**A SERIOUSLY FLAWED PROCESS  
THAT SHOULD BE STOPPED IMMEDIATELY  
TO PROTECT THE INTEGRITY OF THE PUBLIC RECORD**

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**On Behalf of The PIABA Foundation**



## **FOREWORD**

The PIABA Foundation (“Foundation”) is a 501(c)(3) charitable organization that was formed in 2012 by attorneys who are devoted to representing investors in disputes with brokers and brokerage firms in FINRA arbitrations. The Foundation’s mission is to promote investor protection through investor education. The Foundation’s research and work to release this Study was performed by attorney volunteers with experience in representing parties in FINRA’s arbitration process and the funds to purchase the data for this Study was paid for through charitable donations. The Foundation would like to thank all of our donors for making this important Study a reality. The co-authors of this Study would like to thank the other Foundation Board members, Peter Mougey, Richard Frankowski and Jennifer Shaw as well as PIABA and the members of the PIABA Board for your input and support. A special thank you to Alan Perry, Jr. for your thoughts and helpful insights.

FINRA’s BrokerCheck tool provides critical educational information about brokers that helps investors make informed decisions about who they allow to manage their life savings. FINRA arbitrations are private disputes and obtaining information about FINRA’s expungement hearings is not easy for ordinary consumers. The goal of this Study is to raise awareness of the abuses happening in FINRA’s expungement process and to educate the public. Our hope is that it will provide useful and important information to those with oversight authority to correct the serious flaws in FINRA’s expungement system.

Recognizing that this Study is just the first step in correcting the problems outlined here, the Foundation also has started a program that will coordinate with attorneys and law school clinics to represent consumers who wish to participate and oppose expungement requests *pro bono*. The costs necessary to administer this *pro bono* program and the expenses for consumers and attorneys to participate in these expungement proceedings in arbitration, (e.g. court reporter costs) will also be funded through charitable donations. For more information about The PIABA Foundation, please feel free to visit our website, [www.piabafoundation.org](http://www.piabafoundation.org).

## EXECUTIVE SUMMARY

The FINRA process by which brokers can “expunge” (erase) supposedly irrelevant or unfair information from the state sponsored-FINRA database used to generate BrokerCheck reports for investors is broken. It is being systematically gamed, exploited and abused with one-sided hearings, manipulation of arbitrator selection, deletion of significant customer complaints, and abusive (and possibly fraudulent) conduct to such an extent that it must be frozen immediately until they system can be fully vetted and repaired. Until such a time, BrokerCheck cannot be considered a reliable tool for investors to use when researching the background of brokers.

From 2015-2018, there has been an explosive increase in the filing of what are known as “Expungement-Only” cases, which rose 924% from 2015 to 2018. (An Expungement-Only case, as described in more detail below, is an arbitration initiated by a broker against their own member firm solely for the purpose of seeking expungement, without naming the customer).

The 2,194 customer complaints contained in 1,078 arbitration proceedings that brokers requested be expunged increased by 1016% from 2015 to 2018. One individual broker successfully requested that twenty-four (24) complaints be expunged in a single proceeding.

Expungement-Only cases are destroying the integrity of the arbitration process and of BrokerCheck, a key tool used by investors to research brokers:

- The rise of “\$1.00 Expungement Cases” is evidence of corruption in FINRA’s expungement process. Brokers and brokerage firms have been gaming FINRA’s arbitration system by including a \$1.00 demand in damages to reduce the number of arbitrators reviewing expungement requests and to make it cheaper for brokers to get customer complaints expunged and then withdrawing their request at the expungement hearing. From 2015-2018, the number of cases in which nominal damages were requested in the broker’s statement of claim increased from six in 2015 to 456 cases in 2018. In 2018, 84% of all Expungement-Only cases included a request for nominal damages. In total, brokers requested nominal damages 780 times and 756 of those requests (i.e., 97%) requested \$1.00.
- A handful of law firms are repeat players in these cases. For example, only two law firms represented at least one party to Expungement-Only cases in 785 out of 1,078 cases [73% of all cases reviewed]. Data strongly suggests that parties

to Expungement-Only cases have been coordinating to hand-pick “friendly” arbitrators who will be more likely to grant expungement. For example, between 2015 and 2018, the number of arbitrators who issued three (3) or more expungement awards in a given year increased over 6000%. Also, the three arbitrators most frequently selected granted expungement requests over 95% of the time.

- FINRA is essentially subsidizing the most abusive expungement cases with the sham \$1 damage claims. FINRA lost at least \$8,050.00 per case in revenue in \$1.00 Expungement Cases, which amounts to more than \$6 million in lost revenue in 789 cases, a modest portion of which would be sufficient to pay for the recommended remedies outlined in this Study.
- Brokers and their firms have an interest in erasing customer complaints from the brokers’ records and as a result, are not truly in opposition to each other in an Expungement-Only case. Of the 1,078 cases, the respondent brokerage firm did not object or otherwise oppose the individual broker’s expungement request 1,055 times – over 98% of the time.
- Expungements requests in Expungement-Only cases are rarely opposed by either brokerage firms or customers. Customers are supposed to receive notice and be able to appear and object at an expungement proceeding, although it is not clear that always happens. FINRA does not have a process to ensure that the notice provided to customers adequately explains their right to appear and oppose it. Of the 1,078 cases, customers whose complaints are the subject of expungement requests participated and objected to brokers’ expungement requests only 141 times – approximately 13% of the time.
- When a brokerage firm or a customer opposes a request for expungement, arbitrators are significantly more likely to deny the request. But brokerage firms have little incentive to object. Even though respondent brokerage firms opposed expungement less than 2% of the time, doing so resulted in arbitrators denying the expungement requests about 48% of the time. In contrast, when brokerage firms did not object, arbitrators denied the expungement requests only 11% of the time.
- Expungement requests are being granted based upon one-sided and possibly false evidence presented to arbitrators. Because the vast majority of Expungement-Only cases are not opposed, there should be procedural safeguards in place to

prevent brokers from presenting one-sided, false or misleading information to arbitrators.

The PIABA Foundation thus makes the following recommendations:

- FINRA should halt all expungement proceedings immediately and impose a moratorium on the filing of Expungement-Only cases until procedural safeguards are put into place to correct the problems identified in this Study;
- FINRA should commission an independent outside investigation of whether expungements have been granted based upon false and/or fraudulent information;
- FINRA's BrokerCheck and the state sponsored-FINRA Central Registration Depository (CRD) should carry a prominent warning that they are unreliable inasmuch as they do not include all customer complaints because expungement may have resulted in the removal of pertinent information; and
- The SEC or FINRA should establish an Investor Protection Advocate who would be named as a party in every expungement proceeding to ensure the integrity of the process.

## INTRODUCTION

The Financial Industry Regulatory Authority (“FINRA”) works with state securities regulators to maintain a database, known as the Central Registration Depository (“CRD”), of information on individuals working as current and former registered representatives in the brokerage industry. Complaints by investors, for example, are included in the CRD records. Some of the information from a broker’s CRD records, including some customer complaints, can be accessed by the public through FINRA’s BrokerCheck tool on FINRA’s website. An actual CRD can be obtained from some state securities regulators, although no regulators advertise the availability of those records to the investing public. Rather, FINRA as well as state and federal securities regulators actively encourage investors to use FINRA’s BrokerCheck tool and look for customer complaints when deciding whether to hire a particular broker. Therefore, as FINRA recognizes, it is important that the information on CRD, and by extension BrokerCheck, be complete and accurate.

In order to remove customer complaint information from the CRD record, a broker must request that the information be expunged. A broker can request expungement during the actual customer arbitration if one is filed. A broker also may request expungement in a separate case, after the conclusion of the initial arbitration claim. If an arbitration panel grants the request and the broker obtains court confirmation of the arbitration award, the information is removed from the CRD and BrokerCheck. FINRA recognizes that customer complaints should be removed only in extraordinary circumstances. FINRA instructs arbitrators to grant the extraordinary remedy of expungement only after they make an affirmative finding that:

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

Over time, FINRA has expanded the type of customer complaints that must be reported on a broker’s CRD. In May 2009, FINRA expanded its rules to require CRD reporting of customer complaints where a financial advisor was the broker of record for the customer, even if the financial advisor is not named as a party to the arbitration. That change resulted in a drastic increase in the number of complaints

being reported, and in turn, a drastic increase in the number of expungements being sought. Since then, advocates for and against the expungement process have debated the best way to effectively balance the competing interests of full and complete disclosure and protection of brokers' reputations.

This PIABA Foundation study (the "Study") reveals that parties in Expungement-Only cases are abusing the expungement process to erase thousands of customer complaints from their records. The current expungement process fails to properly balance the interests of investors, regulators, and the public in the CRD maintaining complete and accurate information about brokers against the interest of brokers in protecting their reputations from false customer complaints. This failure in the expungement process appears to permit brokers to expunge legitimate customer complaints and thus undermines the accuracy and completeness of CRD records and BrokerCheck. Expungement is being granted as a matter of course, not just as an extraordinary remedy.

Prior reports from other institutions have revealed some of the ongoing problems with the expungement process and provided evidence that expungements are being granted too often and that requests are not being treated as an extraordinary remedy. To date, FINRA's response mainly has been to require arbitrators to undergo training on the expungement process and the importance of CRD regulatory record. Late last month, FINRA announced that its Board approved a rule amendment to "create, among other things, a roster of arbitrators with enhanced training and experience from which a panel would be selected in certain instances to decide an associated person's request to expunge customer dispute information."<sup>1</sup> FINRA did not explain what those "other things" might be and does not identify the "certain instances" in which the expungement roster will be utilized.

There is no reason to believe additional training will have any effect on this problem. FINRA has already tried providing additional expungement training to arbitrators and prior studies have shown that the training didn't result in arbitrators granting fewer expungements or treating the process as an extraordinary remedy. Despite the additional training, arbitrators continue to grant requests for expungement at almost the same alarming rate, supporting the conclusion that additional training has not worked to resolve the problem.

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<sup>1</sup><https://www.finra.org/media-center/newsreleases/2019/report-finra-board-governors-meeting-september-2019>

A significant issue with the current system is the incredible growth of Expungement-Only cases. An Expungement-Only case is an arbitration initiated by a broker against their own member firm solely for the purpose of seeking expungement, without naming the customer.<sup>2</sup> These cases are typically filed after an underlying customer complaint is settled by the brokerage firm. Since the beginning of 2015, there has been an explosive increase in the number of Expungement-Only cases filed. As a result, the Foundation commissioned this Study to analyze arbitration awards in Expungement-Only cases to determine whether FINRA's arbitration practices and procedures adequately protect the integrity of information about brokers on the CRD.

Expungement-Only cases are problematic for a number of reasons. First, the request for expungement in these cases is rarely opposed. Brokerage firms named as respondents rarely oppose a broker's request for expungement. Similarly, customers typically do not participate in these hearings, as their underlying case has already been resolved. It is the rare customer who would say that their complaint was false or factually impossible. Yet, customers do not typically appear in Expungement-Only cases. This may be because of inadequate notice. Instead of providing notice to a customer whose complaint is the subject of a request for expungement, FINRA delegates that responsibility to the requesting broker. The Foundation's Study shows that FINRA does not have adequate procedural safeguards in place to ensure that brokers provide timely, accurate and meaningful notice of the expungement hearing to customers. Even when proper notice is given, customers who have settled their cases may not want to relitigate their dispute or may have a difficult time retaining an attorney to help them to oppose expungement.

As a result, in most Expungement Only cases, neither the customer nor the brokerage firm presents evidence that the request should be denied. Expungement requests are being granted based upon one-sided and possibly false evidence presented by brokers. FINRA instructs arbitrators to evaluate the validity of brokers' requests for expungement but fails to ensure that they have sufficient information to do so. As a result, it appears that arbitrators treat these cases the way judges treat

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<sup>2</sup> Several years ago, brokers initiated some Expungement-Only cases by bringing an arbitration case against customers. Due to a number of reasons, including backlash from consumer advocates, they ceased that practice. Now, the vast majority of Expungement-Only cases are filed by brokers against their brokerage firm. This Study includes data from cases where brokers named customers as well as brokerage firms as respondents in Expungement-Only cases.



unopposed or consent motions in court and grant them unless there is an extraordinary reason not to do so. Thus, expungement is being *denied* only in extraordinary circumstances, the exact opposite of what is supposed to be happening.

To make matters worse, the data strongly suggests that the parties to Expungement-Only cases are coordinating with each other in the arbitrator selection process to hand-pick arbitrators that will be more likely to grant expungement. The legitimacy of FINRA's arbitrator selection process depends on adverse parties ranking and striking arbitrators. FINRA provides each party with a list of potential arbitrators and each party ranks and strikes arbitrators on the list. In cases where parties are adverse to each other, like investor disputes, investors will rank and strike arbitrators in accordance with who they believe will rule in their favor. Brokerage firms rank and strike the list based on which arbitrators they believe will rule against the investor. If the parties are not adverse to each other, FINRA's arbitrator ranking system cannot work properly because the broker and brokerage firms can coordinate with each other to pick the arbitrator most likely to grant expungement.

The Study shows that certain arbitrators are being repeatedly selected by the same law firms representing parties to Expungement-Only cases. For example, from 2015 to 2018, the number of arbitrators who issued three (3) or more expungement awards in a given year increased by 6,100%. In addition, the top three arbitrators selected most frequently by parties between 2015 and 2018 recommended expungement in almost every case. If FINRA creates a roster of experienced and specially trained arbitrators to handle expungement cases, as it has recently proposed, it could institutionalize the problem of high expungement rates by sending all Expungement-Only cases to "expungement friendly" arbitrators.

The Study also found that brokers and brokerage firms have been gaming FINRA's arbitration process by including a \$1.00 demand in damages to reduce the number of arbitrators reviewing expungement requests from a panel of three arbitrator to a single arbitrator. Brokers often then withdraw their nominal damage request at the evidentiary hearing. The \$1.00 trick (\$1 Expungement Cases) also made it cheaper for brokers to get customer complaints expunged. The Study found that by allowing its members to file these cases, FINRA has lost over \$6 million in revenue.

Finally, and perhaps most importantly, the Study found that arbitrators are over 4 times more likely to deny expungement requests when they are presented with any evidence that the request should be denied. Thus, the most effective way to reduce the number of expungements is not to require additional training or create a

roster of specialized expungement arbitrators, but to ensure arbitrators hear evidence that the expungement request should be denied. Since brokerage firms have no incentive to oppose expungement and customers have legitimate reasons not to want to participate in these proceedings, the Foundation recommends that FINRA and/or the SEC create an investor protection advocate (“Advocate”) that is independent from FINRA to participate in every Expungement-Only case.

The Advocate would be responsible for investigating the customer complaint, obtaining and reviewing documents, interviewing the customer, customer’s counsel, and any other relevant witnesses. The Advocate would assist those customers who want to appear and oppose the request. The Advocate would also participate in the expungement hearing by making an opening statement, cross examining the individual broker, presenting testimony and documents, and making a closing argument. Given that this Study has uncovered that FINRA has forgone over \$6 million in forum fees as a result of allowing \$1 Expungement Cases, FINRA should pay for the cost of establishing the Advocate by eliminating this abusive practice.

In addition to creating the Advocate, the Foundation makes the following recommendations to immediately stop further harm to the integrity of BrokerCheck and the CRD:

- FINRA should stay all pending Expungement-Only cases immediately and impose a moratorium on the filing of Expungement-Only cases until procedural safeguards are put into place to prevent the critical problems identified in this Study;
- FINRA should commission an independent outside investigation of whether expungements have been granted based upon false and/or fraudulent information as well as whether parties to Expungement-Only cases have been coordinating to hand-pick expungement-friendly arbitrators; and
- BrokerCheck and CRD should carry a prominent warning that they are unreliable inasmuch as they do not include all customer complaints because expungement may have resulted in the removal of pertinent information.

## METHODOLOGY

In preparing this study, the Foundation reviewed data that it requested Securities Arbitration Commentator (“SAC”) to provide with respect to all arbitration awards issued in Expungement-Only cases filed from January 1, 2015 through December 31, 2018 and resolved with an award on or before July 31, 2019 (the “Review Period”).

The Foundation requested that SAC extract the following information for each Expungement-Only award and for each case:

- (a) Docket No;
- (b) Venue;
- (c) Date Case Filed;
- (d) First Date of Evidentiary Hearing;
- (e) Date Award Issued;
- (f) Name of Respondent(s);
- (g) Name of Respondents’ Attorney (Firm);
- (h) Name of Claimant Broker;
- (i) Name of Broker’s Attorney (Firm);
- (j) Whether Respondent BD Objected to Expungement;
- (k) Whether Customer Objected to Expungement;
- (l) Whether Expungement Was Granted, Denied, or Granted/Denied In Part;
- (m) Basis under Rule(s) 2080/2130 for Granting Expungement;
- (n) Name of Arbitrator;
- (o) Number of Hearing Sessions; and
- (p) Customer Notice, i.e. [Date, Details, if any, and # of Days Before Hearing].

*See* SAC Spreadsheet #1 attached as Exhibit A.

To analyze the number of customer complaints that brokers requested be expunged in each case, the Foundation also requested that SAC extract the following information:

- (a) Docket No.;
- (b) Name of Broker In Cases Where Expungement Was Granted;
- (c) Name of Broker In Cases Where Expungement Was Denied;
- (d) Number of Customer Complaints Requested To Be Expunged;
- (e) Results of Requests, [Granted, Denied, Granted In Part].

*See* SAC Spreadsheet #2 attached as Exhibit B.

To analyze the number of times that brokers filed separate cases requesting expungement, the Foundation also requested that SAC extract the following information for each Expungement-Only award:

- (a) Name of Broker; and
- (b) Number of Cases Filed (Granted/Denied).

*See* SAC Spreadsheet #3 attached as Exhibit C.

To analyze the number of cases in which brokers requested nominal damages as well a request for expungement, the Foundation also requested that SAC extract the following information for each Expungement-Only award:

- (a) Docket Number;
- (b) Date Award Was Issued; and
- (c) Amount of Nominal Damages Requested.

*See* SAC Spreadsheet attached as Exhibit D.

To prepare the report, the Foundation used the information from Exhibits A-D to create a Consolidated Spreadsheet, which is attached as Exhibit E.

Finally, documents are included in the Appendix to provide additional context and support of the Study's findings. These documents include:

- (a) Redacted Statements of Claims filed by brokers seeking to expunge complaints where the brokerage firms paid significant amounts to settle the underlying complaints.
- (b) Examples of notice provided by brokers' counsel to customers informing them of the upcoming evidentiary hearing for expungement.
- (c) Examples of arbitration awards showing the amounts of forum fees charged by FINRA in three arbitrators vs. single arbitrator cases to support that FINRA has subsidized \$1 Expungement Cases.

## FINDINGS

### **I. Expungements Are Not Treated As An Extraordinary Remedy, As They Were Intended.**

1. FINRA has always taken the position that expungement is an extraordinary remedy and should only be granted in appropriate circumstances.<sup>3</sup> Yet, from 2015 to mid-2019, FINRA arbitrators granted expungement requests over 80% of the time.

Year	Expungements Granted (%)
2015	93
2016	81
2017	81
2018	81

Once these complaints are expunged, they disappear completely from CRD and BrokerCheck – making them no longer visible to investors or regulators.

### **II. The Number of Expungement-Only Cases Has Skyrocketed Since January 1, 2015.**

2. During the Review Period, the number of Expungement-Only cases filed with FINRA increased by 924%.

Year	Cases filed
2015	59
2016	135
2017	339

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<sup>3</sup> See, e.g., FINRA Regulatory Notice 17-42 (“It has been FINRA’s long-held position that expungement of customer dispute information is an extraordinary measure, but it may be appropriate in certain circumstances.”) [https://www.finra.org/sites/default/files/notice\\_doc\\_file\\_ref/Regulatory-Notice-17-42.pdf](https://www.finra.org/sites/default/files/notice_doc_file_ref/Regulatory-Notice-17-42.pdf)

2018	545
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3. According to data provided by SAC, the total number of awards involving expungement issued from 2015-2018, including but not limited to awards issued in Expungement-Only cases, is as follows:

2015 – 426 awards, 2016 - 385 awards, 2017- 499 awards, and 2018 - 734 awards.

As a result, Expungement-Only cases have clearly become the preferred choice for brokers seeking expungement.

4. Brokers in Expungement-Only cases frequently request that multiple customer complaints be expunged in a single case. As a result, while the total number of Expungement-Only cases during the Review Period was 1,078, the number of customer complaints that the brokers asked be expungement was 2,194, which is an average of approximately two (2) customer complaints per case.

5. The number of customer complaints that brokers requested be expunged from CRD increased by over 1016%.

Year	Number of customer complaints brokers requested be expunged
2015	102
2016	300
2017	756
2018	1036

6. One individual broker requested that twenty-four (24) complaints be expunged in a single proceeding. The arbitrator granted the broker’s request to expunge all twenty-four (24) of those complaints after conducting only a single hearing session lasting less than four hours. *See* FINRA Award Case No. 17-02465. This is not an isolated incident. The Study found eleven (11) cases in which brokers requested the expungement of ten (10) or more customer complaints in a single case.

7. In 90% of Expungement-Only cases, arbitrators held only one evidentiary hearing (which lasted 4 hours or less) and the vast majority of the hearings were telephonic. Examples of Statements of Claim filed by brokers in

Expungement-Only cases seeking to expunge customer complaints where the brokerage firm settled for significant amounts of money are including in the Appendix.

### **III. Expungement Requests are Rarely Opposed by Brokerage Firms or Customers**

#### **A. Expungement Requests Are Not Opposed By Respondent Brokerage Firms 98% Of The Time.**

8. Brokerage firms very rarely oppose brokers' requests for expungement. Of the 1,078 cases, the respondent brokerage firm did not object or otherwise oppose the individual broker's expungement request 1,055 times out of 1,078 –over 98% of the time. Brokerage firms objected to these expungement requests in only 21 of the 1,078 total requests. That is less than 2% of the time.

#### **B. Customers Participated and Opposed Expungement Requests Only 13% Of The Time.**

9. Customers are not named parties in Expungement-Only cases and are therefore not required to participate in expungement hearings.<sup>4</sup> Of the 1,078 Expungement-Only cases, customers whose complaints are the subject of expungement requests participated and objected to brokers' expungement requests only 141 times, –13% of the time.

#### **C Arbitrators Are Significantly More Likely To Deny Expungement Requests When Someone Objects.**

10. During the Review Period, even though respondent brokerage firms opposed expungement less than 2% of the time, when respondent brokerage firms opposed expungement, arbitrators denied the expungement requests 48% of the time. In contrast, when brokerage firms did not object, arbitrators denied the expungement requests only 11% of the time. Therefore, arbitrators are 436% more likely to deny expungement requests when a brokerage firm objects to the expungement request.

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<sup>4</sup> The Foundation does not recommend that customers be named as parties to these cases. Customers should not be required to essentially relitigate cases that they have settled or otherwise resolved.

11. Even though customers opposed expungements only 13% of the time, when they opposed expungement, arbitrators denied the requests 36% of the time. In contrast, when customers did not object, arbitrators denied the expungement request only 9% of the time. Therefore, arbitrators are 400% more likely to deny an expungement request when customer object.

#### **IV. The Way Expungement-Only Cases Are Administered Contributes To High Expungement Rates.**

##### **A. There Are No Procedural Safeguards In Place To Ensure Customers Are Provided With Timely, Meaningful, and Accurate Notice of Pending Expungement-Only Cases.**

12. One explanation as to why investors rarely participate in Expungement-Only cases is that they may not be aware of the case. The Foundation's review of awards reveals that FINRA itself does not provide notice to customers of the pending expungement requests. FINRA tells arbitrators that they should order the broker to provide a copy of their statement of claim seeking expungement to the customer whose complaint is being sought to be expunged.

13. Yet, neither FINRA nor arbitrators appear to conduct any independent verification. While the data shows that arbitrators told brokers' counsel to provide some form of written notice to customers of the pending expungement requests, there is no consistency as to when notice to customers was provided or what was contained in that notice. The data shows that the timing of notice ranges from a couple of months prior to the evidentiary hearing to a day or two before. In some cases, notice was sent to the customer after the evidentiary hearing. The awards do not show that the arbitrators requested proof of service or reviewed the notice the broker provided to ensure that it was fair and accurate. Therefore, it is impossible to know whether customers received notice of the expungement requests, or whether that notice was reasonable. The authors of the Study were able to review a sampling of notices provided to customers by obtaining them directly from customers or their attorneys. Examples of notice provided to investors in Expungement-Only cases are provided in the accompanying Appendix.

##### **B. Without an Opposing Party, There Are No Procedural Safeguards to Prevent Brokers and Brokerage Firms From Presenting One-Sided and/or False Information to Arbitrators.**



14. Brokers and brokerage firms are the only parties to Expungement-Only cases and both have an incentive to expunge customer complaints from brokers' CRD records. The customers whose complaints are the subject of the expungement request are not parties to the Expungement-Only arbitration and if they participate, their role is akin to a fact witness.

15. Since brokerage firms do not oppose brokers' expungement requests 98% of the time and customers oppose expungement in only 13% of cases, it logically follows that there should be procedural safeguards in place to prevent brokers from presenting one-sided, false or misleading information to arbitrators, who are ethically required to remain neutral in the pending arbitration.

16. FINRA puts the burden of ensuring that only valid expungement requests are granted on arbitrators. But imposing such a burden on arbitrators in unopposed Expungement-Only cases is wholly inconsistent with their role as neutral factfinders and decisionmakers.

17. In fact, FINRA's arbitrator training materials prohibit its arbitrators from conducting their own independent investigations into the validity of the underlying customer complaints. FINRA Dispute Resolution Arbitrator's Guide states in pertinent part:

#### **Questions by Arbitrators and Factual Investigations**

Each case must be judged solely on the written and testimonial evidence presented at the hearing. Each arbitrator has a right to question witnesses. Even though it is proper for an arbitrator to ask questions, every effort should be made to avoid taking over a hearing or becoming an advocate. Parties and their attorneys should be permitted to try their own cases. Generally, arbitrators should refrain from questioning a witness until all parties have finished their examination.

Arbitrators should not make independent factual investigations of a case. When arbitrators are in doubt about an issue, legal or otherwise, they should request briefs from the parties. If cases are cited in a party's motion or brief, and the arbitrators wish to read the full court opinions, the arbitrators should ask the parties to supply copies. Arbitrators generally should review only those materials presented by the parties.

*See FINRA Arbitrator's Guide at page 60 (emphasis added).*

18. FINRA's expungement training materials encourage arbitrators to ask questions during the expungement hearing and request additional documents from the parties. This does not change the fact that arbitrators must remain neutral. The following case shows that important information may not be presented by the parties to arbitrators considering expungement requests.

### Case Study

One broker filed seven (7) separate arbitration cases during the Review Period, which is the most of any other broker. In total, the broker requested to expunge sixteen (16) customer complaints. After filing the first three cases in 2014 and again in 2017, in one week the broker used the same attorneys to file four (4) separate Expungement-Only cases against two of his former brokerage firms and collectively requested that thirteen (13) customer complaints be expunged from his record. The respondent brokerage firms did not oppose any of the expungement requests. One firm didn't even answer the Statement of Claim. Each February 2018 case was assigned a different arbitrator.

Based on the broker's current BrokerCheck Report, at the time that these four Expungement-Only cases were pending, the broker had two other customer arbitrations pending, one unfiled customer dispute listed and four other customer complaints on his record.

Out of the thirteen (13) customer complaints at issue in the cases filed that week, only one customer participated and opposed expungement of their complaint. In total, over all the seven separate cases, the broker successfully expunged ten customer complaints. Importantly, the broker currently has thirteen (13) complaint on his BrokerCheck report **and has had additional complaints since the expungements were granted.**

It is unclear whether any of the arbitrators in these proceedings were aware that there were four expungement cases pending at the same time which objectively would have been material to their decision-making. It is clear, however, that there are not procedural safeguards in place to prevent brokers from providing one-sided, false or misleading information to arbitrators.

See FINRA Award Nos. 18-00657, 18-00622, 18-00674, 18-00646

**V. Brokers Have Been Gaming the System to Obtain Expungements, Contributing to The High Expungement Rates.**

**A. Brokers Have Been Including a Bogus \$1.00 Damages Demand With Expungement Requests To Reduce The Number of Arbitrators and to Make the Expungement Process Cheaper.**

19. A new trick has erupted in the last few years involving brokers demanding \$1.00 in damages along with the expungement request and then withdrawing the \$1.00 demand at the expungement hearing (“\$1.00 Expungement Cases”). This presumably has been done to reduce the number of arbitrators reviewing expungement requests from a panel of three arbitrators to a single arbitrator. It also makes it cheaper for brokers to get customer complaints expunged. By allowing its members to game the system and file \$1.00 Expungement cases, FINRA has lost over \$6 million in revenue.

**B. Since January 2015, the Number of Cases Decided by a Single Arbitrator, Rather than a Panel of Three Arbitrators, Has Skyrocketed.**

20. During the Review Period, the percentage of cases decided by three-arbitrator panels fell while the percentage of cases decided by a single arbitrator increased dramatically.

Year	Total Cases	Three Arbitrator Cases (%)	Single Arbitrator Cases (%)
2015	59	63	37
2016	135	37	63
2017	339	14	86
2018	545	8	92

21. The increase in Expungement-Only cases decided by a single arbitrator is primarily because of the rise in number of \$1.00 Expungement Cases. Under FINRA rules, claims that seek “Unspecified or Non-Monetary” relief must be heard by three (3) arbitrators. *See* FINRA Rule 13401(c). However, claims seeking

damages of \$50,000 or less may be heard by a single arbitrator. *See* FINRA Rule 13401(a). Expungement is very clearly “unspecified or non-monetary” relief, requiring the request be heard by a panel of three arbitrators. Yet, brokers include an obvious sham damages request of \$1.00, which has caused FINRA to classify their case as a single-arbitrator case. Brokers withdrew their request for \$1.00 in damages at hearing.

22. The result of brokers including a request for nominal damages, and then subsequently withdrawing it at the expungement hearing, was that a single arbitrator was appointed under FINRA rules to decide whether to grant the expungement request instead of a panel of three (3) arbitrators. In addition, as explained below, the \$1.00 request significantly reduces cost of the expungement requests to brokers and brokerage firms.

23. During the Review Period, the number cases in which nominal damages were requested in the broker’s statement of claim increased by over 7,000%.

Year	Expungement-Only Cases Requesting \$1.00 in Damages
2015	6
2016	69
2017	248
2018	457

In 2018, 84% of all Expungement-Only cases included a request for nominal damages. In total, brokers requested nominal damages 780 times and 756 of those requests (i.e., 97%) requested \$1.00.

**C. Since 2015, FINRA Has Subsidized \$1.00 Expungement Cases and Allowed Itself to Lose Over \$6 Million in Revenue.**

24. The \$1.00 Expungement Cases allow brokers and the respondent brokerage firms to reduce significantly the fees that both parties are required to pay to FINRA. For example, in \$1.00 Expungement Cases, assuming one (1) evidentiary expungement hearing, the broker and brokerage firm pay a total of only \$300.00 per case in filing fees (\$50.00), hearing session fees (\$50.00 each), member surcharges (\$150.00) and member processing fees (\$0.00).

25. Had brokers not included a request for nominal (\$1.00) damages with the expungement request, FINRA would have received a minimum of \$8,350.00 per case in filing fees (\$1,575.00), hearing session fees (\$1,125.00 each), member surcharges (\$1,900.00) and member processing fees (\$3,750.00). As a result, FINRA lost at least \$8,050.00 per case in revenue in \$1.00 Expungement Cases, which amounts to more than \$6 million in lost revenue to FINRA during the Relevant Period [\$8,050 times 756 cases]. Examples of arbitration awards showing the amounts of forum fees charged by FINRA in three arbitrators and single arbitrator cases are included in the accompanying Appendix.

26. In addition to the lost revenue described above, FINRA subsidized the \$1.00 Expungement Cases, because the amount that FINRA pays the arbitrator in those cases is more than the \$300 in revenue that it received from the broker and the brokerage firm per case.

**D. FINRA Does Not Procedural Safeguards In Place To Prevent Brokers and Brokerage Firms From Undermining FINRA’s Arbitration Selection Process by Hand-Picking Arbitrators Most Likely to Grant Expungement.**

27. The legitimacy of FINRA’s arbitrator selection process depends on adverse parties ranking and striking arbitrators. As in all single arbitrator arbitrations, FINRA provides the “opposing parties” (broker and brokerage firm) a list of ten (10) arbitrators to rank and strike in \$1.00 Expungement Cases. Each party gets up to four (4) strikes. The integrity of the arbitrator ranking process depends on parties having genuinely opposing interests: the brokerage firm would strike the arbitrators that it considers least likely to grant expungement, while the broker would strike arbitrators that they considered most likely to grant expungement.

28. As discussed above, brokerage firms named as respondents in Expungement-Only cases failed to object or otherwise oppose expungement requests over 98% of the time. Respondent brokerage firms that do not oppose the expungement request have no incentive to invest the time and expense required to participate in the arbitrator ranking process. Thus, it is likely that brokers get their number one pick of the arbitrators on the list. That is, if the parties go through the arbitrator selection process at all. Nothing prevents brokers and brokerage firms in Expungement-Only cases from coordinating with each other to select an arbitrator they believe most likely to expunge customer complaints.

29. FINRA does not have a procedural mechanism in place to prevent brokers and their firms in Expungement-Only cases from coordinating with each other to select an arbitrator who they believe is most likely to grant expungement. The data strongly suggests that parties in Expungement-Only cases are steering to a smaller number of arbitrators they consider most likely to grant the expungement request.

30. During the Review Period, the number of arbitrators who served on three (3) or more expungement awards in a given year increased by 6,100%.

Year	No. of Arbitrators Who Served on Three or More Expungement Cases in That Same Year
2015	1
2016	2
2017	27
2018	61

31. There were fifteen (15) arbitrators who served on five (5) or more Expungement-Only cases in 2018. One arbitrator served on eleven (11) cases that year, which was almost one per month. In total, these fifteen (15) arbitrators served on a total of 92 cases in 2018 and granted expungements in 85 of them, which is a 92% expungement granting rate. As stated above, the average number of cases where arbitrators overall granted expungement requests was 81%. This strongly suggests that these arbitrators are being selected more frequently because the parties believe that they are more likely to grant expungement.

32. The data shows brokers and brokerage firms, through their attorneys, are likely gaming FINRA’s arbitrator selection process to hand pick arbitrators. For example, in one Expungement-Only case, the award reflects that one law firm (hereinafter referred to as “Law Firm #1”) represented both parties, *i.e.* the broker and the brokerage firm. Presumably, that one attorney representing both parties picked the arbitrator on behalf of the broker and brokerage firm.

33. Law Firm #1 commonly represents major Wall Street brokerage firms in customer disputes. According to the data, Law Firm #1 also represented those same firms in approximately 230 Expungement-Only cases and represented brokers against these same firms in 73 Expungement-Only cases. Not surprisingly, in cases

where Firm #1 represented brokers, the brokerage firms did not oppose expungement in any case. In addition, in cases where Law Firm #1 represented the broker but not the brokerage firm, the vast majority of the time, the brokerage firm was represented by in-house counsel, which raises concerns that the brokerage firms deferred to Law Firm #1 to select the arbitrators in those Expungement-Only cases.

34. Also, Law Firm #1 and another law firm (“Law Firm #2”), represented at least one party to Expungement-Only cases in 785 out of 1,078 cases [73% of all cases]. This repeat player problem provides motive and opportunity for counsel representing parties in Expungement-Only cases to coordinate with each other to hand-pick arbitrators who are most likely to grant expungements.

**VI. The Three Arbitrators Selected Most Often Recommended Expungement in Almost Every Case.**

35. The PIABA Foundation analyzed all Expungement-Only awards for the three arbitrators who had the highest number of awards in the nation. The most prolific arbitrator granted expungement requests 97% of the time. The second most prolific arbitrator granted expungement 96% of the time. The third most prolific arbitrator granted expungement 95% of the time. In addition, the frequency in which these arbitrators were selected accelerated over time between 2015 and 2018. More detail on those arbitrators’ awards is set forth below:

**Arbitrator #1: Expungement Requests Granted 97%**

**27 Cases - 37 out of 38 Customer Complaints**

Filing Date	# Complaints Broker Asked Be Expunged	# Complaints Expunged in Award
2/17/2015	3	3
5/29/2015	1	1
11/30/2015	1	1
3/1/2016	1	1
6/21/2016	1	1
8/2/2016	1	1
1/19/2017	2	2
2/14/2017	3	3
4/10/2017	1	1
5/11/2017	1	1
7/13/2017	1	1

Filing Date	# Complaints Broker Asked Be Expunged	# Complaints Expunged in Award
8/1/2017	2	2
10/5/2017	1	1
10/13/2017	2	2
11/28/2017	1	1
12/04/2017	2	2
1/19/2018	1	1
2/2/2018	1	1
2/20/2018	1	1
2/20/2018	3	2
4/10/2018	1	1
5/2/2018	1	1
5/14/2018	1	1
5/17/2018	2	2
7/13/2018	1	1
11/14/2018	1	1
12/19/2018	1	1
<b>Total</b>	<b>37</b>	<b>36</b>

36. Law Firm #1 and/or Law Firm #2 represented brokers in 13 of these cases. In addition, Law Firm #1 represented brokerage firms in 7 of the cases.

37. One broker filed three separate arbitrations between 2015 and 2018 seeking to expunge one customer complaint in each case and that broker's counsel was able to select Arbitrator #1 each time. Arbitrator #1 granted expungement in each case. Another broker filed two separate arbitrations between 2016 and 2018, and also was able to select Arbitrator #1 each time. Arbitrator #1 granted expungement in each case even though it would have been clear that these individuals were repeat brokers, a fact that objectively would constitute regulatory value.

**Arbitrator #2: Expungement Requests Granted 96%**

**15 Cases - 27 of out 28 Customer Complaints**

Filing Date	# Complaints Broker Asked Be Expunged	# Complaints Expunged in Award
7/31/2015	2	2
10/30/2015	1	1
8/5/2016	1	1



Filing Date	# Complaints Broker Asked Be Expunged	# Complaints Expunged in Award
10/19/2016	1	1
11/7/2016	1	1
12/7/2016	5	5
2/3/2017	3	3
5/10/2017	1	1
8/4/2017	4	4
1/17/2018	1	1
1/31/2018	3	3
3/29/2018	1	1
3/29/2018	1	1
4/4/2018	2	2
6/1/2018	1	0
<b>Total</b>	<b>28</b>	<b>27</b>

38. Of the 15 cases, Law Firm #1 represented the broker-dealer 8 times, 53% of 9 cases, and Law Firm #2 represented the broker 8 times, 53% of the cases. Law Firm #1 and Law Firm #2 represented both parties in 6 cases, 40% of the cases.

**Arbitrator #3: Expungement Requests Granted 95%**

**13 Cases - 18 out of 19 Customer Complaints**

Filing Date	# Complaints Broker Asked Be Expunged	# Complaints Expunged in Award
6/11/2015	1	1
9/27/2016	1	1
5/31/2017	1	1
8/13/2017	1	1
12/13/2017	1	1
1/18/2018	2	2
2/7/2018	2	2
2/20/2018	1	1
2/26/2018	1	1
2/28/2018	3	2
3/5/2018	1	1
4/16/2018	2	2
7/2/2018	2	2
<b>Total</b>	<b>16</b>	<b>15</b>

39. Of the 11 cases, Law Firm #1 represented the brokerage firm in two cases and Law Firm #1 represented the broker. In total, Law Firm #2 represented the broker in 5 cases, 45%.

40. The above data concerning these three arbitrators, who are the most frequently selected in the entire nation, shows that brokers and brokerage firms, whose counsel are repeat players in this forum, are likely coordinating with each other to select arbitrators. The frequency in which these arbitrators were selected accelerated over time between 2015 and 2018 strongly suggests that parties to Expungement-Only cases are able to identify and select arbitrators who are most likely to grant expungement.

41. The data also shows that if FINRA creates a roster of specially trained arbitrators to handle expungement cases, as it has recently proposed to do, FINRA may very well institutionalize the problem of high expungement rates, because the most frequently selected and most experienced arbitrators, who would presumably be included on that roster, grant expungement at a higher rate than the average.

42. It would not be difficult to determine whether parties are coordinating to hand-pick arbitrators because FINRA requires parties to submit arbitrator ranking forms on its online portal in all cases. A review of all arbitrator ranking forms submitted by the parties in Expungement-Only cases would reveal whether parties are improperly coordinating to select arbitrators.

## **RECOMMENDATIONS**

### **1. Immediately stay all Expungement-Only cases.**

FINRA should immediately stay all pending Expungement-Only cases and impose a moratorium on filing such cases until it can ensure the integrity of the expungement process. Until FINRA takes steps to ensure that expungements are not granted based upon one-sided evidence that is false or misleading and that parties are not coordinating to hand-pick arbitrators, FINRA should not permit expungement other than when it is ordered by an arbitration panel as part of the relief in a customer arbitration.

In addition, FINRA should file a motion to stay in each pending court action seeking confirmation of an expungement recommendation. FINRA should prohibit individual brokers and their firms from pursuing confirmation of expungement awards obtained in Expungement-Only cases until FINRA has determined that those

awards were properly obtained, including determining that no false or misleading information was used to obtain the expungement recommendation.

Finally, it appears that much of the problems described herein are caused by FINRA attempting to fit expungement cases, which at its core is a regulatory process, into its arbitration forum, which is designed to resolve disputes between adverse parties. This “square peg in a round hole” problem may be best resolved by removing expungement matters from FINRA arbitrations altogether and instead creating a new regulatory process that does a better job of balancing the interests of protecting brokers’ reputations with the interest of preserving important information on the CRD. If expungements continue to be resolved in FINRA’s arbitration forum, an entirely new Code of Arbitration specific to expungements needs to be created because the existing Code of Arbitration is designed to resolve disputes between adverse parties.

**2. Conduct an investigation into whether expungements have been awarded as a result of brokers and brokerage firms presenting false and misleading evidence and otherwise undermining the integrity of the process.**

An independent investigation should be commissioned by FINRA to determine whether false and misleading statements and evidence has been used by individual brokers and brokerage firms in order to obtain expungements. This misconduct not only misleads investors and regulators, but it also undermines the integrity of courts that are asked to confirm the expungement award.

There is evidence available from which an investigator can determine whether parties made false and misleading statements. An investigator can review the petition for expungement and related filings as well as filings in the underlying customer arbitration. An investigator can contact the customer and customer’s attorney to learn about key facts and documents that support the customer’s claims. An investigator can listen to the audiotapes of the hearing on expungement to determine whether the parties made false or misleading statements. These statements could constitute perjury as well as violations of FINRA rules.

An independent investigation could also uncover whether, and if so to what extent, parties to Expungement-Only cases have been colluding or otherwise improperly coordinating to select preferred arbitrators. A review of the arbitrator ranking forms submitted by the parties would uncover whether two supposedly adverse parties are working together in the arbitrator selection process thereby

undermining the legitimacy of the expungement system. A review of the arbitrator ranking forms will also reveal whether brokers and brokerage firms are coordinating to ask FINRA to assign a particular arbitrator who does not appear on the list of potential arbitrators.

**3. Users of BrokerCheck should be shown a prominent warning that it does not contain complete and accurate customer complaint information.**

BrokerCheck should include a prominent warning to users that it does not include all customer complaint information about individual brokers. This is necessary to correct the impression – given by FINRA, the SEC and other regulators – that customer complaint information on BrokerCheck is complete and accurate.

According to the SEC website, Investor.gov,

BrokerCheck ... will tell you whether the broker has been: ... named in any consumer-initiated complaints, arbitration proceedings, or civil lawsuits.

<https://www.investor.gov/research-before-you-invest/methods-investing/working-investment-professional/using-brokercheck>.

While the BrokerCheck website warns users that it does not include certain types of civil and criminal matters that do not involve investments or “breach of trust,” there is no mention that it does not include all customer complaints. See <https://brokercheck.finra.org/>. BrokerCheck should display a prominent warning so investors are aware that BrokerCheck does not include all customer complaints.

**4. Establish an investor protection advocate.**

The current system of relying on arbitrators to protect the integrity of the CRD regulatory record is fundamentally flawed. Providing additional training to arbitrators will not solve that problem. Nor will creating a specialized roster of arbitrators to hear expungement requests.

The data shows that the requests for expungements are denied more often when arbitrators hear evidence that they should be denied. If expungement proceedings are going to continue to be under the control of FINRA, FINRA and/or

the SEC should create an investor protection advocate position or office to participate in every expungement case. The Advocate should be independent from FINRA and be allowed to participate in all expungement proceedings with the same rights as a party.

The Advocate would be responsible for investigating the customer complaint, obtaining and reviewing documents, interviewing the customer, customer's counsel, and any other relevant witnesses. The Advocate could assist the customer and fully participate in the expungement hearing by making an opening statement, cross examining the individual broker, presenting testimony and documents, and making a closing argument. Regardless of whether FINRA or the SEC establishes this Advocate position, the Foundation believes that FINRA should fund the Advocate and can do so using the more than \$6 million that will no longer be lost once FINRA bans \$1 Expungement Claims.