

The most significant argument against **Rule 2130** is that it would harm consumers and brokers alike by removing the broker's incentive to settle cases expeditiously.

Sunset for Settlements?

The regulators think they're helping investors by pushing through Rule 2130. They're wrong.

A NASD rule change destined to take effect later this year would have the unintended consequence of making it harder for investors to obtain the redress they seek against brokers.

Indeed, proposed Rule 2130, which would prohibit the expungement of CRD records unless a claim is factually impossible or clearly erroneous, effectively shoots the consumer in the foot by discouraging the settling of cases and delaying their speedy resolution.

Under current regulatory requirements, any allegation against a rep that triggers an arbitration hearing, regardless of veracity, results in a "ding" to the rep's Form U-4. That is to say, a rep's Form U-4 is marked with an allegation of wrongdoing before any court or arbitration panel has ruled on the validity of the accusation.

A broker can cleanse his record in the CRD if the panel sitting on the arbitration recommends it. If the case settles before a hearing, as many do, expungement of the U-4 black mark must be negotiated between the customer and the broker; then approved by the customer, the broker and the arbitration panel; then ordered by a court.

Rule 2130, as proposed by the NASD and approved by the SEC, would render cleansing a CRD record significantly harder. A broker's record would be eligible for expungement only if: (a) the claim brought in arbitration is factually impossible or clearly erroneous, (b) the registered rep was not involved in the alleged violation or (c) the claim is false. A broker who wants the court to approve an expungement would be required to name the NASD as a party to the proceeding, something not required under the current rules. (Rule 2130 appears likely to go into effect, but the NASD has asked that the period to comment on the proposed rule be extended until April 26, 2004.)

Why It's Bad

There are several potent arguments against the proposed rule. The SIA, for example, fears delays to "the rightful vindication of individuals accused of wrongdoing."

But most significant, the rule would harm consumers and brokers alike by removing the broker's incentive to settle cases expeditiously. If settling a case is going to result in either a permanent U-4 blemish or a drawn out expungement process, brokers have very little to lose from fighting allegations tooth and nail.

The NASD acknowledges the settlement chill as a possible side effect of the rule. In Securities Exchange Act Release No. 34-48933, NASD states that "compliance with the proposed rule may have the effect of decreasing the number of settlements that are reached."

Thus, when investor rights groups continue to argue that this change is beneficial to consumers, they are ignoring some pretty obvious negatives. For instance, if an investor loses money due to his broker's mismanagement and then seeks to arrive at a reasonable, expeditious resolution to the dispute, he is likely to have to submit to a drawn out legal dispute, because Rule 2130 would remove the firm's and the broker's incentives for settling the case up front.

This is important because the brokerage industry's system for hearings and arbitrations is getting clogged even without a new rule encouraging them. Of 7,278 cases closed through December 2003, 52 percent were resolved through mediation or direct settlement between the parties. Only 24 percent were completed after hearing. Even with this volume, the arbitrators' dockets are full, and the number of new cases continues to grow-by 16 percent last year to 8,945.

At the same time, arbitrations are getting more involved, and the turnaround time for them has grown 7 percent to 14.6 months. Again, this is before the proposed rule has even taken effect. With the NASD having to be party to all expungement proceedings, this situation would only get worse.

Introducing rules that will only delay an investor's day in court-or that will not lead to the speedy resolution of cases whether through hearing, mediation or settlement-is simply not in anyone's best interests, and the regulatory agencies should think long and hard before enacting them.

Legal Issues

By Richard Roth & David M. Kasell

Harder to Get Clean

Under Rule 2130, erasing a CRD black mark would get significantly tougher.

Currently

1. Investor lodges complaint against broker with NASD.>
2. Complaint entered in CRD.>
3. Case goes to arbitration or trial.>
4. Arbitration agreement or pre-arb settlement approve expungement.>
5. Court confirms expungement.>
6. CRD cleansed.

Under 2130:

- Steps 1-3 remain the same.
4. Expungement only approved if one of three criteria are met:>
 - a. The claim brought in arbitration is factually impossible or clearly erroneous.
 - b. The registered rep was not involved in the alleged violation.
 - c. The claim is proven false.
 5. Court confirms expungement, but NASD must be party to proceeding.>
 6. CRD cleansed.

Writers' BIOS:



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