EXCERPT OF ARBITRATION TESTIMONY[1]

TESTIMONY OF JOHN TAFT
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RBC WEALTH MANAGEMENT
CHAIRMAN
PRIVATE CLIENT GROUP STEERING COMMITTEE
SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION
BEFORE THE
U.S. HOUSE OF REPRESENTATIVES
COMMITTEE ON FINANCIAL SERVICES

HEARING ON:
CAPITAL MARKETS REGULATORY REFORM: STRENGTHENING INVESTOR PROTECTION, ENHANCING OVERSIGHT OF PRIVATE POOLS OF CAPITAL, AND CREATING A NATIONAL INSURANCE OFFICE

OCTOBER 6, 2009

Introduction

Chairman Frank, Ranking Member Bachus, and members of the Committee: My name is John Taft. I am Head of U.S. Wealth Management, RBC Wealth Management, and Chairman of the Private Client Group Steering Committee of the Securities Industry and Financial Markets Association ("SIFMA").[2] Thank you for the opportunity to testify

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[1] The complete testimony is available at http://www.sifma.org/legislative/testimony/pdf/JohnTaft-Testimony-beforeHFSC.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

at this important hearing. I will present SIFMA's views on the discussion draft of the Investor Protection Act of 2009 ("Investor Protection Discussion Draft"),[3] particularly with respect to Section 103 (establishment of a fiduciary duty for brokers, dealers and investment advisers) and Section 201 (predispute arbitration agreements in the securities industry).

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B. Pre-Dispute Arbitration Clauses

The U.S. Treasury White Paper released in June 2009 proposed giving the SEC authority to prohibit pre-dispute arbitration agreements in broker-dealer and investment advisory account agreements with retail customers, if it studies such clauses and concludes that their use harms investors.[4] Similarly, the proposed Consumer Financial Protection Agency[5] 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.[6]

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public's trust in the industry and the markets. More information about SIFMA is available at http://www.sifma.org.

[3] Discussion draft released by Congressman Kanjorski on October 1, 2009, available at http://www.house.gov/apps/list/press/financialsvcs_dem/investor_protection_act_draft.pdf.

[4] U.S. Treasury White Paper, *A New Foundation: Rebuilding Financial Supervision and Regulation* at p.72 (June 17, 2009), available at http://www.financialstability.gov/docs/regs/FinalReport_web.pdf.

[5] Consumer Financial Protection Agency Act (CFPAA) of 2009, H.R. 3126, available at http://www.opencongress.org/bill/111-h3126/text.

[6] See Section 127 of the CFPAA discussion draft released on September 25, 2009.

Although the Treasury White Paper states that the SEC is required to study the use of predispute arbitration clauses to determine whether they harm investors,[7] the Investor Protection Discussion Draft omits this important requirement. We strongly support its restoration. We support continuous study of the fairness and efficiency of the securities arbitration system.

We recognize that Congress is taking a fresh and broad look at arbitration practices generally. An SEC study could help inform Congress's consideration of these issues with respect to securities arbitration in particular. In this context, it would be inappropriate and unfair to investors and securities firms alike to allow the SEC to ban predispute arbitration agreements by fiat without the benefit of study.

For nearly four decades, the SEC has upheld and enforced securities rules that require securities firms to arbitrate at the election of the investor.[8] Securities firms have gained the same right in return by entering into predispute arbitration agreements with their new customers. Such contracts ensure that both sides are treated fairly and effectuate the public policy in favor of predispute arbitration agreements that has been

[7] U.S. Treasury White Paper at p.72.

[8] *See* § 12200 of the Financial Industry Regulatory Authority (FINRA) Code of Arbitration Procedure ("Code of Arbitration Procedure") and Rule 600A(a)(ii) New York Stock Exchange Arbitration Rules (directing that members of the securities industry must arbitrate upon demand of the customer). FINRA's rules have required member firms to arbitrate at the investor's demand since March 1972. *See* FINRA Manual (July 1, 1974) (noting that former Code of Arbitration Procedure ¶ 3702, § 2(a)(2) took effect on March 9, 1972).

recognized by both Congress and the U.S. Supreme Court.[9] The basis for this policy has been that arbitration simultaneously promotes fairness and efficiency.

Accordingly, the SEC should be required to study arbitration clauses and submit to Congress a report on the findings of any such studies, including any legislative recommendations that the SEC finds are in the public interest and for the protection of investors. Frankly, we do not believe that any such study would ever lead to the conclusion that predispute arbitration agreements do not benefit investors.

We base this assertion in part on our own study of arbitration concluded in October 2007.[10] 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 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.

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[9] *See* Federal Arbitration Act, 9 U.S.C. Section 1 *et seq.*, available at http://www.law.cornell.edu/uscode/html/uscode09/usc_sup_01_9_10_1.html; *Shearson/American Express, Inc.* v. *McMahon*, 482 U.S. 220, 225-226 (1987).

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

Pre-dispute arbitration clauses are vital to the securities arbitration system. In fact, prohibiting such clauses would 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, 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 the proposed legislation. We urge Congress to consider these factors in its deliberation over the securities arbitration proposal. We also urge further study of predispute arbitration clauses in the securities industry to determine whether there is any basis whatsoever for concern that these clauses may harm investors.