



NASAA

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August 17, 2009

Ms. Elizabeth M. Murphy  
Secretary  
Securities and Exchange Commission  
100 F. Street, NE  
Washington, DC 20549

**Re: Proposed Rule Change Petition Submitted by the Public Investors  
Arbitration Bar Association (“PIABA”) on June 11, 2009**

Dear Ms. Murphy:

The North American Securities Administrators Association, Inc. (“NASAA”)<sup>1</sup> has a long record of advocating for the fair treatment of investors as they seek to resolve disputes with financial services intermediaries. Our commitment to this goal has led us to support efforts to improve the current dispute resolution process as well as efforts to give investors a meaningful choice when it comes to picking a dispute resolution forum. The proposal to eliminate the industry arbitrator requirement as embodied in PIABA’s rule-making petition is but one step, albeit an important one, to improve a process that is sorely in need of reform. Therefore, we are pleased to submit this letter in support of PIABA’s petition and to call again for additional changes to the dispute resolution process that will serve the interests of investors.

**Eliminate Mandatory Pre-Dispute Arbitration Provisions**

NASAA has publicly supported legislation designed to prohibit broker-dealers from requiring investors to accept mandatory arbitration clauses in customer account agreements. In 2007 we testified to this effect before the Constitution Subcommittee of the Senate Judiciary Committee. In our testimony in support of the “Arbitration Fairness Act of 2007,” NASAA highlighted the impact on investors of the U.S. Supreme Court’s decision in *Shearson/American Express Inc. v. McMahon*, 482 U.S. 220 (1987), which held that predispute arbitration clauses were enforceable in the securities context. Specifically, the impact of that decision is more profound today because the profile of those investing in our capital markets has changed significantly since the *McMahon* case was decided in 1987. Twenty years ago, those investing in the securities markets were

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<sup>1</sup> The oldest international organization devoted to investor protection, the North American Securities Administrators Association, Inc., was organized in 1919. Its membership consists of the securities administrators in the 50 states, the District of Columbia, the U.S. Virgin Islands, Canada, Mexico and Puerto Rico. NASAA is the voice of securities agencies responsible for grass-roots investor protection and efficient capital formation.

less dependent on the performance of their investments to fund their retirements or pay for a child's education.

Another significant change since the Supreme Court's decision is the proliferation of the use of predispute arbitration provisions. Investors essentially no longer have a choice when it comes to deciding on the appropriate forum for addressing disputes with their financial services professionals. Today, almost every broker-dealer includes in their customer agreements, a predispute arbitration provision that forces public investors to submit all disputes that they may have with the firm and/or its associated persons to a mandatory arbitration process administered by the Financial Industry Regulatory Authority ("FINRA). It is, therefore, somewhat ironic that the only chance of recovery for most investors who fall victim to wrongdoing on Wall Street is through a single securities arbitration forum administered by the securities industry.

It is not surprising that many investors view industry arbitration as biased and unfair – an opinion that has, in fact, been substantiated by various studies conducted of the FINRA dispute resolution system. For example, in the study conducted by Edward S. O'Neal and Daniel S. Solin, entitled "*Mandatory Arbitration of Securities Disputes, A Statistical Analysis of How Claimants Fare*" and cited in the PIABA petition, the authors concluded that for the time period 1999 through 2004 claimant win rates and the amount of awards versus damages claimed declined.<sup>2</sup> The PIABA petition further notes that claimants still fare no better, the "win" rate in 2008 being 42 percent.<sup>3</sup> It is noteworthy that a "win" in arbitration often amounts to recovery of only a fraction of the losses incurred by the investor and, in certain instances, the sum awarded amounts to less than the costs and fees the investor paid out of pocket to pursue the case.<sup>4</sup>

Also cited in the PIABA petition is a more recent review of the arbitration process entitled "*Perceptions of Fairness of Securities Arbitration: An Empirical Study.*"<sup>5</sup> This study surveyed participants in the arbitration process and, based on responses to the survey questions, concluded that individual investors have negative views of arbitration. This conclusion supports the assertion that, from the investors' standpoint, the system is biased against them.

FINRA should require its member firms to offer their customers a meaningful choice between binding arbitration and civil litigation. If it is true that arbitration is fair, inexpensive, and efficient, as its adherents claim, then these benefits will prompt investors to choose arbitration. If, on the other hand, arbitration does not offer these advantages, then this mode of dispute resolution should not be forced upon the investing public. NASAA believes the "take-it-or-leave-it" clause in brokerage contracts is inherently unfair to investors, and we will continue to support efforts to end this practice.<sup>6</sup>

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<sup>2</sup>Cited in the rule-making petition at page 11 and available at [www.slcg.com/pdf/news/Mandatory%20Arbitration%20Study.pdf](http://www.slcg.com/pdf/news/Mandatory%20Arbitration%20Study.pdf)

<sup>3</sup>Rule-making petition at page 12.

<sup>4</sup>In our own review of arbitration awards NASAA has observed instances in which panels have awarded a token amount of damages while assessing forum fees that are slightly less than the award and, in a few cases, actually exceeded the award.

<sup>5</sup>Cited in the rule-making petition at page 10 and available at [www.law.pace.edu/files/finalreporttosica.pdf](http://www.law.pace.edu/files/finalreporttosica.pdf).

<sup>6</sup>NASAA's legislative agenda for the 111<sup>th</sup> Congress reiterated our support for the "Arbitration Fairness Act of 2007."

## **Eliminate the Requirement for an Industry Arbitrator**

Securities arbitration cases involving claims of at least \$100,000 are heard by a three-member panel that includes one “non-public” or securities industry member, and two “public” members, who may have ties to the industry. Many proponents of the current system have justified mandatory industry participation based on the industry representative’s role as an educator for the other panelists. This might be a colorable argument in instances where all parties voluntarily agree that an industry expert is needed. However, if there is no agreement then there is no justification for the industry presence on the panel. First and foremost, expert witnesses ably serve the purpose of educating the arbitrators. In addition, where arbitration was once selected on a voluntary basis by investors seeking to handle simple disputes, the advent of mandatory arbitration moved all customer grievances to a more sophisticated arbitration process. Cases are typically presented by lawyers, they generally last for several days and the use of retained expert witnesses to present industry practices, procedures and rules to the panels is typical.

The very notion of having a matter heard by a panel of independent arbitrators assumes that they come to the arbitration process with no preconceived opinion or interest in any party or issue involved in the conflict. However, industry arbitrators bring their particular experiences, based on their firm’s training, policies and procedures, to the decision-making process. As evidenced by industry scandals and regulatory enforcement actions, the industry’s way of doing things is not always in conformance with the law. Even if the industry arbitrator has no preconceived notions, the industry arbitrator creates a presumption of bias that is contrary to the principles of fair play and justice.

Additionally, one could readily conclude that the assertion that arbitrators must be “educated” by an industry-affiliated panelist indicates that the current training of arbitrators is inadequate. While a pool of uneducated arbitrators is a serious problem, there are ways to correct this which will not taint the average investor’s view of a currently mandatory process.

FINRA has made much of a recent pilot program it implemented whereby a limited number of firms, in a limited number of cases, agreed to a panel consisting of all public arbitrators. FINRA believes that the pilot program should be allowed to run its course through October 2010 before undertaking any efforts to expand it to all arbitrations. NASAA, though supportive of the pilot program as a step in the right direction, maintains that FINRA must do more. As stated in our announcement regarding the pilot program, investor protection demands that all investors be given the opportunity to have their disputes heard by panels that do not include an industry arbitrator. A sufficient number of studies have been conducted and they clearly point to the conclusion that the FINRA dispute resolution process is flawed. Pilot programs and further studies, no matter how well intentioned, will not remedy the problems.

Thank you for the opportunity to comment on the rule-making petition and should you have any questions or wish to discuss the matters raised herein please contact me at your convenience.

Sincerely,

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Rex A. Staples  
General Counsel  
North American Securities Administrators Association