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To Be Discussed at the June 5, 2025 meeting of the SEC Investor Advisory Committee

Recommendation of the SEC Investor Advisory Committee's Disclosure Subcommittee Regarding the Use of Mandatory Arbitration Clauses By Registered Investment Advisers

On December 10, 2024, the SEC's Investor Advisory Committee hosted a panel discussion entitled, "Examining the use of mandatory arbitration clauses by Registered Investment Advisers."

The Committee heard from the following panelists:

- Stacy A. Puente, Ombuds and Assistant Director, Office of the Investor Advocate, U.S. Securities and Exchange Commission
- Kevin Carroll, Deputy General Counsel, Litigation and Private Client (Legal), Securities Industry and Financial Markets Association (SIFMA)
- Robin Traxler, Senior Vice President, Policy and Deputy General Counsel, Financial Services Institute (FSI)
- Adam Gana, Partner at Gana Weinstein LLP and President of the Public Investors Advocate Bar Association (PIABA), and
- Stephen Brey, State of Michigan, Department of Licensing and Regulatory Affairs, Corporations, Securities, and Commercial Licensing Bureau, Securities and Audit Division and Vice-Chair of the Investment Adviser Section Committee and Co-Chair of the Investment Adviser Regulatory Policy & Review Project Group at NASAA.

The panel's focus was on the use and scope of mandatory arbitration clauses by registered investment advisers and the impact of such clauses on clients. The panelists discussed the use of mandatory arbitration clauses by registered investment advisers and compared the use and contents of mandatory arbitration clauses by brokerage firms. Ms. Puente specifically discussed the details of a 2023 study issued by the SEC's Ombuds Office in coordination with the Office of Investor Research and the Investor Advocate Office of Chief Counsel. The panelists also discussed the costs, concerns, and benefits of predispute arbitration clauses. Overall, the panel discussion highlighted the lack of harmonization governing the use and scope of predispute arbitration clauses by investment advisers and brokerage firms.

Background

Arbitration has a long history in the securities industry, especially by brokerage firms. In 1977, the Self-Regulatory Organizations (SROs), including at the time the NASD (FINRA's predecessor) and the NYSE, formed the Securities Industry Conference on Arbitration, SICA.[1] The purpose of SICA initially was to develop uniform rules governing SRO arbitrations between brokerage firms and customers.[2]

[1] See SEC Audit 289, *Oversight of Self-Regulatory Organization Arbitration* (Aug. 24, 1999), available at https://www.sec.gov/about/oig/audit/289fin.pdf.
[2] *See id*.

SICA developed a Uniform Code of Arbitration Procedure, which was adopted by the SROs between 1979 and 1980.[3]

To this day, the Uniform Code is the foundation for the FINRA Code of Arbitration for Customer Disputes.[4]

Notwithstanding this history, arbitration agreements have not always been enforceable. In 1953, the Supreme Court determined that an agreement to arbitrate future controversies was void under §14 of the Securities Act of 1933 because it was deemed to be a "stipulation" binding the customer to "waive compliance" with a "provision" of the Act.[5] In 1987, the Supreme Court overturned its 1953 decision and determined that arbitration of federal securities claims was, in fact, permissible.[6]

By 1992, arbitration clauses were becoming more widely used by brokerage firms. A 1992 study by the U.S. General Accounting Office (the GAO) found that at large firms, arbitration clauses were generally not required for individual cash accounts or institutional accounts, however, were required for individual investors' margin and options accounts.[7] The GAO also found that about 40% of small and medium firms required arbitration clauses for individual cash and institutional accounts, and 70% of small firms and 90% of medium firms required arbitration clauses for individual margin and options accounts.[8] Large firms reported that they did not plan to change their use of arbitration clauses, while small and medium firms that had not previously required arbitration reported that they planned to begin using such clauses.[9] Today, nearly all brokerage firms require arbitration clauses in their customer accounts.[10]

Concerns about arbitration resurfaced in connection with the financial crisis of 2008. In 2010, Congress adopted the Dodd-Frank Wall Street Reform and Consumer Protection Act.[11] Section 921(a) and (b), in response to concerns "that mandatory pre-dispute arbitration is unfair to the investors," [12] amended the Securities Exchange Act of 1934 and the Investment Advisers Act of 1940, and gave the SEC the authority:

> by rule, [to] prohibit, or impose conditions or limitations on the use of, agreements that require customers or clients of any [broker, dealer, or municipal securities dealer

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[3] *See id. See also*, SEC Release No. 34-15984, *Broker-Dealers Concerning Clauses in Customer Agreements Which Provide for Arbitration of Future Disputes* (July 10, 1979), available at https://archives.federalregister.gov/issue_slice/1979/7/10/40461-40465.pdf

[4] *See* FINRA Rules 12000, *et seq.*, available at https://www.finra.org/rules-guidance/rulebooks/finra-rules.

[5] *See* Wilko v. Swan, 346 U.S. 427 (1953).

[6] *See* Shearson/American Express Inc. v. McMahon, 482 U.S. 220 (1987).

[7] *See* U.S. General Accounting Office, *Securities Arbitration; How Investors Fare* (May 1992), available at https://www.gao.gov/assets/ggd-92-74.pdf.

[8] *See id*.

[9] *See id*.

[10] Kevin Carroll, *Securities Arbitration System Works Effectively and Benefits Investors*, SIFMA (Oct. 5, 2021), available at https://www.sifma.org/resources/news/blog/securities-arbitration-system-works-effectively-and-benefits-investors/.

[11] Public Law 111-203, 124 Stat. 1376 (2010)

[12] S. Rep. No.111-176, 110 (Apr. 30, 2010). The Senate Report noted the support for the provision by AARP, NASAA, the Consumer Federation of America, and PIABA.

> or investment adviser] to arbitrate any future dispute between them arising under the Federal securities laws, the rules and regulations thereunder, or the rules of a self-regulatory organization if it finds that such prohibition, imposition of conditions, or limitations are in the public interest and for the protection of investors.[13]

The SEC has not yet exercised this authority.

Presently, the rules governing the use of predispute arbitration clauses vary depending on whether the clause is used by a broker, an SEC-registered investment adviser, or a state-registered investment adviser.

Brokerage Firm Arbitration Clauses

FINRA oversees the brokerage firm industry and has adopted rules governing the use of predispute arbitration clauses.[14] Pursuant to the rule, any predispute arbitration clause must be highlighted and preceded by the following language:

> This agreement contains a predispute arbitration clause. By signing an arbitration agreement the parties agree as follows:
>
> > (1) All parties to this agreement are giving up the right to sue each other in court, including the right to a trial by jury, except as provided by the rules of the arbitration forum in which a claim is filed.
> >
> > (2) Arbitration awards are generally final and binding; a party's ability to have a court reverse or modify an arbitration award is very limited.
> >
> > (3) The ability of the parties to obtain documents, witness statements and other discovery is generally more limited in arbitration than in court proceedings.
> >
> > (4) The arbitrators do not have to explain the reason(s) for their award unless, in an eligible case, a joint request for an explained decision has been submitted by all parties to the panel at least 20 days prior to the first scheduled hearing date.
> >
> > (5) The panel of arbitrators may include a minority of arbitrators who were or are affiliated with the securities industry.
> >
> > (6) The rules of some arbitration forums may impose time limits for bringing a claim in arbitration. In some cases, a claim that is ineligible for arbitration may be brought in court.

[13] 15 U.S. Code § 78o(o) and 15 U.S. Code § 80b-5(f).
[14] FINRA Rule 2268, available at https://www.finra.org/rules-guidance/rulebooks/finra-rules/2268.

> (7) The rules of the arbitration forum in which the claim is filed, and any amendments thereto, shall be incorporated into this agreement.[15]

Additionally, firms are prohibited from including any condition that:

> (1) limits or contradicts the rules of any self-regulatory organization;
>
> (2) limits the ability of a party to file any claim in arbitration;
>
> (3) limits the ability of a party to file any claim in court permitted to be filed in court under the rules of the forums in which a claim may be filed under the agreement;
>
> (4) limits the ability of arbitrators to make any award.[16]

FINRA also prohibits the use of class action waivers.[17]

FINRA rules require that brokerage firms consent to FINRA as an available arbitration forum at the election of the customer, even if another forum is designated in the agreement, and even in the absence of a written agreement.[18]

FINRA sets the venue of the arbitration proceeding in the hearing location closest to the customer's residence at the time of the events giving rise to the dispute.[19] If the arbitration is before a single arbitrator, that arbitrator will be a public arbitrator, meaning the person may not be associated with a broker or dealer, associated with the CFTC, NFA, or MSRB, or an investment company or an investment adviser.[20] In the event the arbitration is held before three arbitrators, either party – the customer or the brokerage firm may elect to have an all-public panel of arbitrators.[21]

FINRA has established a small claims process for claims with damages of $50,000 or less.[22] These claims may be considered on the basis of written submissions, or by a specialized streamlined hearing process.[23] This has the effect of significantly reducing the cost of the process and the time frame from filing to decision.

FINRA has set fees for the arbitration which differentiate between customers and firms. The customers pay a lower portion of the fees up front.[24] There are member surcharges that are fully paid by the brokerage industry.[25] FINRA has also established rules governing the timing of filing claims[26]

[15] FINRA Rule 2268(a).
[16] FINRA Rule 2268(d).
[17] FINRA Rule 2268(f).
[18] FINRA Rule 12200.
[19] FINRA Rule 12213.
[20] FINRA Rule 12100(aa).
[21] FINRA Rule 12403(c).
[22] FINRA Rule 12800.
[23] *Id*.
[24] FINRA Rule 12900.
[25] FINRA Rule 12901.
[26] FINRA Rule 12206.

and answers[27] and the types of motions to dismiss which may be filed.[28] Finally, FINRA has established a discovery guide which sets forth the presumptively discoverable documents for both customers and firms,[29] as well as a process by which other discovery requests may be made.[30] Arbitrators are required to issue a written award, although it need not contain any explanation for its decision.[31] Arbitration awards are publicly available on FINRA's website.[32]

FINRA also makes available comprehensive statistics about its arbitration forum.[33] It discloses how many cases are filed each year, how many cases are resolved, and the average turnaround time from filing to resolution.[34] It includes details about the top 15 controversy types alleged in customer arbitrations, as well as the top 15 types of securities complained about.[35] It includes details about how cases close – after a hearing, settlement, mediation, or withdrawal, as well as results of cases that resolve with an award.[36] FINRA also includes information about its hearing site locations, including the numbers and types of arbitrators assigned to each location.[37]

If an arbitration complaint is filed against a broker, that complaint must be disclosed on the broker's U4 or U5 and is then made available on BrokerCheck.[38] If an arbitration award is issued against a broker, that is also disclosed on BrokerCheck, as are any arbitration awards issued against brokerage firms.[39]

SEC-registered Investment Adviser Arbitration

In January 2023, the SEC's Ombuds Office, in coordination with the Office of Investor Research and the Investor Advocate Office of Chief Counsel, launched a study to evaluate: (1) the occurrence of mandatory arbitration clauses in SEC-registered investment adviser agreements; (2) the occurrence of certain restrictive terms in mandatory arbitration clauses, such as damage limitations and class action waivers; (3) the frequency of SEC-registered adviser arbitration; (4) the frequency of unpaid arbitration awards among SEC-registered advisers; and (5) the effects of mandatory arbitration clauses on clients harmed by their advisers.[40] The study was conducted in response to concerns

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[27] FINRA Rule 12303.
[28] FINRA Rule 12504.
[29] FINRA Rule 12506.
[30] FINRA Rule 12507.
[31] FINRA Rule 12904.
[32] FINRA, *Arbitration Awards Online*, available at https://www.finra.org/arbitration-mediation/arbitration-awards.
[33] FINRA, *Dispute Resolution Services Statistics*, available at https://www.finra.org/arbitration-mediation/dispute-resolution-services-statistics.
[34] *Id*.
[35] *Id*.
[36] *Id*.
[37] *Id*.
[38] FINRA Rule 8312.
[39] *Id*.
[40] *See* SEC Office of the Ombuds and Office of the Investor Advocate, *Mandatory Arbitration among SEC-Registered Investment Advisers* (June 2023), available at https://www.sec.gov/files/2023-oiad-ria-mandatory-arbitration-report.pdf. *See also, SEC Office of the Investor Advocate, Fiscal Year 2023 Report on Activities* (Dec. 5, 2023), available at https://www.sec.gov/files/2023-oiad-annual-report.pdf.

raised by the U.S. House of Representative's Committee on Appropriations, which directed the SEC to "gather detailed information about how such contracts are used by SEC-registered investment advisers and the effect such contracts have on investors who are harmed by the conduct of advisers."[41] The findings of the study were published in June 2023.[42]

During the panel, Ms. Puente presented the findings of the Study. Of the advisory agreements reviewed, 61% included mandatory arbitration clauses.[43] Of those agreements including mandatory arbitration clauses, 92% designated a specific dispute resolution forum, with the American Arbitration Association (AAA) being the most frequently designated.[44] When a clause designated specific forum rules, 83% of the time the clauses designated the AAA commercial rules.[45] Ms. Puente commented that commercial rules are intended to be used for business-to-business disputes. When the arbitration clauses designated a hearing venue, 97% of the time it did not consider the client's location.[46]

In terms of conditions included with the arbitration clauses, 6% included class action waivers, 5% limited the types of claims that could be asserted, 11% limited the potential damages, and 18% included fee-shifting provisions.[47] Ms. Puente also pointed out that investment advisers are not required to disclose the presence of mandatory arbitration clauses in their SEC filings; rather they are required to disclose material information which is determined by the adviser.[48] Investment advisers are also not required to disclose arbitration awards unless deemed material.[49]

Over the course of the Study, the SEC met with eight external stakeholder groups: American Association of Individual Investors, Better Markets, FINRA, Financial Services Institute, Investment Adviser Association, North American Securities Administrators Association, PIABA, and SIFMA.[50] Ms. Puente summarized that most of the stakeholders agreed that disclosure about arbitrations should be disclosed more consistently.[51]

Finally, Ms. Puente presented the recommendations and conclusions that were presented in the Investor Advocate's Report on Objectives for Fiscal Year 2023.[52] The first recommendation was that the SEC should require consistent disclosure of customer arbitration information for SEC-registered

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[41] U.S. House of Representatives, Financial Services and General Government Appropriations Bill, 2023 at p. 103 – 104 (June 17, 2022), available at https://docs.house.gov/meetings/AP/AP00/20220624/114951/HMKP-117-AP00-20220624-SD002.pdf.
[42] *Id*.
[43] SEC Investor Advisory Committee Meeting Webcast Archive (Part 1) (Dec. 10, 2024), testimony of Stacy Puente, available at https://www.youtube.com/watch?v=Kjhjyd6ve4Y.
[44] *Id*.
[45] *Id*.
[46] *Id*.
[47] *Id*.
[48] *Id*.
[49] *Id*.
[50] *Id*.
[51] *Id*.
[52] *Id*.

investment advisers and brokerage firms.[53] Ms. Puente did note however, that it would be difficult to evaluate the truth or fulsomeness of the disclosures given the privatized nature of investment adviser arbitration.[54] The next conclusion was that the restrictive clauses included in investment adviser arbitration clauses may violate an investment adviser's fiduciary duties owed to their clients.[55] Ms. Puente also presented steps investors may take to protect themselves, including reviewing the terms of any arbitration clauses and asking investment advisers about pending or past client arbitrations or litigations.[56]

State-registered Investment Adviser Arbitration

During the panel, Mr. Brey discussed arbitration clauses for state-registered investment advisers. Mr. Brey described the different approaches states take when considering mandatory arbitration clauses.[57] Certain states, including Virginia and Ohio, prohibit mandatory arbitration clauses.[58] Some states take the position that the civil liability provisions within the state's securities acts entitle investors to file disputes in court.[59] Some states consider the inclusion of a mandatory arbitration clause as a violation of the investment adviser's fiduciary duty.[60] Other states do not take issue with mandatory arbitration clauses, but rather examine the use of unfair cost assignments or venue provisions.[61] Mr. Brey suggested that the IAC consider recommending that the SEC utilize its Section 921 authority to prohibit mandatory pre-dispute arbitration provisions in investment adviser contracts or to, at least, prohibit mandatory arbitration clauses that effectively deprive investors of a chance to have their claims heard in a fair forum.[62] Mr. Brey also suggested amendments to Form ADV Parts 1 and 2A that would be designed to gather additional information on the use of pre-dispute mandatory arbitration clauses by investment advisers.[63]

Costs, Concerns, and Benefits of Arbitration

During the panel, Ms. Puente presented a comparison of the costs of pursuing an arbitration through FINRA and under the AAA Commercial Rules.[64] The filing fees for a FINRA arbitration ranged from $50

[53] *Id*.
[54] *Id*.
[55] *Id*.
[56] *Id*.
[57] SEC Investor Advisory Committee Meeting Webcast Archive (Part 1) (Dec. 10, 2024), testimony of Stephen Brey, available at https://www.youtube.com/watch?v=Kjhjyd6ve4Y.
[58] *Id*.
[59] *Id*.
[60] *Id*.
[61] *Id*.
[62] *Id*.
[63] *Id*. Mr. Gana also discussed the potential for amendments to the Form ADV to promote disclosure. See Adam Gana, James Fallows Tierney, and Zahra Hodjat, *Arbitration of Investment Adviser Disputes is Unfair*, Case Western Reserve Law Review (forthcoming) (2025), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=5146785.
[64] SEC Investor Advisory Committee Meeting Webcast Archive (Part 1) (Dec. 10, 2024), testimony of Stacy Puente, available at https://www.youtube.com/watch?v=Kjhjyd6ve4Y.

to $2,300; and for a AAA commercial case the filing fees ranged from $925 to $11,000.[65] Mr. Gana presented similar information.[66]

Ms. Puente also discussed the potential costs that may be incurred by an investor if the investment adviser has designated an inconvenient venue.[67] For example, if the investment adviser is located in Alaska and the investor is located in Florida, there would be travel costs for the investor to get to Alaska for the hearing.[68]

Ms. Puente also summarized the perspectives about the concerns and benefits of mandatory arbitration that were shared by stakeholders as part of the Study.[69] In terms of benefits, arbitration simplifies the dispute resolution process, in part by limiting discovery and foreclosing the right to appeal.[70] Additionally, arbitration maximizes privacy during and after the arbitration process.[71] It may also increase the predictability and efficiency of the process by designating a known forum which has familiar rules.[72]

In terms of concerns, critics of mandatory arbitration generally believed the clauses were contracts of adhesion, and the selection of forum, rules, and venues were sometimes made to benefit the investment adviser at the expense of the investor.[73] Limited discovery could limit investor access to relevant evidence, and the lack of appeal prevented any review of arbitrator decisions.[74]

During the panel, Mr. Carroll also discussed the benefits of arbitration: that it is typically faster and less expensive, that decisions are faster and final, and that information may be kept private.[75] Mr. Carroll also acknowledged that investors should have the benefit of a conspicuous clause that puts the investor on fair notice that future disputes will be resolved in arbitration, and access to a forum that provides prompt resolution of disputes, fair and transparent procedural rules, and fair outcomes.[76]

Mr. Gana also acknowledged that arbitration may have benefits and can be faster and less expensive than litigation.[77] Mr. Gana used examples of investment adviser contracts to demonstrate the

[65] *Id.*
[66] SEC Investor Advisory Committee Meeting Webcast Archive (Part 1) (Dec. 10, 2024), testimony of Adam Gana, available at https://www.youtube.com/watch?v=Kjhjyd6ve4Y.
[67] SEC Investor Advisory Committee Meeting Webcast Archive (Part 1) (Dec. 10, 2024), testimony of Stacy Puente, available at https://www.youtube.com/watch?v=Kjhjyd6ve4Y.
[68] *Id.*
[69] *Id.*
[70] *Id.*
[71] *Id.*
[72] *Id.*
[73] *Id.*
[74] *Id.*
[75] SEC Investor Advisory Committee Meeting Webcast Archive (Part 1) (Dec. 10, 2024), testimony of Kevin Carroll, available at https://www.youtube.com/watch?v=Kjhjyd6ve4Y.
[76] *Id.*
[77] SEC Investor Advisory Committee Meeting Webcast Archive (Part 1) (Dec. 10, 2024), testimony of Adam Gana, available at https://www.youtube.com/watch?v=Kjhjyd6ve4Y.

concerns, explaining the potential impact on investors.[78] Mr. Gana discussed that hedge clauses may limit the liability of investment advisers in ways that would not happen in court.[79] Mr. Gana also discussed the increased costs and inconvenience that may result from venue selection and choice-of-law provisions.[80] He also described the impact of one-way fee shifting provisions.[81]

Recommendations of the Committee

The Investor Advisory Committee is recommending that the SEC engage in rulemaking to harmonize the regulation of registered investment advisers and brokerage firms.[82] In disputes with a firm or investment professional, investors should be entitled to a fair and transparent dispute resolution process. Accordingly, the Investor Advisory Committee makes the following recommendations with respect to the use of predispute arbitration clauses by SEC-registered investment advisers:

I. The SEC should prohibit the use of specific types of restrictive clauses within predispute arbitration clauses and require similar investor protections available through FINRA Dispute Resolution to harmonize the scope and content of predispute arbitration clauses used by registered investment advisers and brokerage firms;
II. The SEC should require notice and disclosure of predispute arbitration clauses and arbitration awards in a manner consistent with disclosures made by brokerage firms under FINRA Rules;
III. The SEC should continue to gather and assess data regarding the use of predispute clauses by investment advisers and the outcomes of client-involved arbitrations; and
IV. The SEC should develop investor education materials that explain arbitration and provide investors with suggested questions to ask their investment adviser or broker.

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[78] *Id.*
[79] *Id.*
[80] *Id.*
[81] *Id.*
[82] The Committee acknowledges that some have called for the prohibition of mandatory predispute arbitration agreements. *See e.g.*, Letter from Better Markets, et al. to The Honorable Gary Gensler, Chair, U.S. Securities and Exchange Commission re: Critical Need for Rulemaking to Prohibit Forced Arbitration (Jan. 31, 2024), available at https://www.consumer-action.org/downloads/coalition/SECArbitrationRulemaking_Feb2024.pdf. As the panel focused on the disparities between investment adviser arbitration and brokerage firm arbitration and not on the underlying question of whether such arbitration should be allowed at all, the Committee is not here commenting on whether such clauses should be banned. In Recommendation III below, we suggest that the SEC, through its examination program, should continue to gather information and assess data regarding the use of arbitration clauses by investment advisers. This will allow the agency to assess any issues with such provisions, as well as the merits of predispute arbitration provisions.

FINRA Rule 2268 prohibits the inclusion of certain terms in predispute arbitration clauses, including those that limit or contradict the rules of any self-regulatory organization, limit the ability of a party to file any claim in arbitration or to file any claim in court permitted to be filed in court under the rules of the forums in which a claim may be filed under the agreement, or limit the ability of arbitrators to make any award. FINRA also prohibits the use of class-action waivers. Additionally, FINRA Rule 12213 requires that venue for any arbitration involving a customer be set in the hearing location closest to the customer's residence at the time of the events giving rise to the dispute. As discussed above, FINRA Rule 12800 allows for a simplified dispute resolution process for claims of $50,000 or less.

FINRA initially adopted Rule 2268 "to provide customers with effective disclosure of the meaning and effect of predispute arbitration clauses and in order to maintain the integrity of the arbitration process."[83] As discussed by the panelists, these provisions help to make the arbitration process a fairer and transparent process.

The SEC should adopt rules similar to FINRA Rules 2268, 12213, and 12800.[84] To the extent an investment adviser wishes to include a predispute arbitration within a client agreement, the investment adviser should not be permitted to include any clause that limits or contradicts the rules of any self-regulatory organization, limits the ability of a party to file any claim in arbitration or to file any claim in court permitted to be filed in court under the rules of the forums in which a claim may be filed under the agreement, or limits the ability of arbitrators to make any award. Further, investment advisers should be required to agree to a venue closest to the investor's residence at the time of the events giving rise to the dispute. Additionally, the investment adviser should be required to agree to streamlined, simplified processes for smaller claims. This would help ensure investors working with an SEC-registered investment adviser receive the same protections as investors working with a FINRA registered brokerage firm. Moreover, adoption of these requirements would be consistent with an investment adviser's fiduciary duty to act in the best interest of its client and not place its own interest ahead of a client's interest.

II. The SEC should require notice of and disclosure of predispute arbitration clauses and arbitration awards in a manner consistent with disclosures made by brokerage firms under FINRA Rules.

As discussed above, FINRA Rule 2268 requires consistent, prominent notice of arbitration agreements within any customer agreement. The SEC should require similar notice of arbitration agreements when used by investment advisers.

Additionally, the SEC should require that investment advisers include a copy of any predispute arbitration clauses as part of its disclosure obligations under the Form ADV. Further, investment advisers should be required to disclose pending and resolved arbitration claims. This will help level

[83] FINRA Notice to Members 89-21, *Proposed Amendment Re: Predispute Arbitration Clauses in Customer Agreements* (Mar. 1, 1989), available at https://www.finra.org/rules-guidance/notices/89-21.
[84] Such rules may be adopted pursuant to the authority granted to the SEC in §921 of Dodd-Frank, or pursuant to Section 206 of the Investment Advisers Act of 1940 (15 U.S.C. §80b-6).

the playing field and ensure investors have access to similar information about investment advisers as they presently have about FINRA registered brokers.

Lastly, as discussed above, FINRA maintains a searchable database of all FINRA arbitration awards. The SEC should require that investment advisers submit any arbitration awards to it to be included in a similar database of Investment Adviser Arbitration Awards. Investors should have the appropriate information from which they can make an informed decision about whether they want to work with a particular investment adviser.

As with recommendation I, this recommendation is intended to harmonize investor protections across the registered investment adviser and brokerage firm industries.

III. The SEC should continue to gather and assess data regarding the use of predispute clauses by investment advisers and the outcomes of client-involved arbitrations.

The 2023 study by the Office of the Ombuds and Office of the Investor Advocate acknowledged the difficulties in determining the frequency of investment adviser arbitrations or the frequency of unpaid awards due to the lack of publicly available information. Through its examination program, the SEC should gather data about the use of arbitration clauses, the terms of those clauses, and the details of any arbitrations or litigations involving investment advisers. Periodically, the SEC should make a report of its findings on a collective basis publicly available. This work will position the SEC to comprehensively evaluate any issues with, as well as the merits of, predispute arbitration provisions.

IV. The SEC should develop investor education materials that explain arbitration and provide investors with suggested questions to ask their investment adviser or broker.

The SEC should develop investor education materials that explain to investors what to expect from the arbitration process, and how it differs from court. The SEC may use the information that FINRA requires firms to include within predispute arbitration clauses as a starting point: (i) that investors may be giving up the right to sue their investment adviser in court, including the right to a trial by jury; (ii) that arbitration awards are generally final and binding; a party's ability to have a court reverse or modify an arbitration award is very limited; (iii) that the ability to obtain documents, witness statements and other discovery is generally more limited in arbitration than in court proceedings; (iv) that generally arbitrators do not have to explain the reason(s) for their award; (v) that the panel of arbitrators may include a minority of arbitrators who were or are affiliated with the securities industry; and (vi) that the rules of some arbitration forums may impose time limits for bringing a claim in arbitration.

The SEC should also suggest questions an investor may ask to prompt a conversation with their investment adviser or broker about any predispute arbitration clause. For example, (i) does the account agreement contain a predispute arbitration clause; (ii) what are the terms of the clause; (iii) where would the arbitration be held; (iv) who would decide the arbitration case and how would the arbitrators be selected; (v) what are the expected costs of bringing an arbitration case; and (vi) what are the benefits of proceeding with arbitration. Additionally, the SEC should encourage investors to ask about any pending or resolved client or customer complaints.