EXCERPT OF ARBITRATION TESTIMONY[1]

TESTIMONY OF
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EXECUTIVE VICE PRESIDENT OF THE
SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION
BEFORE THE
U.S. HOUSE OF REPRESENTATIVES
COMMITTEE ON FINANCIAL SERVICES
HEARING ON:
"INDUSTRY PERSPECTIVES ON THE OBAMA ADMINISTRATION'S
FINANCIAL REGULATORY REFORM PROPOSALS"
JULY 17, 2009

I. Introduction

Chairman Frank, Ranking Member Bachus and members of the Committee:

My name is Randy Snook and I am Executive Vice President of the Securities Industry and Financial Markets Association ("SIFMA").[2] Thank you for your invitation to testify at this important hearing. I will present SIFMA's views on some of the proposed regulatory reforms set forth in Treasury's June 17, 2009 White Paper, *A New*

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[1] The complete testimony is available at http://www.sifma.org/legislative/testimony/pdf/Snook-testimony-7-17-09.pdf.

[2] The Securities Industry and Financial Markets Association brings together the shared interests of more than 600 securities firms, banks and asset managers locally and globally through offices in New York, Washington, D.C. and London. Its associated firm, the Asia Securities Industry and Financial Markets Association, is based in Hong Kong. SIFMA's mission is to champion policies and practices that benefit investors and issuers, expand and perfect global capital markets and foster the development of new products and services. Fundamental to achieving this mission is earning, inspiring and upholding the public's trust in the industry and the markets. (More information about SIFMA is available at http://www.sifma.org.)

Foundation: Rebuilding Financial Supervision and Regulation, and certain related legislative proposals.

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3. Pre-Dispute Arbitration Clauses

Treasury has proposed giving the SEC authority to prohibit pre-dispute arbitration clauses in broker-dealer and investment advisory account agreements with retail customers, if it studies such clauses and concludes that their use harms investors. Similarly, the CFPA, as proposed, would have authority to prohibit or limit the use of arbitration clauses in consumer contracts to the extent that the CFPA finds such prohibition or limitation to be in the public interest and for the protection of consumers.

Congress has maintained a policy in favor of arbitration since the passage of the Federal Arbitration Act. The basis for this policy has been that arbitration simultaneously promotes fairness and efficiency. The U.S. Supreme Court has expressly approved the use of pre-dispute arbitration clauses.

SIFMA supports the idea of conducting further study of securities arbitration and pre-dispute arbitration clauses. In fact, we conducted our own study of the matter in October 2007.[3] Based on empirical data, we confirmed that securities arbitration is faster and less expensive than litigation. Small investors benefit in particular, as arbitration allows them to pursue claims that they could not afford to litigate or that would be dismissed in court. Moreover, the percentage of claimants who recover in securities arbitration – either by award or settlement – has remained constant in recent years and average inflation-adjusted recoveries have been increasing. In sum, we found that the

[3] Available at http://www.sifma.org/regulatory/pdf/arbitration-white-paper.pdf.

securities arbitration system properly protects investors, in part because it is subject to public oversight, regulatory oversight by multiple independent regulators and procedural rules specifically designed to benefit investors.

Pre-dispute arbitration clauses are vital to the securities arbitration system. In fact, it is our view that prohibiting such clauses would essentially be tantamount to doing away with securities arbitration. Research shows that parties rarely agree to arbitrate after a dispute arises. Rather, a variety of tactical considerations tend to drive parties to litigate. Claimants' counsel may prefer litigation to drive up costs and induce nuisance settlements, use a judicial forum to seek publicity or attract other clients, seek "jackpot justice" or shop for forums thought to have anti-business jury pools. Securities firms may favor litigation to take advantage of their greater financial resources to the detriment of the small investor by engaging in extensive discovery or filing numerous motions.

Accordingly, the result of a voluntary, post-dispute arbitration approach is likely to be that most disputes end up in lengthier, costlier litigation. This outcome would likely result in a complete denial of justice for individuals with smaller claims. This cannot be the intended result of Treasury's proposal. We urge Congress to consider these factors in its deliberation over Treasury's pre-dispute arbitration clause proposals. We also suggest that further study of this subject might be particularly instructive.