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October 25, 2013

Richard G. Ketchum
Chair and Chief Executive Officer
Financial Industry Regulatory Authority
1735 K St. NW
Washington, D.C. 20006

Dear Chairman Ketchum:

It has been some time since we last communicated, and I trust you are doing well. I write to express my serious concerns about three issues related to the Financial Industry Regulatory Authority's (FINRA) ability to protect investors from "rogue brokers" that were recently exposed in *the Wall Street Journal.*[1] First, I was alarmed to learn that arbitration awards and settlements do not show up in FINRA's BrokerCheck database because brokers have been able to successfully expunge the information. Investors cannot protect themselves from dishonest brokers if they cannot determine whether brokers with whom they are considering investing their funds have large or repeated settlements or awards due to their wrongdoing or mismanagement. Second, I am appalled that $51 million in arbitration awards granted to investors in 2011 remain unpaid. Investors are required to participate in FINRA's arbitration program if they have a claim against their broker. If an investor successfully proves their claim but is never paid, the integrity of the entire system is threatened. Finally, I question FINRA's record in tracking rogue brokers if, as reported earlier this month, over 5,000 stockbrokers from firms expelled by FINRA are still selling securities, a practice commonly known as "cockroaching."

As you will likely recall from your days as head of the SEC's Division of Market Regulation. at the time, these are issues I have raised before. The genesis of BrokerCheck is Section 510 of the Penny Stock Reform and Civil Remedies Act of 1990, a bill that I co-authored in the House of Representatives. This provision of the law required registered securities associations, notably the National Association of Securities Dealers (NASD), to maintain an 800 telephone number that investors could call to check the disciplinary histories of broker dealers.

After the 800 number was launched in 1991, I continued to monitor its performance, including the NASD's commendable decision to supplement the hotline with a website that would enable consumers to access broker disciplinary information, as well as the industry's ability to adequately discipline unscrupulous brokers who broke the rules. After reading the *Wall*

[1] Eaglesham, Jean and Barry, Rob, "More Than 5,000 Stockbrokers From Expelled Firms Still Selling Securities". (Wall Street Journal October 4, 2013);Eaglesham, Jean and Barry, Rob, "FINRA to Consider Requiring Brokerages to Carry Arbitration Insurance" (Wall Street Journal October 4, 2013); Eaglesham, Jean and Barry, Rob"Stockbroker Requests to Scrub Complaints Are Often Granted"( Wall Street Journal October 16, 2013).

*Street Journal* stories, I learned that many of the same problems I had identified and believed had been corrected by the industry in the early 1990s continue to plague the securities industry.

In February 1993, a year after the NASD Hotline was established, the General Accounting Office (GAO) reported that the NASD had decided to expand the information made available to the public to include, among other things, arbitration decisions. Despite those welcome reforms, however, I continued to hear reports of significant deficiencies in the NASD Hotline and of unscrupulous brokers fleecing unsuspecting customers. As a result, the House Telecommunications and Finance Subcommittee, which I then chaired, began an investigation of the adequacy of regulatory and supervisory standards for brokers with extensive disciplinary histories and asked the General Accounting Office (GAO) to undertake a comprehensive examination of the nature and adequacy of SEC oversight in this area. In September 1994 the Telecommunications and Finance Subcommittee held hearings on sales practice abuses and the continued presence of "rogue brokers" in the securities industry. During those hearings, the GAO released a report, prepared in response to my request, which found that unscrupulous brokers were difficult to track for a variety of reasons, including that many disciplinary actions went unreported. It recommended that the Central Registration Depository (CRD) be improved.

At the conclusion of the Subcommittee's hearings, I wrote the GAO asking that it conduct a survey of the effectiveness of the NASD Hotline (the predecessor to BrokerCheck) because of egregious omissions in the information provided to the public. I also wrote to then-Chair of the Securities and Exchange Commission (SEC), Arthur Levitt, asking the Commission to explain,

> "why the NASD is not providing investors who call the Hotline with information about settlements of complaints involving abusive sales practices, whether the Commission believes that such information should be provided to investors, and if so, what steps are being taken to assure that the NASD makes this information available."[2]

In a letter dated October 28, 1994, Chairman Levitt responded confirming that NASD did not then disclose settlements of arbitration claims, only awards pursuant to a decision by an arbitrator. The SEC pledged to undertake an examination of the operation of the NASD hotline during fiscal year 1995.

As a result of these actions, NASD rules subsequently were amended so that settlements and arbitration awards against brokers were required to be disclosed to the investing public. It appeared that the problem had been addressed satisfactorily by the industry and by the SEC. Thus, I was concerned to read the *Wall Street Journal* article reporting that this very same problem is again impacting the securities industry, albeit in a slightly different, though no less insidious form.

On October 16, 2013, the *Wall Street Journal* reported on a study of FINRA arbitrations between brokers and clients from 2007 to 2011. The study found that brokers routinely ask arbitrators to expunge from their disciplinary record arbitration awards or settlements of investor

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[2] Letter from Edward J. Markey to Arthur Levitt, September 28, 1994.

complaints and that in an astonishing 90 percent of the cases that were settled, the arbitrators granted those requests. Even in cases that proceeded to a hearing, half the requests were granted. The result, of course, is to hide bad brokers from the investing public. The news story also revealed that many times investors are required as a condition of settlement to agree not to oppose an expungement request. Such extortionary tactics further undermine the integrity and reliability of the BrokerCheck system.

I am aware that on the eve of the publication of the *Wall Street Journal* investigation, FINRA sent a notice to its arbitrators reminding them that expungement is an extraordinary remedy, as well as of their obligation to provide a written explanation for granting expungement. In my view, counseling arbitrators is simply not enough.

In addition I believe BrokerCheck itself needs to be retooled. In the description of BrokerCheck provided on the FINRA website, there is no mention of the fact that an investor can learn of any disciplinary actions taken or complaints filed against a broker. Instead, the website states only that BrokerCheck provides the "professional background" of current and former FINRA-registered brokers. If investors are not aware that this information is available, they will not be able to take advantage of it. Worse, even when one actually does a search, disciplinary action is euphemistically labeled "Disclosure Information." Moreover, the information provided is misleading. Under the heading, "Disclosure Information", FINRA assures investors that "disclosure events are certain criminal matters; regulatory actions; civil judicial proceedings; customer complaints, arbitrations, or civil litigations; employment terminations; and financial matters in which the broker has been involved." Nowhere does FINRA disclose that not all "disclosure events" are reported because some have been expunged. And without such notice, investors have no way of knowing that they may be looking at only a sliver of a broker's arbitration data, one that is biased in favor of the broker.

The *Wall Street Journal* followed its story on the BrokerCheck system with another regarding FINRA arbitrations. Specifically, the *Journal* reported that often arbitration awards are not paid because brokerage firms faced with awards simply close their doors or declare bankruptcy. The Securities Investment Protection Corporation does not provide protection to investors for unpaid arbitration awards, and it is rare that arbitration awards are fully paid if the brokerage firm declares bankruptcy. Thus, investors are left with only a pyrrhic victory. I know that FINRA is considering a requirement that brokerage firms carry insurance that would cover arbitration awards. I encourage you to vigorously pursue this and any other possible solutions to this injustice.

Finally, with respect to the "cockroaching" problem, FINRA simply must do a better job of tracking and removing unscrupulous brokers from the industry. The *Wall Street Journal* investigation, which had to be conducted using state regulatory information because FINRA refuses to release all of its disciplinary records,[3] reported that at least 610 brokers had worked at more than one firm that FINRA had expelled. More troubling is the fact that on average, a broker who left at least two firms that were eventually expelled and who joined another firm had greater than eight times as many arbitration claims and other required disclosures as the industry

[3] FINRA of course allows access to BrokerCheck, but we now know how deficient that data is.

average. If brokers with eight times as many arbitration claims and disclosures as the industry average are still allowed to practice, FINRA needs to revise its disciplinary system. To be sure, there are hundreds of thousands of brokers who play by the rules and well serve the investing public, but that is cold comfort to an unsuspecting investor who loses their life savings to a rouge broker and all the more reason FINRA can and should ferret out those few brokers who are bad.

Concurrent with this letter, I have written to SEC Chair Mary Jo White, enclosing a copy of this letter, urging the SEC to promulgate new rules for FINRA that mandate the disclosure of arbitration awards and settlements. In addition, these rules should ban any settlement provisions relating to expungement. Further, the expungement process itself needs to be modified so that expungement truly becomes the rare exception rather than the rule. In my opinion, arbitrators should not be allowed to decide whether to expunge an arbitration award or settlement from a broker's disciplinary record. Rather, FINRA should establish an internal process that determines whether a particular settlement or award meets stringent and narrow expungement standards. In addition, I have asked the SEC to address the problem of deadbeat brokers who refuse to pay arbitration claims and the need to better police brokers who migrate from bad firms to worse.

Unfortunately, what I said in 1994 is as true today as it was then: "It takes only a few rogue brokers to create an enormous amount of financial harm for investors. It is simply unacceptable that individuals who rack of repeated disciplinary infractions should be allowed to continue ripping off the investing public." Without an effective BrokerCheck in place and without a more rigorous disciplinary system, investors will continue to be harmed by unscrupulous brokers.

I look forward to your response addressing these concerns. Please contact Lisa Foster or Justin Slaughter on my staff at 202-224-2472 with any questions. I request a response to this letter by November 15, 2013.

Sincerely,

Edward J. Markey

Edward J. Markey
United States Senator