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Regulators to Congress: End Mandatory Arbitration

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Congress should prohibit mandatory, industry-run securities arbitration, and instead “offer a meaningful choice between binding arbitration and civil litigation,” a leading state regulator told a Congressional panel today.

Speaking at a hearing of the House Financial Services Committee on capital markets regulatory reform, Texas Securities Commissioner Denise V. Crawford, president of the North American Securities Administrators Assn. (NASAA), said that NASAA, a group of state regulators, believes the take-it-or-leave-it clause in brokerage contracts is “inherently unfair to investors,” and that Congress “should prohibit the mandatory natures of securities arbitration.” Instead, she said, the choice between binding arbitration and civil litigation “should be solely that of the investor.”

It is currently standard practice for broker-dealers to include a clause in their customer agreements requiring public investors to submit all disputes they have with the firm to a mandatory arbitration program run by the Financial Industry Regulatory Authority (FINRA), the main self-regulatory organization for broker-dealers. “When arbitration is inadequate to protect the substantive rights of investors, an independent judicial forum must be an option,” Crawford said.

Speaking at the same hearing, Richard G. Ketchum, chairman and CEO of FINRA, said FINRA would not object if mandatory arbitration were disallowed. “FINRA has long maintained that a determination about whether mandatory arbitration agreements should be allowable is...best made by Congress and the SEC,” he said. “Our view is that Congressional or SEC action is necessary...As such, we do not object to the Administration’s proposal.”

The Obama Administration has proposed as part of its regulatory reform plan that Congress authorize the SEC to restrict or prohibit mandatory arbitration agreements.

FINRA operates the largest securities arbitration forum in the U.S., with a roster of 6,300 arbitrators in public and non-public categories. Public arbitrators are from outside the securities industry, while non-public arbitrators have some affiliation with broker-dealers. Current rules require that cases be heard by a three-member panel that includes one non-public and two public members.