

Procedure to require a finding in an arbitration award of one or more of the expungement criteria discussed in the Notice; and (3) the adoption of a rule or Interpretive Material that clearly articulates NASD's authority to pursue disciplinary action against a member or associated person who seeks to have information about an arbitration claim expunged after there has been an award rendered against that member or associated person by the arbitrators or seeks to expunge any arbitration award that does not contain an expungement order and a finding of at least one of the criteria set forth in the Notice. NtM 01-65 provided members and other interested parties with a checklist of four questions that they could use to respond to the request for comment in addition to, or in lieu of, sending written comments. NASD noted that the checklist did not cover all aspects of the proposal, and it encouraged commenters to provide written comments, as necessary. NASD extended the comment period from November 24, 2001 to December 31, 2001. NASD received a total of 579 responses to the Notice.

Forty of the 579 responses to NtM 01-65 consisted solely of written comments. A significant percentage of the remaining 539 commenters identified themselves as registered representatives associated with NASD member firms, and these commenters overwhelmingly opposed the imposition of any additional substantive or procedural obligations before expungement of customer dispute information could be effected. Commenters responded to the four questions as follows:⁹

Question 1 asked: "Should [NASD] adopt a rule that would require members to provide notice to [NASD] and make [NASD] a party to the proceeding before seeking a court order directing expungement or confirming an arbitration award that contains an expungement directive?" Forty commenters answered "yes," 495 commenters answered "no," and four commenters did not answer this question.

Question 2 asked: "Should [NASD] establish specific standards that must be met before it will execute orders directing it to expunge customer dispute information from the CRD system? Are the standards identified in the Notice (i.e., factually impossible/clear error;

without legal merit; and defamatory in nature) appropriate?" Fifty-one commenters answered "yes," 483 commenters answered "no," and five commenters did not answer this question.

Question 3 asked: "Should [NASD] execute arbitrators' directives to expunge customer dispute information from the CRD system if (1) arbitrators make specific findings in stipulated or consent awards; (2) arbitrators expressly include those findings in an award; and (3) a party confirms the award in a court of competent jurisdiction?" Eighty-eight commenters answered "yes," 441 commenters answered "no," and 10 commenters did not answer this question.

Question 4 asked: "Should [NASD] adopt a rule or Interpretive Material that would explicitly articulate [NASD's] authority to pursue disciplinary actions for violations of just and equitable principles of trade against a member or associated person who seeks to have information about an arbitration claim expunged after there has been an award rendered against that member by the arbitrators or seeks to expunge any arbitration award that does not contain an expungement order and a finding of at least one of the criteria described in the Notice?" Forty-eight commenters answered "yes," 483 commenters answered "no," and eight commenters did not answer this question.

Of the 40 commenters who responded by letter, 25 were NASD members or persons associated with NASD members.¹⁰ NASAA, the Securities Industry Association ("SIA"), the Public Investors Arbitration Bar Association ("PIABA"), the National Association of Investment Professionals ("NAIP") also commented, as did a number of non-industry persons who have an interest in the arbitration process. There was a wide variance in these comments, ranging from approval of some or all of the proposed procedures to total disapproval. Among the concerns raised by commenters were: the proposed procedures requiring court confirmation would be burdensome and costly; mandatory court confirmation and naming NASD as a party would undermine the arbitration process; the proposed procedures would create a conflict of interest between firms and representatives in settlements because the firm might wish to settle a case, regardless of its merits, thereby precluding the representative from obtaining an expungement; and the

proposed criteria for expungement were too vague and/or too restrictive.

Some of these commenters recommended new requirements in the arbitration process to handle expungement requests. For example, it was suggested that arbitrators be required to decide claims of defamation based on the law of the state in which the party claiming defamation maintains his/her/its principal office, or in accordance with the terms of an agreement between the parties. Another suggestion was to require claimants to attest that they are bringing the claim in good faith and to give arbitrators the authority to award sanctions against claimants who bring claims in bad faith or without a reasonable basis. Some commenters suggested that a party submitting a stipulated award containing a recommendation for expungement to a court for confirmation should attach an affidavit setting forth facts constituting "factual impossibility" and/or "clear error."

Based on the comments to NtM 01-65, NASD is proposing to retain the core substantive requirements of the expungement program described in NtM 01-65, but is also proposing certain modifications to the program proposed in the Notice. NASD recognizes that any expungement program requires a balancing of competing interests. NASD believes that the proposed rule will: help to ensure that information submitted to and maintained on the CRD system is accurate and complete; give regulators the broad access to customer dispute information that they need to fulfill their regulatory responsibilities; give individuals in the brokerage community a fair process that protects their reputations and permits expungement from the CRD system when appropriate; and gives investors access to accurate information about brokers with whom they conduct, or may conduct, business.

NASD has incorporated the following modifications based on its review of the comments. NASD proposes to modify the three broad categories proposed in NtM 01-65: "without factual basis," "without legal merit," and "defamatory in nature." The "without factual basis" standard would include, as identified in the Notice, the "factually impossible" and "clear error" standards. Of the three categories proposed, the "without legal merit" standard drew the most comments, ranging from claims that it is too narrow, too broad, or too vague. To address those comments, NASD proposes to change the "without legal merit" standard to a standard of "failure to state a claim upon which relief can be granted" or "frivolous." NASD

⁹ Some commenters submitted duplicate responses to the questions; NASD considered these as one vote per question. For those commenters who changed their answers to the questions in a second response, NASD considered only the second response. NASD staff also notes that not all commenters responded to each question.

¹⁰ A number of commenters did not identify any affiliation.