May 2, 2013

The Honorable Mary Jo White
Chairman
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: Request for action pursuant to Dodd-Frank Wall Street Reform and Consumer Protection Act, Section 921, *Authority to restrict mandatory pre-dispute arbitration*

Dear Chairman White:

As you begin your tenure as chairman and deliberate over the pressing issues facing investors, the undersigned organizations urge you to review and exercise the explicit authority to restrict pre-dispute binding mandatory arbitration that Congress granted to the Securities and Exchange Commission (SEC or Commission) in 2010 under Section 921 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank).[1]

Section 921 authorizes the Commission to prohibit or limit the use of pre-dispute binding mandatory (or forced) arbitration clauses in contracts that investors enter into with broker-dealers and investment advisors, if doing so is in the public interest and for investors' protection.[2] Forced arbitration in the securities sector has long concerned our organizations, as this prevalent practice forces investors to surrender their ability to seek redress in court as a condition to receiving brokerage and other financial services. However, recent developments have injected a new urgency into the matter, which now demands immediate attention and action from the Commission.

The brokerage company Charles Schwab (Schwab) has been locked in a battle for the past year with the Financial Industry Regulatory Authority (FINRA), over whether Schwab is authorized to eliminate its customers' ability to pursue claims in collective or class actions against the brokerage company. Schwab inserted class action bans (or "waivers") into the arbitration clauses in its various customer brokerage applications and contracts.[3] According to FINRA, contracts with the class action bans were sent to almost 7 million Schwab customers.[4]

FINRA's enforcement department charged Schwab with violating FINRA's rules, which provide that broker-dealers may require arbitration only of individual claims and must permit investors to participate in judicial class actions.[5] A FINRA administrative panel recently concluded however, that although Schwab flouted FINRA's rules, the U.S. Supreme Court's 2011 decision, *AT&T Mobility v. Concepcion* prevented the rules' enforcement. *Concepcion* dramatically expanded the Federal

[1] Public Law 111-203 (2010).
[2] Id. Section 921 amends Sec. 15 of the Securities Exchange Act of 1934 (15 U.S.C. 78o) and Sec. 205 of the Investment Advisers Act of 1940 (15 U.S.C. 80b– 5).
[3] See, e.g. Schwab One® Brokerage Account Application, Sec. 16, http://bit.ly/17tCizS; Schwab IRA Account Application, Sec. 11, http://bit.ly/10RARrv.
[4] *FINRA Dept. of Enforcement v. Schwab & Co.*, Disciplinary Proceeding No. 2011029760201, Feb. 1, 2012.
[5] FINRA Manual, Rule 2268(d). See, also, Code of Arbitration Procedure for Customer Disputes, Rule 12204.

Arbitration Act (FAA), holding that it preempts state laws that prohibit class action bans in arbitration clauses in consumer and employment contracts.

Concepcion facilitates a principal goal of companies that use forced arbitration, that is, eliminating class actions and effectively eradicating claims that require use of class proceedings, such as claims involving practices that harm large numbers of investors but cause financial injuries that are too small to make it possible for most individuals to pursue claims on their own. The result is that *Concepcion* and now the FINRA-Schwab decision have expanded opportunities for securities firms to carry out—without accountability—misleading and illegal actions that harm investors. While we are pleased FINRA will appeal the decision,[6] it is in the Commission's power under Dodd-Frank to act definitively.

The securities market is a leading example of the principle that private enforcement is a necessary counterpart to public enforcement. Private action encourages ethical corporate behavior and permits investors to recover losses caused by misconduct.[7] SEC commissioners have shared this sentiment. In a 2011 speech, Commissioner Elisse Walter expressed concern that the "trend away from private rights of action" has placed additional pressure on the Commission and increasingly burdens "already scarce governmental resources."[8] In 2006, Former Commissioner Harvey J. Goldschmid said that, "(p)rivate enforcement is a necessary supplement to the work that the S.E.C. does. It is also a safety valve against the potential capture of the agency by industry."[9]

The 2008 financial crisis, the effects of which the country continues to wrestle with five years later, should be enough to motivate the Commission to restore investors' legal rights. Brokerage firms were responsible for many fraudulent actions that led to or arose from the financial crisis. Indeed, the Commission identified Schwab as one of the firms that misled investors and "concealed the extent of risky mortgage-related and other investments in mutual funds and other financial products."[10] Ensuring that investors can choose the forum in which to resolve disputes with broker-dealers and investment advisors is critical both to remedying those past abuses and deterring future misconduct.

Similarly, Congress is aware of the integral role of private enforcement in protecting the integrity of the securities market. It realized that the SEC alone cannot combat the fraud and malfeasance that can run rampant at the hands of insatiable market participants. In Dodd-Frank, Congress provided the Commission with the authority to preserve judicial remedies for investors to supplement the Commission's own limited enforcement resources. It is clearly in the public's interest for the

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[6] Caitlin Nish, *FINRA to Appeal Ruling on Schwab Class-Action Ban,* THE WALL STREET JOURNAL, Feb. 26, 2013, http://on.wsj.com/ZBL8q8.
[7] Nishal Ray Ramphal, *The Role of Public and Private Litigation in the Enforcement of Securities Laws in the United States*, Pardee RAND Graduate School, Aug. 2007.
[8] Commissioner Elisse B. Walter, *Remarks Before the FINRA Institute at Wharton Certified Regulatory and Compliance Professional (CRCP) Program*, Nov. 8, 2011, http://1.usa.gov/Zlznml.
[9] Stephen Labaton, *Businesses Seek Protection on Legal Front*, THE NEW YORK TIMES, Oct. 29, 2006, http://nyti.ms/ZPkSxn.
[10] SEC Enforcement Actions, Addressing Misconduct That Led To or Arose From the Financial Crisis (Key Statistics Through Feb. 1, 2013), http://1.usa.gov/lamcc2.

Commission to employ the explicit authority granted to it under Dodd-Frank. To adequately protect investors, they must be empowered to choose the forum in which to resolve disputes with broker-dealers and investment advisors.

Sincerely,

AARP
Americans for Financial Reform
American Association for Justice
Center for Justice and Democracy
Citizen Works
Consumer Action
Consumer Federation of America
Consumers Union
DC Consumer Rights Coalition
Homeowners Against Deficient Dwellings
National Association of Consumer Advocates
National Association of Shareholder and Consumer Attorneys (NASCAT)
National Consumers League
Public Citizen
U.S. Public Interest Research Group (PIRG)
Workplace Fairness

Cc: Commissioner Elisse B. Walter
Commissioner Luis A. Aguilar
Commissioner Troy A. Paredes
Commissioner Daniel M. Gallagher