

**Americans for Financial Reform \* Alliance for Justice \* Center for Justice and Democracy \* Consumers Union \* National Association of Consumer Advocates \* National Consumers League \* Public Investors Arbitration Bar Association (PIABA) \* Public Citizen \* U.S. PIRG**

January 21, 2015

FINRA Dispute Resolution Task Force

Via [DRTaskForce@finra.org](mailto:DRTaskForce@finra.org)

Re: Request for support of release of arbitration data

Dear Members of the FINRA Dispute Resolution Task Force:

The undersigned organizations write to ask you to support the public release of research and data that addresses the resolution of disputes in the FINRA arbitration system between investors and brokerage firms or investment advisers. Specifically, we request that you support the release of information, including data in the form of studies and reports, that FINRA and/or the SEC have collected regarding investor awareness and understanding of predispute binding mandatory (or forced) arbitration; effectiveness of FINRA's arbitrator selection process; prevalence of forced arbitration clauses in brokerage firm and investment advisory contracts; and other feedback that FINRA has collected from investors about any or all of these issues.

In its announcement forming the arbitration task force, FINRA declared that the task force "would consider possible enhancements to its arbitration forum to improve the transparency, impartiality, and efficiency of FINRA's securities arbitration forum for all participants."<sup>1</sup> FINRA also released a list of topics for its review, including "access to FINRA forum."<sup>2</sup> We call on the task force to follow through on its stated mission and urge the public release of information listed in the Appendix that would improve transparency and inform the SEC, FINRA, and stakeholders (investors, industry, journalists, and the public at large) about the workings of FINRA's mandatory arbitration system and the impact that the lack of access to the court system has had on investor protection.

**LONG-TIME CONCERN OVER INVESTOR MANDATORY ARBITRATION**

In the many damaging corporate scandals such as the tech bubble-dotcom market crash of the early 2000s and the financial meltdown of 2008, brokerage firms and investment

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<sup>1</sup> FINRA, *Finra Announces Arbitration Task Force*, July 17, 2014, <http://bit.ly/WhZLTq>.

<sup>2</sup> FINRA Dispute Resolution Task Force Issues, Dec. 2014, <http://bit.ly/1wwXuSU>.

advisers were caught reaping rewards by, among other things, pitching risky investments to main street investors and causing them severe financial harm. Individual clients seeking compensation for their injuries likely were required to resolve their disputes in private FINRA arbitration because of language in their contracts with broker-dealers or advisers that deprived investors of their right to access the courts. For many investors, industry-sponsored arbitration was akin to adding further insult to the financial injuries they suffered from broker-dealer and investment adviser misconduct.

Mandatory arbitration deprives investors doing business with brokerage firms and investment advisers of the right to a judge and jury. Investors do not receive open hearings and often do not receive fair ones. In addition, the process is unlikely to result in adequate awards against brokers to deter misconduct and compensate injured investors. There is even evidence that brokers have been able to use the arbitration process to clean their records of investor complaints, as if they never occurred.<sup>3</sup> Although it is intended as a substitute for public courts, FINRA's arbitration system stunts development of critical legal policy. It also can deprive investors of the benefits of the law because arbitrators are not obligated to follow it, and written opinions are closed to the public or may not be issued at all.<sup>4</sup> Meanwhile, important information about arbitrator selection and other elements of FINRA's arbitration system remain unavailable to the public.

Public interest organizations, investor advocates, state securities regulators,<sup>5</sup> and federal officials have long expressed concern about the rights of main street investors and their experiences with mandatory arbitration.<sup>6</sup> Prior to the Supreme Court decisions that permitted the use of forced arbitration in investor contracts,<sup>7</sup> the SEC was troubled by the practice.<sup>8</sup> SEC staff stated that arbitration clauses in investment adviser contracts should not constitute waiver of investors' rights, including investors' right to choose the forum, whether the court system or arbitration, in which to resolve their disputes.

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<sup>3</sup> Susan Antilla, *THE NEW YORK TIMES*, *A Murky Process Yields Cleaner Professional Records for Stockbrokers*, Sept. 25, 2014, <http://nyti.ms/1uqiwyn>.

<sup>4</sup> FINRA Decision and Awards, FINRA Customer Code Rule 12904, Awards, <http://bit.ly/1zfEjNs>.

<sup>5</sup> North American Securities Administrators Association, *Issue Focus: Mandatory Pre-dispute Arbitration, Congress Should Improve the Fairness of the Securities Arbitration Process*, <http://bit.ly/1uvnpVR>.

<sup>6</sup> See, e.g. Staff of the U.S. Securities and Exchange Commission, *Study on Investment Advisers and Broker-Dealers, As Required by Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act*, Jan. 2011, at 43-44, *citing* McEldowney Financial Services, SEC Staff No-Action Letter, Oct. 17, 1986, <http://1.usa.gov/165Pgr7>.

<sup>7</sup> *Shearson/Am. Exp., Inc. v. McMahon*, 482 U.S. 220, 107 S. Ct. 2332, 96 L. Ed. 2d 185 (1987) and *Rodriguez de Quijas v. Shearson/Am. Exp., Inc.*, 490 U.S. 477, 109 S. Ct. 1917, 104 L. Ed. 2d 526 (1989).

<sup>8</sup> Staff of the U.S. Securities and Exchange Commission, *Study on Investment Advisers and Broker-Dealers, As Required by Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act*, Jan. 2011, at 43-44, *citing* McEldowney Financial Services, SEC Staff No-Action Letter, Oct. 17, 1986, <http://1.usa.gov/165Pgr7>.

As you know, the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act), the financial reform law was passed to rein in corporate abuses that led to the financial crisis of 2008. In the legislative process leading up to its passage, members of Congress showed concern over the industry's use of arbitration clauses in investor contracts. They highlighted weaknesses in the process, such as secret proceedings that can hurt future investors who lack information to properly evaluate firms' and individuals' records.<sup>9</sup>

In Section 921 of the Dodd-Frank Act, Congress granted the SEC specific authority to restrict the use of forced arbitration clauses in brokerage firm and investment adviser contracts if it finds such a restriction would protect investors and be in the public interest. "If arbitration truly offers investors the opportunity to efficiently and fairly settle disputes, then investors will choose that option," concluded a House committee report for a bill that preceded Dodd-Frank.<sup>10</sup>

Fostering investor trust after the financial crisis by ensuring individuals' access to the court system was a clear congressional priority. In fact, other Dodd-Frank provisions prohibit the use of predispute arbitration in certain circumstances, such as in residential mortgages, and whistleblower claims under the Sarbanes-Oxley Act of 2002.<sup>11</sup> In 2012, the SEC approved amendments to FINRA rules barring forced arbitration for Sarbanes-Oxley whistleblower disputes in accordance with Dodd-Frank.<sup>12</sup>

### **AFTER DODD-FRANK, MORE ATTACKS ON INVESTOR RIGHTS**

While the SEC has so far declined to exercise its ability to write a rule on predispute arbitration clauses or even examine the issue, attacks on investor rights have continued. In 2012, brokerage firm Charles Schwab & Co., hoping to capitalize on a 2011 Supreme Court decision, *AT&T Mobility v. Concepcion*,<sup>13</sup> sought to expand its use of forced arbitration by adding terms to the arbitration requirement in its contracts that prohibited its customers from participating in class actions against it.

Consumer organizations and investor advocates responded to the developments, writing to SEC Chairman Mary Jo White to protest Schwab's actions and urge the agency to exercise its authority under Section 921.<sup>14</sup> A public petition targeting Schwab's class action ban was

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<sup>9</sup> Report of the Senate Committee on Banking, Housing, and Urban Affairs on S. 3217, S. Rep. No. 111-176, April 30, 2010, <http://1.usa.gov/1qED3ml>.

<sup>10</sup> House Committee on Financial Services on H.R. 3817, H.R. Rep. No. 111-687, Part 1, at 50.

<sup>11</sup> Dodd-Frank Wall Street Reform and Consumer Protection Act, Sections 1414(e) and 922(c)(2), Public Law 111 - 203.

<sup>12</sup> FINRA, Regulatory Notice 12-21, Arbitration of Whistleblower Disputes, April 2012, <http://bit.ly/1sfkgPz>.

<sup>13</sup> *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740, 179 L. Ed. 2d 742 (2011).

<sup>14</sup> Letter to Mary Joe White, Chairman, Securities Exchange Commission, May 2, 2013, <http://bit.ly/1za2L2A>.

launched.<sup>15</sup> Meanwhile, editorials in trade publications called for an end to forced investor arbitration.<sup>16</sup>

Senator Al Franken (Minn.), led 37 members of the House and Senate in a letter to the SEC expressing alarm at Schwab's new terms as "further attempts to erode investor rights."<sup>17</sup> Representative Keith Ellison (Minn.), a member of the House Financial Services Committee, responded to Schwab's move by introducing the Investor Choice Act of 2013 (H.R. 2998). The bill would have prohibited the use of arbitration clauses in contracts that investors enter into with broker-dealers and investment advisers. It would have restored investors' ability to choose the forum in which to settle disputes, and specifically prohibited any restrictions on investors' ability to band together in class actions. Public interest organizations strongly supported Rep. Ellison's Investor Choice Act.<sup>18</sup>

Ultimately, organizations were pleased that FINRA successfully challenged Schwab's class action ban on the ground that the restriction violated FINRA rules,<sup>19</sup> and that the firm agreed to remove the provision from its customer contracts.<sup>20</sup> However, investor advocates remain wary of the ongoing risk that other firms may be emboldened to follow in Schwab's footsteps and seek to further limit investors' rights. It is reason for the FINRA Arbitration Task Force to evaluate the need for investor choice and access to the court system. Indeed, the mere existence of the task force and its stated mission is a tacit acknowledgement that the investor mandatory arbitration system is flawed.

## **THE NEED FOR PUBLIC DISCLOSURE OF ARBITRATION DATA**

Academics, state regulators, and investor advocates have sought to examine various components of investor arbitration.<sup>21</sup> Some analyses have used general data that FINRA discloses on its website regarding its arbitration hearing outcomes.<sup>22</sup> However, additional

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<sup>15</sup> Susan Antilla, THE NEW YORK TIMES, *Schwab Case Casts Spotlight on Securities Arbitration and Its Flaws*, Sept. 4, 2013, <http://nyti.ms/1wg2ueL>. Jed Horowitz, REUTERS, *Schwab reverses ban on client class-action lawsuits*, May 16, 2013, <http://reut.rs/1qzpqVI>.

<sup>16</sup> Editorial, INVESTMENTNEWS, *Time to end mandatory arbitration*, Aug. 18, 2013, <http://bit.ly/1wBKwFw>.

<sup>17</sup> Office of Sen. Al Franken, *Sen. Franken Leads Charge to Protect Consumers' Legal Rights Against Wall Street*, April 30, 2013, <http://1.usa.gov/1DfrAj0>.

<sup>18</sup> Letter to Rep. Keith Ellison, Aug. 2, 2013, <http://bit.ly/1vTnGqU> and North American Securities Administrators Association, *NASAA Strongly Supports the Investor Choice Act of 2013*, Aug. 2, 2013, <http://bit.ly/1BeavRK>.

<sup>19</sup> Financial Industry Regulatory Authority, *In the Matter of FINRA Department of Enforcement v. Charles Schwab & Co., Inc.*, Decision, April 24, 2014, <http://bit.ly/1ulpggG>.

<sup>20</sup> FINRA Letter of Acceptance, Waiver and Consent, No. 2011029760202, April 24, 2014, <http://bit.ly/1scAUzs>.

<sup>21</sup> See, e.g. Massachusetts Securities Division Staff, *Report On Massachusetts Investment Advisers' Use Of Mandatory Pre-Dispute Arbitration Clauses In Investment Advisory Contracts*, Feb. 11, 2013, <http://bit.ly/1Bh1tn5>.

<sup>22</sup> FINRA, *Dispute Resolution Statistics*, <http://bit.ly/1BAxEkh>.

information would be useful to evaluate other critical aspects of the system, including the impact that lack of access to the civil justice system has on investor protection. The SEC and FINRA have information that would be valuable in informing the agency and the public regarding the effect of arbitration on investors.

The Public Investor Arbitration Bar Association (PIABA), an organization of lawyers who primarily represent investors, has, during the last year, released a series of studies examining some of the structural and procedural traits of FINRA arbitration. The published data in PIABA's reports indicates that FINRA arbitration proceedings foster secrecy of information that should be available to investors and that aspects of the system suggest partiality towards industry participants.

Briefly, the studies found that most stockbrokers' requests to remove investor complaints from their public record are granted, resulting in the omission of critical information from FINRA BrokerCheck system;<sup>23</sup> that the BrokerCheck system also omits other critical information concerning prior conduct of stockbrokers and broker-dealer firms that investors need to make informed decisions;<sup>24</sup> and that FINRA's arbitrator selection process is not only secretive but it results in an arbitration roster that lacks diversity.<sup>25</sup>

PIABA filed a Freedom of Information request for records regarding SEC oversight of the FINRA arbitration system to further inform its research. The SEC, while admitting that it had about 65 documents responsive to the information request, refused to disclose the documents, successfully claiming in court that they were exempted under FOIA from disclosure.<sup>26</sup> Despite SEC's failure to disclose critical information, FINRA can encourage release of this and other data for a proper and open appraisal of the system.

We recognize that FINRA has made incremental changes to its arbitration process. And we note FINRA's official statements that it does not object to a rule that would restrict mandatory arbitration. FINRA has contended that the decision about whether to allow mandatory arbitration is best made by Congress and the SEC.<sup>27</sup> However, FINRA has an opportunity to elevate the dialogue about its arbitration process and investor protection by encouraging the disclosure of data and information about its arbitration process.

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<sup>23</sup> Public Investors Arbitration Bar Association, *PIABA Study: Stockbroker Arbitration Slates Wiped Clean 9 Out Of 10 Times When "Expungement" Sought In Settled Cases*, Oct. 6, 2013, <http://bit.ly/1wjQk3g>.

<sup>24</sup> PIABA, *PIABA Warning: Finra Withholds Critical "Red Flag" Information In Broker Background Check Disclosures To Investors*, March 6, 2014, <http://bit.ly/1yVpDnL>.

<sup>25</sup> PIABA, *Study: Industry-Run Finra Arbitrator Pool Lacks Diversity And Fails To Detect, Communicate Potential Biases*, Oct. 7, 2014, <http://bit.ly/1upeGEz>.

<sup>26</sup> *Pub. Investors Arbitration Bar Ass'n v. S.E.C.*, 771 F.3d 1 (D.C. Cir. 2014).

<sup>27</sup> Richard Ketchum, Text of Testimony Before the Committee on Financial Services, U.S. House of Representatives, Oct. 6, 2009, <http://bit.ly/1wgXZRd>.

Finally, many of our organizations are strong supporters of openness in government and the public's ability to access information. Transparency is even more critical when an issue affecting the public interest, such as FINRA's arbitration system (operated under SEC oversight), is being debated and evaluated.

## **CONCLUSION**

As long as brokerage firms and investment advisers retain the ability to require investors to resolve disputes in arbitration, FINRA arbitration may be inherently biased against individuals. The system is ripe for change to level the playing field and ensure that every investor has the right to access the court system. In the meantime, the task force has the ability to urge disclosure of critical information that will shed light on the FINRA arbitration system. We urge you to include in your recommendations to the National Arbitration and Mediation Committee (NAMC), FINRA's Standing Board Advisory Committee, a request to disclose information about its arbitration process.

Please send a reply to Hugh Berkson, President-Elect, Public Investors Arbitration Bar Association (PIABA), [hberkson@hcsattys.com](mailto:hberkson@hcsattys.com), (216) 781-5515 and Christine Hines, Public Citizen, [chines@citizen.org](mailto:chines@citizen.org), (202) 454-5135.

Sincerely,

Americans for Financial Reform  
Alliance for Justice  
Center for Justice and Democracy  
Consumers Union  
National Association of Consumer Advocates  
National Consumers League  
Public Investors Arbitration Bar Association (PIABA)  
Public Citizen  
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## **APPENDIX: RECOMMENDED INFORMATION FOR PUBLIC RELEASE**

Given that the SEC has not yet begun to exercise its authority under Section 921, we appreciate that FINRA has acknowledged through the task force that its arbitration system is ready for review, particularly in light of Congress' stated concerns during the financial reform negotiations. We urge FINRA to encourage transparency and to facilitate the release of data and information as described below.

- We request that FINRA support the release of information, including data in the form of studies and reports, that FINRA and/or the SEC have collected regarding investor awareness and understanding of predispute binding mandatory (or forced) arbitration; data to support stated goals of FINRA's arbitrator selection process; the prevalence of forced arbitration clauses in brokerage firm contracts; and other feedback that FINRA has collected from investors about any or all of these issues.
- We request the FINRA support release of any data from investigations regarding arbitration awards, in particular any data allowing comparison of cases where investors are awarded a fraction of their losses to those where investors are fully compensated for their losses.
- We request that FINRA support release of any data or analysis by the SEC or FINRA concerning arbitrators' records, including any analysis of the percentage of cases in which individual arbitrators have found in favor of a brokerage firm over an investor or vice versa.
- We request that FINRA support release of any SEC or FINRA analysis of data on the likelihood of an investor prevailing on any particular type of claim or the likelihood of any particular arbitrator issuing an award in favor of an investor or a brokerage firm.
- We request that FINRA support release of any data or information addressing whether investor protection is less secure in the investment advisory context where the choice of arbitration providers is solely within the discretion of the investment advisers or in FINRA arbitration, the required forum for brokerage firms.