Written Statement of the North American Securities Administrators Association (NASAA) on "Mandatory Binding Arbitration: Is it Fair and Voluntary?"

House Committee on the Judiciary Commercial and Administrative Law Subcommittee

Tuesday, September 15, 2009

Introduction to NASAA

The North American Securities Administrators Association (NASAA) is the oldest international organization devoted to investor protection. It was organized in 1919 and is a voluntary association with a membership consisting of 67 state, provincial and territorial securities regulators in the 50 states, the District of Columbia, Puerto Rico, the U.S. Virgin Islands, Canada, and Mexico.

These state administrators are responsible for enforcement of state securities laws, licensing of firms and investment professionals, registration of certain securities offerings, examination of broker-dealers and investment advisers, and investor education.

Summary of NASAA's Position on Existing Securities Arbitration

- NASAA supports the elimination of mandatory pre-dispute arbitration clauses in brokerage accounts
- NASAA urges the removal of mandatory industry arbitrators from the three-person arbitration panel
- NASAA believes that securities arbitrators should provide a written decision in certain circumstances to create a more transparent forum and a more equitable system
- NASAA believes that every arbitration award must include a reasoned explanation for the assessment of fees and is opposed to the current opaque and arbitrary manner in which arbitrators assess fourm fees against the parties.

NASAA supports H.R. 1020, the "Arbitration Fairness Act of 2009" and recommends that language be added to the term "consumer dispute" to include "services relating to securities and other investments." This addition would make H.R. 1020 consistent with its Senate counterpart.

Mandatory Securities Arbitration

Over twenty years ago, investors had a choice of investing with a firm that required arbitration or one that recognized a judicial forum for disputes. Today, almost every broker-dealer includes in their customer agreements, a predispute arbitration provision that forces public investors to submit all disputes that they may have with the firm and/or its associated persons to mandatory arbitration. The only chance of recovery for most investors who fall victim to wrongdoing on Wall Street is through a single securities arbitration forum maintained by the securities industry.

Many investors remain unaware of this industry arbitration provision, fail to appreciate its significance, or are powerless to negotiate a different approach to dispute resolution with their brokers.

It is not surprising that many investors view industry arbitration as biased and unfair. Even in 1987, Justice Blackmun, in *Shearson/American Inc.*v.*McMahon* dissent, noted: "The uniform opposition of investors to compelled arbitration and the overwhelming support of the securities industry for the process suggest that there must be some truth to the investors' belief that the securities industry has an advantage in a forum under its own control." (482 U.S. 220, 260, citing Sheldon H. Elson of the ABA Arbitration Task Force). Investors' perception that the industry has an advantage is supported by arbitration statistics.

A recent study entitled, "Perceptions of Fairness of Securities Arbitration: An Empirical Study" which surveyed participants in the arbitration process and, based on responses to the survey questions, concluded that individual investors have negative views of arbitration. This conclusion supports the assertion that, from the investors' standpoint, the system is biased against them.

NASAA believes the "take-it-or-leave it" clause in brokerage contracts is inherently unfair to investors, and we support the "Arbitration Fairness Act of 2009" as a positive step in the right direction. In the securities context, the investor and the brokerage firms are not on equal footing. Brokerage firms have significantly more resources to fight investor claims and they currently have the benefit of arbitrating in their own industry forum with an industry member hearing the case. Adding to this advantage is the level of familiarity and comfort that firms have in the arbitration forum. Brokerage firms are literally "repeat customers" having resolved thousands of complaints by arbitration and by this fact enjoy an advantage over the individual investor who may well be facing an arbitration panel for the first time. The hazards of litigation for the firm are thereby reduced further diminishing a firm's motivation to settle a complaint. The option to litigate in an independent judicial forum would go a long way towards bringing balance to the process and helping wronged investors in their attempts to recover their losses.

Mandatory Non-Public Arbitrator

Securities arbitration cases are heard by a three-member panel that includes one "non-public" or securities industry member, and two "public" members, who may have worked in the industry. Neither of the public arbitrators is required to be an investor advocate, even though the non-public arbitrator is required to be an industry representative, and only FINRA, the industry SRO, selects who is qualified to be in the arbitrator pool. As long as arbitration panels include a mandatory industry representative of the securities industry and include public arbitrators who could have ties to the industry, the arbitration process will be both patently and fundamentally unfair to investors.

NASAA urges the removal of the mandatory industry arbitrator from the arbitration process, and for public arbitrators to have no ties to the industry. This change will bring greater fairness to securities arbitration and instill greater confidence in retail investors that their complaints will be heard in a fair and unbiased forum. The presence of an industry arbitrator should be solely at the

discretion of the investor.

Written Arbitration Decisions

NASAA believes a more transparent forum will result in a more equitable system, and to this end believes that the arbitrators must provide a written decision in certain circumstances. These are:

a. When an investor receives an award that lacks correlation to the damages sought
b. When the arbitrator chooses to disregard the law on any issue
c. Decisions that are not unanimous
d. At either parties pre-hearing request

Written decisions stating the basis for the award will permit a court to determine whether the award should be vacated on review for manifest disregard of the law, and will in many cases allow the parties to feel they have had their "day in court," which should lead to greater satisfaction with the forum in general.

Arbitration Forum Fees

NASAA is opposed to the current opaque and arbitrary manner in which arbitrators assess forum fees against the parties. Currently, even when an investor receives an award based upon the respondents wrongdoing, the investor is often assessed a significant forum fee. An investor would not be subject to these fees in a civil court proceeding. It is NASAA's belief that every award must include a reasoned explanation for the assessment of forum fees.

Conclusion

NASAA believes that the securities arbitration system should be truly voluntary, the composition of arbitration panels should be unbiased, the arbitrators should be required to provide a written decision in certain circumstances, and the award of forum fees should be supported by reasoned explanations.

As long as securities arbitration remains mandatory, investors will continue to face a system that is not fair and transparent to all. For this reason, NASAA supports the passage of H.R. 1020, the "Arbitration Fairness Act of 2009," and respectfully suggests that it be amended to clarify that its provisions extend to securities arbitration.