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Senator: FINRA Too Weak to Go After Deadbeat Brokers.

In letters to Ketchum and SEC Markey calls for tougher expungement rules and more effort to throw out rogues

Sen. Edward J. Markey, D-Mass., is pushing the SEC and Finra to tighten the screws on rogue

The lawmaker who 20 years ago wrote the legislation that led to the creation of a database containing background information about brokers is calling on financial regulators to crack down on brokers who violate securities rules and continue to practice.

In a letter Friday, Sen. Edward J. Markey, D-Mass., told Securities and Exchange Commission Chairman Mary Jo White that the commission should take “remedial regulatory action” to address what he calls weaknesses in the Financial Industry Regulatory Authority Inc.’s ability to protect investors from “unscrupulous brokers.”

Mr. Markey said that it is too easy for brokers to clear their records of disciplinary actions in the BrokerCheck database and avoid paying arbitration awards to harmed investors.

“Plainly, the Finra rules need to be strengthened,” Mr. Markey wrote. “[A]ll arbitration awards and settlements should be reported by BrokerCheck. Expungement should truly be rare, and arbitrators should not be allowed to decide that an award should be expunged. Rather, Finra should establish an internal process that determines whether a particular award or settlement meets stringent expungement criteria.”

The SEC, which has authority over Finra, also should prevent brokers from wiggling out of paying arbitration awards by shutting down their operations or declaring bankruptcy. He cited Finra statistics which show that \$51 million in arbitration awards from 2011 have not yet been fulfilled.

“Current regulations allow brokerages to open with far too little capital — certainly not enough to pay an arbitration award,” Mr. Markey wrote. “The SEC needs to investigate these deadbeat brokers and amend existing or promulgate new rules to address this problem.”

In calling for the reforms, Mr. Markey highlighted a recent report in the Wall Street Journal which said that more than 5,000 brokers who worked for firms thrown out of the industry by Finra are still practicing. He also referred to a recent study by the Public Investors Arbitration Bar Association that showed that expungement was granted more than 90% of the time it is requested by brokers in arbitration cases that were settled from 2007 through 2011.

“If brokers with that number of disciplinary disclosures are allowed to continue practicing, Finra needs to revise its disciplinary system,” Mr. Markey wrote.

Mr. Markey sent letters to both Finra and the SEC on Friday. The SEC declined to comment.

In a statement, Finra said that it has barred more than 2,300 brokers from the industry over the past five years and is reviewing expungement rules.

“FINRA has been actively assessing the expungement process,” the organization said. “We have recently begun to implement changes and will continue to take any and all steps necessary in this and other areas to ensure the integrity of BrokerCheck and strengthen investor protection.”

In response to the PIABA study earlier this month, Finra released a statement saying that the regulator granted 838 expungements following court orders between 2007 and 2011, or less than 5% of the 17,635 arbitration cases filed during that period.

Bryan Ward, a partner at Sutherland Asbill & Brennan LLP, said it’s difficult for brokers to get arbitration claims removed from their records. Their requests are reviewed by arbitrators and then have to be approved by a court.

“It seems like a lot of commotion without a single instance of expungement having been granted improperly,” Mr. Ward said, referring to Mr. Markey’s letter. “It seems to be used appropriately, given the numbers.”

Mr. Ward also said it’s not practical to remove arbitrators from the expungement process.

“The point of the Finra arbitration system is to allow arbitrators to make findings of fact rather than Finra itself,” Mr. Ward said. “It would certainly be a burden on Finra to be making those decisions.”

Nearly every client agreement at brokerages includes a clause requiring mandatory arbitration of investor disputes. Finra operates the arbitration system.

In a statement, Mr. Markey said the investor-protection rules regarding broker disciplinary disclosure that emanated from his legislation more than 20 years ago need to be updated.

“It is unacceptable that some brokers have been able to conceal significant disciplinary information from the public,” Mr. Markey said. “Even worse, it is unacceptable that once a consumer has won an award against a brokers by a securities industry arbitration panel, that some brokers have failed to pay the award that has been ordered. I will continue to call for a most rigorous tracking and disciplinary system.”

By Mark Schoeff Jr.