

## Labor & Employment

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# Working Together to Achieve Accuracy on Regulatory Form U-5

BY TAMMY MARZIGLIANO  
AND CARMEL MUSHIN

For employees who work in the financial service industry, the Uniform Termination Notice for Securities Industry Registration (Form U-5 or U-5) is a critical document, and should be taken very seriously. The Form U-5 is a regulatory form that brokerage firms must file whenever an associated person's registration and employment with the firm is terminated.

The U-5 outlines dates of employment, positions held, which registrations are being terminated, and, most importantly, the reason for the termination of employment. The form also requires an affirmation from the firm verifying the accuracy and completeness of the information contained in the U-5 prior to filing with the Financial Industry Regulatory Authority (FINRA).<sup>1</sup> The accuracy of the U-5 is important because the reported information is used by a number of constituencies for various reasons. For example, firms use the information to help them make informed employment decisions about whom they should hire. Thus, in some respects, the U-5 is an employee's résumé from the employer's perspective. In the

often-uncomfortable context of employer and employee separation, disputes over the contents of a Form U-5 can quickly arise. Therefore, it is essential that employers and employees work together to ensure accuracy in the filing of a Form U-5. If they don't, they can easily find themselves entrenched in burdensome and expensive arbitration with little up-side for either party.

### Form U-5 and What's at Stake

Under Article V, §3 of the FINRA By-Laws, firms are required to file the Form U-5 with FINRA's Central Registration Depository (CRD) no later than 30 days after terminating an associated person's registration. An amended U-5 must be filed if a firm learns of facts that make a previously filed U-5 inaccurate and the firm must also provide the person whose registration has been terminated with a copy (initial or amended) at the same time that it is filed.<sup>2</sup> Once filed, the Form U-5 is shared among national and state regulatory bodies to elicit and collect

information that is relevant to regulators in connection with their licensing and enforcement activities. The U-5 is available to all member firms of FINRA, and those firms review the U-5s of prospective employees before making any hiring decisions. Although public investors cannot access the CRD system itself, a portion of the information contained on the U-5 is made publicly available through FINRA BrokerCheck, which investors and others members of the public use when considering whether to do business with a registered (or formerly registered) person.<sup>3</sup>

The Form U-5 was created to provide transparency to regulators and investors,<sup>4</sup> but it can be a dangerous tool if used with malice by an employer. Even one nega-



tive statement on the Form U-5 can end a career.<sup>5</sup> Many brokerage firms will decline to take a chance hiring individuals with negative marks on their Form U-5.<sup>6</sup> As a result, former employees who believe the information on their U-5 is inaccurate may be forced to bring an arbitration action to correct information contained on the U-5 in an effort to protect their name and clear their record.<sup>7</sup> Employers, on the other hand, must consider their obligation to provide truthful information on the U-5 in at least two respects—their regulatory obligation and the risk of arbitration if an employee challenges the accuracy of the information on the U-5.

Among other things, the U-5 requires firms to report the reason or reasons for an employee's termination and whether he or she was accused of or found to have engaged in investment-related misconduct.<sup>8</sup> Specifically, §3 of the U-5 asks employers to provide the general reasons for termination, and §7 is comprised of disclosure questions.<sup>9</sup> Indeed, most disputes between employers and employees over the contents of the U-5 arise from the information employers provide in these sections of the Form U-5.<sup>10</sup>

In §3, an employer must indicate whether the employee's termination is classified as: "Voluntary," "Deceased," "Permitted to Resign," "Discharged," or "Other."<sup>11</sup> If the employer selects one of the last three, an explanation is required.<sup>12</sup> Sometimes the context of the situation may lend itself to more than one way to describe the reason for termination.

Section 7 of the U-5 consists of a series of "yes" or "no" questions relating to the disclosure of *investment-related* investigations, accusations, customer complaints, regulatory actions, and criminal convictions. For example, question 7B on the Form U-5 asks whether the employee was or is "under internal review for fraud or wrongful taking of property, or violating *investment-related* statutes, regulations, rules or industry standards of conduct." Section 7 also covers misconduct associated with investment-related issues, such as fraud, wrongful taking of property, and felony convictions or charges.

If the answer to any disclosure question is "yes," §7 requires that the employer provide additional details on the appropriate Internal Review Disclosure Reporting Page (DRP), which is then attached and submitted to the CRD along with the Form U-5. Once in the system, the DRP effectively becomes a part of the U-5, meaning that it is equally available for review by prospective employers.

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### U-5 Expungement Process

An employee who seeks to have inaccurate U-5 information completely removed from the CRD system and therefore out of reach of prospective employers must initiate a FINRA arbitration to obtain an expungement order; amendment of the U-5 is not enough. A willing employer may amend a previously filed Form U-5 by changing the language and providing FINRA with an explanation for the amendment.<sup>13</sup> If FINRA approves, the amendment will apply moving forward; however, the pre-amended U-5 is archived in the CRD and therefore remains accessible to prospective employers. For this reason, expungement is the only complete solution once the Form U-5 has been filed. An order of expungement directs CRD personnel to delete from all current and previous U-5 filings any record of the damaging language.

An expungement proceeding, even one that is consented to by both parties, can be onerous. An employee must first initiate an arbitration proceeding with FINRA against the employer. "FINRA can expunge information from the CRD system in intra-industry disputes only to the extent that it is directed to do so in an arbitration award."<sup>14</sup> Rule 13302 of FINRA's Code of Arbitration Procedure for Industry Disputes provides

that an employee initiating arbitration must file (i) a submission agreement confirming the claimant's submission of the dispute to FINRA arbitration, and (ii) a statement of claim outlining the issues, facts, and any remedy being sought, and which may include supporting documents.<sup>15</sup>

Next, under Rule 13303, the respondent employer has 45 days from the date it received the statement of claim to file a submission agreement and answer to the statement of claim, which must include any defenses the employer may assert. After all these documents have been filed, the parties proceed to the process of arbitrator selection by ranking. Unless the parties agree otherwise, a panel of the top three arbitrators selected will preside over the arbitration if the only relief sought is expungement.<sup>16</sup>

Similarly, where the parties have agreed to mutually seek expungement of the Form U-5, they must go through the same process to initiate an arbitration proceeding. However, since the parties can submit documents simultaneously and jointly elect more expedient procedural steps, the process can be less time consuming than in the adversarial context. For example, parties can submit their initial documents together and include a proposed award to help expedite this process. They can also agree in writing to elect a single arbitrator and to avoid a hearing altogether.<sup>17</sup>

After both parties have met all of the procedural prerequisites, the burden is on the employee to persuade the arbitrator or arbitrators that the information contained in the U-5 is defamatory, misleading, inaccurate, or erroneous.<sup>18</sup> If an employee prevails, he or she must have the expungement order confirmed in court.<sup>19</sup> The only exception to this rule is if the award is based on a finding that the language contained in the U-5 is of a defamatory nature.<sup>20</sup>

FINRA will expunge the information, without a court order, if the arbitration panel awards expungement relief based on the defamatory nature of the information contained in the CRD system, and explicitly states in the award that it is recommending expungement on that basis. If, however, the arbitration

panel does not state that it is awarding expungement relief based on the defamatory nature of the information, FINRA will not expunge the information unless the arbitration award is confirmed by a court of competent jurisdiction.<sup>21</sup>

This is the one exception to the moratorium imposed by FINRA (NASD at the time) on expunging information based solely on directions to do so in an arbitration award.<sup>22</sup> The reason the moratorium was imposed relates to potential conflicts with state law.<sup>23</sup> Specifically, state and securities regulators raised concerns that some states consider certain information filed with the CRD system a state record that is not capable of legal expungement by arbitration order.<sup>24</sup> Thus, only in cases where an arbitrator has found that the information is defamatory in nature can the CRD initiate the expungement process absent a court order. Notably, an arbitrator's finding that information contained in the U-5 is defamatory in nature does not mean that the arbitrator has concluded that the employer has committed defamation, and agreeing to expungement on consent does not mean that an employer has conceded that it defamed its former employee.

If an expungement application is granted, it is critical that the order lists in detail each section of the U-5 that needs to be expunged and how it will be modified. For example, when the order seeks expungement of information contained in §3, "the arbitration award should identify the specific filing at issue and address both (1) the reason for termination, and (2) the termination comment."<sup>25</sup> In circumstances where the reason for termination requires an explanation, "the award should provide a termination comment if there is none or replacement language if the original termination comment is to be changed.... The arbitration award should address all references to information in the broker's CRD record that should be expunged."<sup>26</sup>

This is especially important with respect to improperly appended DRPs; it is not enough to indicate that the corresponding §7 question be marked "no" instead of "yes." In cases where an employee's U-5 did not

previously contain information giving rise to the DRP at issue, there must be clear language stating that the DRP itself must be expunged from the U-5.<sup>27</sup> This comes up, for example, when the respondent employer agrees to amend the U-5 after the DRP was filed but before the expungement award was issued. If the award does not specify that the expungement be applied to all versions of the U-5, traces of the DRP will remain accessible by prospective employer in the pre-amendment U-5.

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The expungement of the Form U-5 does not end with a FINRA expungement order or a confirmation in court. The employee must file the award with FINRA's online registration database. From there it can take weeks or even months for the defamatory language and/or the DRP in the U-5 to be amended and expunged. This is because personnel monitoring the CRD must manually go into FINRA's system and re-code a substantial amount of information in order to achieve the goals of the expungement: complete and total erasure of the information found to be defamatory in nature from the database. Best-case scenario, the whole process could take several months.

## Conclusion

Whether the parties are adverse or united in their position on other issues, if employers and employees make a point of engaging in an open conversation about what the Form U-5 will say before it is filed, they might be able to avoid time-consuming and costly arbitration. Often parties can agree on language that meets the employer's obligation to provide truthful information on the U-5 without improperly jeopardizing the employee's interest in securing new employment.

1. See FINRA Regulatory Notice 10-39, "Obligation to Provide Timely, Complete and Accurate Information on Form U5," at 1 (September 2010) [Notice 10-39].

2. *Id.*

3. *Id.*

4. NASD Notice to Members 99-54, "NASD Regulation Seeks Comment on Issues Relating to Arbitrator-Ordered Expungements of Information From the Central Registration Depository," at 351 (July 1999) [Notice 99-54].

5. See, e.g., *Dawson v. N.Y. Life Ins.*, 135 F.3d 1158, 1164 (7th Cir. 1998).

6. See Karen Donovan, "A License to Lie," Registered Rep., May 1, 2007, at 51.

7. See Thomas J. Kavaler, et al., "An Overview of Industry Arbitration," Practising Law Institute, Corporate Law and Practice Course Handbook Series: Securities Arbitration 669, 704 (1991).

8. FINRA, Form U-5: Uniform Termination Notice for Securities Industry Registration (05/2009) [FINRA Form U-5], available at <http://www.finra.org/web/groups/industry/@ip/@comp/@regis/documents/appsupportdocs/p015114.pdf>.

9. See FINRA Form U-5, at 7-8.

10. See Dayna B. Tann, "Licensing a Lie: The Privilege Attached to the Form U-5 Should Reflect the Realities of the Workplace," 83 St. John's L. Rev. 1017, 1021 (2009); David A. Lipton, "Broker-Dealer Registration Process: Matters Incidental to Registration," 15 Broker-Dealer Reg. §2:22.

11. See FINRA Form U-5, at 1.

12. *Id.*

13. See Notice 10-39, at 1.

14. See John Nachmann, "Expungement of Information From the Central Registration Depository in Intra-Industry Disputes," FINRA's The Neutral Corner, Vol. 2, at 3 (2010) [FINRA's The Neutral Corner].

15. FINRA Code of Arbitration Procedure for Industry Disputes, R. 13302, available at [http://finra.complinet.com/en/display/display\\_main.html?rbid=2403&element\\_id=4193](http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=4193) [FINRA Industry Code of Arbitration].

16. See FINRA Industry Code of Arbitration, R. 13401(c) ("[I]f the claim does not request money damages, the panel will consist of three arbitrators, unless the parties agree in writing to one arbitrator[.]").

17. See *Id.*; R. 13600(a) ("Hearings will be held, unless: ... (a) The parties agree otherwise in writing.").

18. See Notice 99-54, at 352.

19. *Id.*

20. *Id.*

21. See FINRA's The Neutral Corner, at 3.

22. See NASD Notice to Members 99-09, "NASD Regulation Imposes Moratorium on Arbitrator-Ordered Expungements of Information from the Central Registration Depository" at 47-8 (February 1999) [Notice 99-09]; see also FINRA Rule 2080 (formerly NASD Rule 2130) Frequently Asked Questions, available at <http://www.finra.org/Industry/Compliance/Registration/CRD/FilingGuidance/P005224>.

23. See Notice 99-09, at 47.

24. *Id.*

25. See FINRA's The Neutral Corner, at 4.

26. *Id.*

27. See *id.*