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NASAA

December 10, 2010

Ms. Elizabeth M. Murphy
Secretary
U. S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Release No. 34-63250; File No. SR-FINRA-2010-053

Dear Ms. Murphy:

The North American Securities Administrators Association, Inc. ("NASAA") hereby submits the following comments in response to Proposal SR-FINRA-2010-053 submitted by the Financial Industry Regulatory Authority, Inc. ("FINRA") to amend the Panel Composition Rule and other related rules of the Code of Arbitration Procedure for Customer Disputes. Although NASAA remains opposed to mandatory pre-dispute arbitration because it denies investors a choice in forum to resolve their disputes, this proposal greatly improves the existing system and is long overdue.

NASAA applauds FINRA's decision to provide all customers with disputes over $100,000 with the opportunity to choose a panel of arbitrators without a non-public/industry-affiliated member. However, the exercise of this option as proposed contains traps for the unwary, particularly by pro se customers (individual investors representing themselves), and we urge FINRA to address those problems. NASAA advocates implementation of the following improvements to the proposed rules. As proposed, the customer must indicate his choice of an All-Public Panel within 35 days of service of the Statement of Claim before any arbitrator lists are generated, and failure to indicate a choice will default to a "majority public" panel. The rule does not address whether the customer will receive any notice of this option at the time of filing, a standard form to indicate their selection, or a reminder of the deadline for making such an option. NASAA strongly believes the initial default provision in customer arbitrations should be the All-Public panel. If the All-Public panel is not the initial default, FINRA must provide mechanisms to ensure that customers are adequately instructed on how to properly exercise this option.

Another concern regarding the proposed structure is that pro se investors may be confused when they receive a list of industry arbitrators after having chosen the All-Public panel option initially.[1] In this circumstance, FINRA must clearly explain that the customer has the

[1] NASAA is troubled by the confusing terms used in describing the panel composition and the arbitrators themselves. "Non-public" in reality mean industry-affiliated. It would be much more clear if the panels were

right to strike all arbitrators on that list, and further, that if they do not strike all the names, an industry arbitrator will be appointed to the panel despite the customer's initial choice of an All-Public panel. One method of clarifying this might be to color-code the page with the industry arbitrators on it, with an option at the top of the list permitting them to strike all industry arbitrators by checking one box. FINRA must also explain that if they do not return the lists to FINRA on time, an industry arbitrator will be included on their panel. Addressing these potential pitfalls by making the All-Public panels the initial default option and providing ample notice of the procedures and how to follow them in order to preserve their choice of an All-Public panel would largely alleviate these concerns and permit NASAA to wholeheartedly endorse this proposal.

Perceived Fairness and Neutrality

As recognized in many other comments, NASAA believes this option makes arbitration less prejudicial to customers, hopefully in outcome as well as perception.[2] If the results of FINRA's Public Arbitrator Pilot Program are borne out, we expect this will be the case.[3] Proponents of the current system argue that there is no evidence that the perception of evidence is warranted. We believe the pilot program results have provided such evidence. As recognized by Professors Black and Gross in their comment letter dated 12/3/10, "customers' perceptions of fairness are important to the integrity of the dispute resolution process." This is particularly important where, as here, the award provides no explanation of findings or reasoning, and gives virtually no basis for an appeal. The study conducted by Black and Gross produced empirical findings documenting that investors had serious concerns about the fairness of the system, which would be significantly alleviated with this proposal. NASAA incorporates and reiterates their position.

Industry Arbitrators Not Necessary or Neutral

Many proponents of the current system justify the mandatory arbitrator as a "free" subject matter expert who can educate the other panelists as a benefit to both parties. This might be a colorable argument where all parties voluntarily agree that an industry expert is needed, and that the particular industry arbitrator is appropriately neutral. This would only occur in rare instances, since in complex cases where an expert is required or an industry-wide practice is

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described as "mixed affiliation" rather than "majority public" and if the "non-public" arbitrators were described as "industry-affiliated."

[2] For a detailed explanation of investors' perceptions of the current system, please read the comment letter submitted on 12/3/10 by Professors Barbara Black and Jill Gross, based upon their study for SICA, *When Perception Changes Reality: An Empirical Study of Investors' Views of the Fairness of Securities Arbitration*, 2008 J DISP. RESOL. 349.

[3] Proponents of the current system also argue without citation that the current system is less expensive and more efficient than litigation. There are virtually no court cases to compare since 1987, because mandatory pre-dispute provisions became standard in the industry, and investors lost their right to go to court in this type of case. What we do know is that filing and jury fees are typically much lower in court than in FINRA arbitration, and that there are no forum fees in court. In court, certain expenses are taxed to the unsuccessful party. In a typical case, discovery expenses are likely to be similar with the exception of depositions in court cases. However, this expense may be less than the forum fees, and discovery depositions serve a beneficial purpose of adding some certainty that makes settlement negotiations more informed. If FINRA arbitration is truly a less expensive and more efficient option, investors will continue to choose it even if given the right to go to court.

challenged, the parties are better served by retaining their own experts who testify on the record and can be cross-examined.

The very notion of a panel of neutrals assumes the arbitrators come to the process with no preconceived opinion or interest in any party or issue involved in the conflict. Industry arbitrators bring their own particular experiences, based on their firm's training, policies and procedures, to the decision-making process, creating an unavoidable bias. As evidenced by industry scandals and regulatory enforcement actions, the industry's way of doing things does not necessarily conform to the law. Even where 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 without tainting the average investor's view of the currently mandatory process, and focusing on the law as opposed to industry practice.

Specious Procedural Protection

SIFMA argues in its comment letter that without a mandatory industry arbitrator on the panel in cases involving individual brokers, those brokers will somehow lose important "procedural protections." If the current system intended to provide "procedural protections" to those in the industry by mandating an industry arbitrator, it should be no surprise that investors see this as biased. FINRA arbitration is the only forum available to the customers, however, they receive no comparable "procedural protection" requiring an investor advocate on the panel. The truth is that the individual brokers lose no procedural protection here – the broker has no more right to an industry arbitrator on the panel than a doctor has a right to a doctor on the jury in a medical malpractice case. The same potential for "damage" exists in both venues, so if such a "right" exists, certainly the courts would have a similar requirement. As the common law and rules of evidence recognize, the *only* appropriate and fair way for the factfinder to be educated about the industry is by experts subject to cross-examination. Even when the expert is court-appointed, both parties have the opportunity to cross-examine the expert. Especially where investors are prevented from seeking justice in the court system by pre-dispute, mandatory arbitration provisions, the important evidentiary considerations underpinning these rules should be respected.

NASAA urges adoption of the proposed amendments to FINRA's Panel Composition Rule, and we look forward to continuing to work closely with FINRA on further improvements to the securities arbitration process. Questions concerning this letter can be addressed to Leslie Van Buskirk, at Leslie.VanBuskirk@dfi.wisconsin.gov or Rex Staples, NASAA General Counsel at re@nasaa.org.

Sincerely,
/S/
Leslie Van Buskirk
Chair, NASAA Arbitration Project Group