

**Securities and Exchange Commission
Investor Advisory Committee
Panel on Securities Arbitration – May 17, 2010
Financial Industry Regulatory Authority
Statement on Key Issues**

FINRA would like to thank the SEC for its invitation to participate in this important dialogue on securities arbitration.

Background on FINRA Dispute Resolution

FINRA operates [FINRA Dispute Resolution](#), the largest securities dispute resolution forum in the world, administering between 3,500 and 8,000 arbitrations and numerous mediations each year through its network of four regional offices and [72 hearing locations](#). FINRA maintains a diverse roster of over 6,000 arbitrators. These neutrals are not professional arbitrators. They serve for an [honorarium](#) of about \$400 per day (\$475 for the chair). FINRA administers three types of claims in the forum. The first and largest group, about 75 percent of cases, involves claims by customers against their brokerage firm and/or individual brokers. The second type of claim involves disputes between brokerage firms and their employees, about 23 percent of cases, and the third concerns disagreements between firms, about 2 percent of cases. FINRA continuously reviews its arbitration program to ensure that it maintains its investor focus and that it continues to be procedurally fair and transparent.

FINRA monthly publishes on its Web site its [arbitration and mediation case statistics](#). During 2009, investors settled their disputes, directly or through mediation, in 59 percent of all FINRA cases. Another 20 percent of the cases were withdrawn or closed for other reasons such as a stipulated award or a party bankruptcy. Arbitrators decided the remaining 21 percent of investor disputes in 2009, awarding investors damages in 45 percent of those cases. In total, approximately 70 percent of customer claimant cases resulted, through settlements or awards, in some recovery for the investor. In the first quarter of 2010, arbitrators decided 17 percent of the closed cases, awarding damages to investors in 49 percent of those decisions.

FINRA arbitration is different from court litigation in a number of ways – the most important of which is that it is an equity forum. The arbitrators are not bound to follow the substantive law or rules of procedure that govern litigation, nor must they apply the strict rules of evidence used in court. FINRA arbitration is typically faster than litigation with the average turnaround time currently at about 12 months. It also is less costly

because arbitrators rarely permit [depositions](#) during discovery, and appeals of arbitration awards are rare. FINRA arbitration is also different from court because FINRA strictly curtails [motions to dismiss](#) investor claims before the investor has had a full opportunity to be heard.

FINRA Strives to Serve the Needs of Investors

Transparent Predispute Arbitration Agreements – FINRA’s rules do not require brokerage firms to include predispute arbitration agreements in their contracts with investors. FINRA’s position is that a determination about whether brokerage firms should be allowed to include such agreements is a decision best made by Congress and the SEC. In light of clear Supreme Court precedent that upholds the ability of firms to include predispute arbitration agreements in investor contracts, FINRA believes that Congressional or SEC action would be necessary to prohibit or limit the use of such agreements.

As long as predispute arbitration agreements are permitted, however, FINRA wants to ensure that investors are made aware of such agreements before they sign them and that the content of those agreements does not limit investors’ substantive rights. Thus, when firms use these agreements, FINRA regulates their content and form ([FINRA Rule 3110\(f\)](#)). Predispute arbitration clauses in investor agreements must be highlighted and preceded by specified language stating, among other matters, that parties to a predispute arbitration agreement are giving up the right to sue each other in court; and that arbitration awards are generally final and binding. The contract also must contain a highlighted statement immediately preceding the signature line that states that the contract contains a predispute arbitration agreement, and the firm must give a copy of the agreement to the investor, who must acknowledge receiving it. FINRA rules also protect investors by prohibiting agreements that would limit the ability of any investor to file any claim in arbitration or that limits the power of arbitrators to make any award. For example, arbitrators can and do award punitive damages in favor of investors.

Brokerage firms cannot compel investors to arbitrate in the absence of an agreement. However, FINRA gives investors the absolute right to demand arbitration against firms and brokers, even in the absence of an agreement to arbitrate (Code of Arbitration Procedure for Customer Disputes (“Code”) [Rule 12200](#)). FINRA believes it is essential for investor protection that FINRA maintain Code Rule 12200 if Congress or the SEC decides to limit or prohibit mandatory arbitration.

Fee Structure – Unlike other forms of consumer arbitration, in the FINRA arbitration forum the industry bears the majority of the costs. On an annualized basis, investors pay approximately 25 percent of all case fees and industry parties pay about 75 percent. When investors initiate a case, they are required to pay a filing fee on a sliding scale according to the size of the claim. FINRA waives or defers payment of all or part of the filing fee upon a showing of financial hardship. At the end of the case, the arbitrators determine how to allocate the [hearing session fees](#). Again, FINRA waives any hearing fees allocated to investors upon a showing of financial hardship. FINRA provides hearing facilities at no cost to the parties and pays for [arbitrator compensation](#). Brokerage firms must pay additional [surcharges](#) and [processing fees](#) in each case, and arbitrators may not reallocate such fees to investors.

FINRA Claim Service – FINRA [serves](#) the claim for investors initiating a case. If FINRA is unable to serve a firm or its employees, FINRA staff works with investors to facilitate proper service.

Hearing Locations in Each State – FINRA conducts arbitration hearings in [72 cities](#) including at least one in each state of the United States, one in San Juan, and one in London. [FINRA selects the hearing location](#) closest to the investor’s residence at the time of the events giving rise to the dispute, unless the customer requests a hearing location in the customer’s state of residence (if different from the nearest location) at the time of the events giving rise to the dispute.

Definition of Public Arbitrator – FINRA classifies arbitrators as “public” or “non-public.” FINRA’s rules provide that public arbitrators may not have ties to the securities industry (Code [Rule 12100](#)). Cases involving [claims up to \\$100,000](#) are heard by a single public arbitrator. Larger claims are heard by a panel of three arbitrators – one public, one chair-public, and one non-public. FINRA has revised the rules several times to narrow the definition of who may be classified as a public arbitrator (Code [Rule 12100](#)).

Investor Involvement in Arbitrator Selection – Investors participate in selecting the arbitrators who serve on their cases. Under the [Code](#), FINRA sends to parties [computer generated random lists](#) of proposed arbitrators, along with [extensive background disclosure statements](#) for each arbitrator. In a three-arbitrator case involving investors, [parties receive three lists](#) (one public, one chair-public, and one non-public) each with eight proposed arbitrators. FINRA rules permit each party to [strike up to four of the eight names](#) on each list and to rank the remaining arbitrators in the order of their preference. FINRA [combines the rankings](#) for each category and [appoints](#) the highest ranked available arbitrator remaining on each list. When there are no names remaining on a list because the claimant and respondent each struck four different arbitrators, or because a mutually acceptable arbitrator is unable to serve,

FINRA staff uses the computerized Neutral List Selection System to “extend the list” by generating randomly the names of additional arbitrators to complete the panel.

Parties may only [challenge](#) extended list arbitrators for cause. FINRA would grant a challenge for cause if, for example, an arbitrator were related to or was a business partner or social friend of one of the parties or counsel.

Feedback from users of our forum indicates that parties prefer to select their arbitrators. To raise the likelihood that the parties will get panelists they choose and rank, as opposed to extended list appointments, FINRA recently filed a proposed amendment with the SEC [to increase the number of arbitrators on each list](#) from eight to ten, while maintaining the current four strikes per party. If approved, this change will assure that parties will have a panel of arbitrators they have selected in almost every case.

Public Arbitrator Pilot Program – In 2008, FINRA launched a pilot program for eligible claims that gives investors the ability to select an all-public panel. The [Public Arbitrator Pilot Program](#), which will run for two sequential years, will allow FINRA to determine whether a permanent change in panel selection, that gives investors more choice, is a better way to serve investors. Year One began October 6, 2008. Year Two began October 6, 2009, and will end October 5, 2010. In Year One, 11 firms volunteered to participate in the pilot program, each contributing a set number of cases to the pilot program per year. In Year Two, FINRA expanded the number of participating firms to 14 firms and several of the pilot program firms have agreed to increase their Year Two case commitments.

Investors in cases proceeding under the pilot program may choose a panel made up of three public arbitrators instead of two public arbitrators and one non-public arbitrator. FINRA provides parties with the same three lists (one public, one chair-public, and one non-public) that it provides to parties in non-pilot cases. However, in the pilot, parties may strike all eight of the arbitrators on the non-public list. If the parties strike all eight non-public arbitrators, the panel will be completed from the public lists. If a party wants a non-public arbitrator to serve on a case, then the party may choose to rank one or more of the eight arbitrators on the non-public list.

During the course of the pilot program, over 770 arbitration cases involving participating firms have the option to have all-public panels. As of May 3, 2010, investors filed 819 eligible cases with 57 percent choosing to participate in the pilot (467 pilot cases to date). During this period, parties have completed arbitrator ranking in 332 of the 467 pilot cases. Investors have chosen to rank one or more non-public arbitrator on the list in 172, or 52 percent, of those 332 cases.

Close Arbitrator Challenges Decided in Investors' Favor – Parties are entitled to [challenge the appointment of an arbitrator](#) to their case. FINRA grants a challenge for cause where it is reasonable to infer, based on information known at the time of the request, that the arbitrator is biased, lacks impartiality, or has a direct or indirect interest in the outcome of the arbitration. In close calls regarding an investor's challenge to an arbitrator for bias, FINRA will remove the arbitrator from the case (Code [Rule 12410](#)).

Discovery Guide for Investor Disputes – FINRA requires parties to cooperate in the exchange of documents and information to expedite the arbitration proceeding (Code [Rule 12505](#)). In addition, in 1999, FINRA adopted the [Discovery Guide](#) (“Guide”) for use in cases involving investors. The Guide enumerates documents that parties are required to exchange without arbitrator or staff intervention. The Guide is particularly helpful to investors without attorneys because it makes them aware of documents that firms and brokers may have that might lead to relevant evidence in the case.

FINRA is currently updating the Guide to address feedback from forum users. The new Guide will be easier for investors to use because it replaces the 14 current lists, that enumerate documents that parties must produce depending on the type of claim alleged, with two lists – one for investors and one for firms/brokers. Each item on the lists (with a few exceptions) would be presumptively discoverable in every investor case regardless of an investor's claim type. The FINRA Board has approved the updated Discovery Guide which we will file shortly with the SEC for public comment and approval.

Expedited Arbitration for Senior and Seriously Ill Parties – FINRA [expedites](#) case administration of matters involving senior or seriously ill parties. When a senior or seriously ill party advises FINRA of a desire for expedited hearings, FINRA begins the arbitrator selection process, schedules prehearing conferences, and serves the award as quickly as possible. The arbitrators press for early hearing dates and discovery deadlines to expedite the process. FINRA also determines promptly whether the parties are interested in mediation.

From January 1, 2008 to date, FINRA has closed 403 cases in the program, 96 of which closed by hearing. The 96 hearing cases took 12.3 months to process, compared to 14.3 months for non expedited cases. Thus, FINRA completed the expedited cases about 14 percent faster than all cases closed by hearing.

Arbitrator Disciplinary Referrals of Brokerage Firms/Brokers – At the end of a case, arbitrators may make a referral to FINRA's regulatory division if they believe there is evidence of serious wrongdoing that warrants further investigation and possible disciplinary action (Code [Rule 12104\(b\)](#)). They may also make a disciplinary referral as a sanction if a firm or broker fails to comply with any provision of the arbitration rules or

any arbitrator order (Code [Rule 12212](#)). For example, the arbitrators may refer a firm for failing to provide documents to investors under the Discovery Guide.

The FINRA Board recently approved a proposal to permit arbitrators to make referrals to FINRA at any time during an arbitration proceeding instead of waiting until the end of the case if the arbitrators have reason to believe that firm or broker conduct poses a serious, ongoing, imminent threat to investors that requires immediate action. In light of recent events, FINRA believes the rule change is necessary to protect the investing public. FINRA expects to file the proposed rule change with the SEC shortly.

Help in Enforcing Awards – Once an investor has won an award, FINRA takes steps to ensure the award is paid quickly. Brokerage firms and individual brokers are required to pay arbitration awards within 30 days or face suspension from the securities industry until the award is paid or a settlement reached (FINRA [Rule 9554](#)).

Helping Investors with the Arbitration Process

FINRA helps investors through the arbitration process in several ways – including through its education efforts, Web site videos and guides, and support of law school arbitration clinics. FINRA also has staff available to answer investors' questions.

Robust Web Site – FINRA Dispute Resolution's Web site, <http://www.finra.org>, provides various resources for investors regarding FINRA's arbitration and mediation processes. Through the Web site, investors can obtain, among other things: an [overview of arbitration and mediation](#); information on [how to file a claim](#); the [Code](#); and guidance on [how to find an attorney](#). The Web site also provides [Dispute Resolution materials in Spanish](#), including the entire [Code](#). In late 2008, FINRA posted [webcasts](#) that explain in plain English what to expect from FINRA's arbitration and mediation processes. The FINRA Dispute Resolution Web site has over 17,000 visitors each month and more than 11,000 [individuals subscribe](#) to FINRA Dispute Resolution's monthly Web site updates.

FINRA Investor Education Foundation ("Foundation") – [FINRA's Foundation](#) is the largest in the United States dedicated to investor education. The Foundation provided a grant to the Pace Law School Investor Rights Clinic to produce the [Guide to Securities Industry Disputes](#) ("*Pace Guide*") for investors who hope to prevent or may already have a dispute with their securities broker. The *Pace Guide* takes investors through the arbitration and mediation processes and seeks to assist investors representing themselves by providing a foundation in the basic rules and procedures in arbitration and mediation. The *Pace Guide* is available on the Foundation's Web site.

Support for Law School Clinics – Through assistance in organization and training of students, FINRA supports several law school clinics that represent small investors who cannot afford to hire an attorney or whose losses are too small to retain an attorney. The clinics, located in New York, Pennsylvania, California, and Illinois, provide an essential service for investors. Under the supervision of experienced practitioners, students provide services such as interviewing investors, reviewing client documents, investigating facts, analyzing cases for merit, negotiating settlements, and representing clients in mediations and arbitrations before FINRA.

In January 2010, [the Foundation announced \\$1 million in grants](#) to launch four law school clinics in new geographic regions that will provide legal help to underserved investors involved in securities disputes. These start-up grants of \$250,000 each will help fill some of the gap in legal representation for investors with small claims who cannot obtain legal counsel.

Mediation – Since 1995, FINRA has offered investors the option of using its [mediation program](#). Mediation is an informal, voluntary process in which an impartial person, trained in facilitation and negotiation techniques, helps the parties to reach a mutually acceptable resolution. Even if the parties cannot negotiate an acceptable settlement, they may still benefit from the process by narrowing the issues for arbitration.

FINRA mediators are independent neutrals, not FINRA employees. They are carefully screened, and many have extensive knowledge of securities law and industry practices. FINRA staff and the [National Arbitration and Mediation Committee](#) (“NAMC”), a majority public committee, review each applicant against demanding qualification criteria. All parties must agree to the selection before a mediator is assigned to a case, and either side can stop the mediation process if dissatisfied with the mediator.

FINRA mediations result in settlements more than 80 percent of the time. The resulting settlements often save the parties substantial time and expense. Every October, FINRA offers investors reduced mediation fees for smaller cases during “[Mediation Settlement Month](#).”

FINRA is Committed to Fairness

FINRA is committed to providing a neutral forum where trained arbitrators and mediators deliver fair, expeditious, and cost-effective dispute resolution services for investors, brokerage firms, and brokers.

Neutral Roster – The quality of the arbitrators is a key determinant of the quality of the arbitration outcome. FINRA is committed to maintaining a roster of neutrals with the experience to evaluate investors' disputes fairly. FINRA's roster of approximately 6,200 arbitrators and 300 mediators come from a broad cross-section of individuals.

Arbitrator Approval Process – FINRA conducts a background check of all applicants. A subcommittee of the NAMC reviews and approves or disapproves all new applicants.

Arbitrator Training – Candidates must successfully complete 13 hours of [arbitrator training](#) and pass a test before becoming eligible to serve on arbitration cases. Arbitrators who serve as [chairpersons](#) are required to take [additional training](#). FINRA also conducts neutral workshops as an additional means of providing information to neutrals.

FINRA recently completed an extensive review of its [Basic Arbitrator Training](#) course. The training relates to arbitrator skills, arbitrator ethics and the arbitration rules. A special Task Force comprised of representatives of the investors' bar and the securities industry oversaw the review. The Task Force considered carefully the proper instructions for arbitrators regarding substantive law and agreed that FINRA should continue its current practice: our training provides procedural guidance to arbitrators but does not instruct them concerning substantive law. Specifically, FINRA instructs arbitrators that they should ask the parties to brief legal issues if they need additional information to resolve an issue. In the training materials, the Task Force crafted guidance to arbitrators to consider various laws and to look to parties and their counsel to provide authorities for the proper standards to apply.

Detailed Arbitrator Disclosures – Arbitrators are [required to disclose a complete history of](#) their education, employment, and brokerage accounts, if any, plus potential conflicts of interest due to business, personal or client relationships. The more information that investors have about arbitrators, the better the system works to ensure that arbitrators have no ties to the parties or others involved in the dispute. FINRA requires arbitrators to disclose all conflicts. As part of the arbitrator selection process, FINRA provides the parties with an [extensive background disclosure statement](#), including a list of the arbitration decisions, for each potential arbitrator. FINRA also requires each arbitrator to execute an [oath](#)

in each case on which that arbitrator serves. The oath contains an affirmation that the arbitrators have no direct or indirect interest in the matter and have no relationship with any party, counsel, or witness that would prevent them from deciding the controversy fairly.

Arbitrator Evaluations – FINRA continually reviews the quality of the arbitrator roster. FINRA also asks parties to complete a user survey at the end of a case to provide feedback on the fairness and quality of the process and the roster. The [evaluation form](#) is available on the FINRA Web site. FINRA also asks each arbitrator to complete a peer review survey. FINRA staff conducts quarterly roster reviews to assess the cumulative evaluations of each arbitrator's service.

Arbitrator Removal – FINRA has procedures to govern the permanent removal of an arbitrator from the roster. Triggering events for removal include party, counsel, and peer complaints, and staff observations. Dispute Resolution senior management and two public members of the NAMC must agree before an arbitrator can be removed. From 2003 to the present, FINRA has permanently removed 170 arbitrators through this process.

Investor Opt-Out for Class Actions – FINRA prohibits a brokerage firm or broker from enforcing an arbitration agreement against an investor who is a member of a court class action (Code [Rule 12204](#)). Conversely, an investor in a class action who prefers to be in arbitration may file an arbitration claim upon opting out of the class.

Rigorous Program Oversight – FINRA Dispute Resolution is subject to oversight by the SEC that includes periodic examinations, approval of all rule and substantive procedural changes after a period of public comment, and review of investor complaints.

FINRA Supports Transparency in the Forum

Open Rulemaking Process – The SEC reviews FINRA's rule proposals and, as part of the approval process, publishes proposed rule changes in the [Federal Register](#). Investors and their representatives have a chance to comment on a rule proposal which can lead, and in the past has led, to important changes in such proposals.

Publicly Available Awards and Case Statistics – Arbitration awards are [publicly available](#) in a free, searchable database provided on the FINRA Web site. Since its inception, visitors have accessed the site over five million times. In March 2010 alone, 255,000 visitors accessed the site. In addition, FINRA [publishes data](#) about case results such as the number of cases settled or withdrawn, the percentage of decisions favorable to investors, and the processing times for cases.

FINRA BrokerCheck – FINRA provides investors with [BrokerCheck](#), a free online tool to help investors research the backgrounds of current and former FINRA-registered brokerage firms and individual brokers. Through BrokerCheck, investors can view the disciplinary history, arbitration decisions, and other matters, for any brokerage firm or broker in a single centralized location. The information made available through BrokerCheck is derived from the [Central Registration Depository](#) (CRD[®]), the securities industry online registration and licensing database.

Conclusion

Over the last 10 years, FINRA has helped resolve over 72,000 disputes and returned billions of dollars to investors through settlements and arbitration awards. As described above, we have significantly improved our program over the years, and will continue to work with investor and industry groups to make further enhancements in the future.

Attachment: Data on Closed Cases Available on FINRA Web [site](#).

ATTACHMENT

How Arbitration Cases Close

Cases Decided by Arbitrators	2008	% of Cases	2009	% of Cases	Mar. 2010	% of Cases
After Hearing	721	19%	839	18%	247	17%
After Review of Documents	176	5%	310	7%	61	4%
Total	897	24%	1,149	25%	308	21%
Cases Resolved by Other Means	2008	% of Cases	2009	% of Cases	Mar. 2010	% of Cases
Direct Settlement by Parties	1,779	47%	2,170	47%	797	55%
Settled Via Mediation	384	10%	322	7%	101	7%
Withdrawn	421	11%	598	13%	158	11%
All Others*	279	7%	358	8%	85	6%
Total	2,863	76%	3,448	75%	1,141	79%

*All Other reasons for closed includes cases closed by: Stipulated Award, Bankruptcy of Critical Party; Uncured Deficient Claim; Forum Denied; Stayed by Court Action, etc. Note cases counted as closed in this report do not include those cases that closed and were then reopened.

Results of Customer Claimant Arbitration Award Cases

Year Decided	All Customer Claimant Cases Decided (Hearings & Paper)	Percentage Decided of All Customer Claimant Cases Closed	Percentage (and Number) of Cases Where Customer Awarded Damages*
2008	474	20%	42% (199 cases)
2009**	669	21%	45% (304 cases)
2010	181	17%	49% (88 cases)

* Percentage of customer claimant award cases reflects only instances in which investors as claimants recovered monetary damages or non-monetary relief.

** Please note: In 2009, approximately 70 percent of customer claimant cases resulted, through settlements or awards, in monetary or non-monetary recovery for the investor.