

January 31, 2024

The Honorable Gary Gensler  
Chair  
U.S. Securities and Exchange Commission  
Washington, DC

**Re: Critical Need for Rulemaking to Prohibit Forced Arbitration**

Dear Chair Gary Gensler

The undersigned organizations call upon the Securities and Exchange Commission (SEC) to adopt rules, pursuant to Section 921 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act), to ban the use of mandatory pre-dispute arbitration agreements in investment adviser and broker-dealer contracts.<sup>1</sup> Broker-dealers and investment advisers commonly include mandatory pre-dispute arbitration provisions in their investor agreements. The provisions are poorly understood by investors, however, and, if a dispute later arises, they force investors out of court and into arbitration forums that are often unfair, opaque, and expensive, often resulting in lower recovery for investors who have suffered fraud or abuse.<sup>2</sup>

Investors should have the ability to choose, *after* a dispute arises, whether to opt for arbitration. They should not be forced to sign pre-dispute arbitration agreements as a condition of obtaining the services of an investment adviser or broker-dealer. Enacting a rule under Section 921 of the Dodd-Frank Act to prohibit the inclusion of mandatory *pre-dispute* arbitration provisions in investment adviser and broker-dealer contracts would strike a fair and equitable balance between protecting investors from being unfairly forced into arbitration on the one hand, while preserving their freedom to pursue arbitration after a dispute arises on the other. Such a rule would place parties in investment adviser and broker-dealer relationships on the fair footing necessary to facilitate equitable dispute resolution.<sup>3</sup>

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<sup>1</sup> Dodd-Frank Wall Street Reform and Consumer Protection Act (2010), 124 Stat. 1376.

<sup>2</sup> See generally Better Markets, *Forced Arbitration: Taking Away Your Rights and Your Money* (June 11, 2019) (detailing Better Markets advocacy surrounding arbitration), <https://bettermarkets.org/newsroom/forced-arbitration-taking-away-your-rights-and-your-money/>; Consumer Advocates Letter to The Honorable Rohit Chopra, Director, Consumer Financial Protection Bureau, Re. Critical Need for Action to Limit Forced Arbitration (Sept. 13, 2022), [https://www.consumeradvocates.org/wp-content/uploads/2022/09/ConsumerClntntoCFPB\\_September\\_2022.pdf](https://www.consumeradvocates.org/wp-content/uploads/2022/09/ConsumerClntntoCFPB_September_2022.pdf); *Petition For Rulemaking: To Require Meaningful Consumer Consent Regarding the Use of Arbitration to Resolve Disputes Involving Consumer Financial Products and Services* (Sept. 13, 2023), [https://www.consumeradvocates.org/wp-content/uploads/2023/09/Petition\\_CFPB\\_1028Rulemaking092023.pdf](https://www.consumeradvocates.org/wp-content/uploads/2023/09/Petition_CFPB_1028Rulemaking092023.pdf).

<sup>3</sup> See Jean R. Sternlight, *Creeping Mandatory Arbitration: Is It Just?*, 57 STAN. L. REV. 1631, 1631-32 (2005) (“While arbitration has been used as a dispute resolution technique for thousands of years, in the past it has been agreed to knowingly and voluntarily, typically by two or more businesses. The involuntary imposition of arbitration in lieu of open court procedures is a new and most controversial phenomenon.”).

**I. The Commission has the clear authority to restrict the use of mandatory pre-dispute arbitration agreements in investment adviser and broker-dealer contracts.**

Section 921 of the Dodd-Frank Act expressly empowers the SEC to take the requested action.<sup>4</sup> That section authorizes the Commission to prohibit or limit the use of pre-dispute mandatory arbitration clauses in contracts that investors enter into with broker-dealers and investment advisors, if doing so is in the public interest and for the protection of investors. Section 921(a) provides:

The Commission, by rule, may prohibit, or impose conditions or limitations on the use of, agreements that require customers or clients of any broker, dealer, or municipal securities dealer to arbitrate any future dispute between them arising under the Federal securities laws, the rules and regulations thereunder, or the rules of a self-regulatory organization if it finds that such prohibition, imposition of conditions, or limitations are in the public interest and for the protection of investors.<sup>5</sup>

Section 921(b) provides:

The Commission, by rule, may prohibit, or impose conditions or limitations on the use of, agreements that require customers or clients of any investment adviser to arbitrate any future dispute between them arising under the Federal securities laws, the rules and regulations thereunder, or the rules of a self-regulatory organization if it finds that such prohibition, imposition of conditions, or limitations are in the public interest and for the protection of investors.<sup>6</sup>

These provisions give the SEC clear authority to restrict mandatory pre-dispute arbitration clauses in broker-dealer and investment adviser contracts.

**II. Mandatory pre-dispute arbitration agreements are pervasive in the financial services industry, incomprehensible to many investors, and forced on them through lack of bargaining power.**

The use of mandatory pre-dispute arbitration agreements is pervasive. “An overwhelming majority of retail brokerage and many investment advisory agreements include language requiring all disputes between the customer and broker-dealer/investment adviser be resolved through

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<sup>4</sup> 15 U.S.C. § 78o(o), *Authority to restriction mandatory pre-dispute arbitration*; see also Barbara Black, *How To Improve Retail Investor Protection After The Dodd-Frank Wall Street Reform And Consumer Protection Act*, 13 U. PA. J. BUS. L. 59, 59 (2010) (“[S]ection 921 grants the SEC authority to prohibit the use of predispute arbitration agreements that would require investors to arbitrate future disputes arising under the federal securities laws and regulations or the rules of a self-regulatory organization.”).

<sup>5</sup> 15 U.S.C. § 78o(o).

<sup>6</sup> 15 U.S.C. § 80b-5(f).

arbitration.”<sup>7</sup> The SEC’s recent report on the use and abuse of mandatory pre-dispute arbitration agreements by registered investment advisers found that “approximately 61% of SEC-registered advisers that serve retail investors incorporated mandatory arbitration clauses into their investment advisory agreements.”<sup>8</sup> Thus, “only in rare instances can an investor open a brokerage or investment advisory account without agreeing to submit to mandatory pre-dispute arbitration.”<sup>9</sup>

As a result, “unknowing, relatively powerless citizens enter into mandatory arbitration provisions routinely in order to conduct commonplace transactions in our consumer society.”<sup>10</sup> Yet despite their pervasiveness, the evidence shows that few people read the arbitration clauses tucked away in fine-print contracts.<sup>11</sup> Among those who do, few understand their implications.<sup>12</sup>

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<sup>7</sup> William Alan Nelson II, *Take It or Leave It: Unconscionability of Mandatory Pre-Dispute Arbitration Agreements in the Securities Industry*, 17 U. PA. J. BUS. L. 573, 574 (2015).

<sup>8</sup> RESPONSE TO CONGRESS: MANDATORY ARBITRATION AMONG SEC-REGISTERED INVESTMENT ADVISERS, AS DIRECTED BY THE HOUSE COMMITTEE ON APPROPRIATIONS H.R. REPT. NO. 117-393, at 4 (2023).

<sup>9</sup> Nelson, 17 U. PA. J. BUS. L. at 575.

<sup>10</sup> Thomas M. Madden, *Mandatory Pre-Dispute Arbitration: An Alternative Approach*, 2019 MICH. ST. L. REV. 1033, 1058 (2019).

<sup>11</sup> See Ian Ayres & Alan Schwartz, *The No-Reading Problem in Consumer Contract Law*, 66 STAN. L. REV. 545 (2014); Florencia Marotta-Wurgler et al., *Does Anyone Read the Fine Print? Consumer Attention to Standard-Form Contracts*, 43 J. LEG. STUD. 1, 2 (2014) (conducting an empirical study to find that “only one or two in 1,000 shoppers access a product’s EULA [End User License Agreement] for at least 1 second.”); Jonathan A. Obar & Anne Oeldorf-Hirsch, *The Biggest Lie on the Internet: Ignoring the Privacy Policies and Terms of Service Policies of Social Networking Services*, INFO., COMM. & SOC’Y (2018) (describing an empirical study in which 93% of consumers agreed to a contract without noticing a “child assignment clause” that would have provided the consumer’s first-born child as payment); Yannis Bakos et al., *Does Anybody Read the Fine Print? Consumer Attention to Standard Form Contracts*, 43 J. LEGAL STUD. 1, 2–3 (2014); Florencia Marotta-Wurgler, *Does Contract Disclosure Matter?*, 168 J. INSTITUTIONAL & THEORETICAL ECON. 94, 100–106 (2012).

<sup>12</sup> See Roseanna Sommers, *What Do Consumers Understand About Predispute Arbitration Agreements? An Empirical Investigation* (forthcoming) (“[M]ost consumers misperceive the consequences of signing a predispute arbitration agreement. Most mistakenly believe that, after agreeing to terms and conditions mandating binding arbitration, they can still: choose to settle their dispute in court, have a jury decide their case, join a class action, and appeal a decision made based on a legal error. ... Indeed, less than 1% of respondents correctly understood the full significance of the arbitration agreement, as indicated by their responses to questions about whether they retained the rights to sue, have a jury decide their case, access the public courts, and appeal a decision based on a legal error.”); Mark L. Egan, Gregor Matvos & Amit Seru, *Arbitration with Uninformed Consumers*, NATIONAL BUREAU OF ECONOMIC RESEARCH, Working Paper 25150 (Oct. 2018) (“This paper studies the impact of the arbitrator selection process on consumer outcomes by examining roughly 9,000 consumer arbitration cases in the securities industry. ... We establish several facts that suggest that firms hold an informational advantage over consumers in selecting arbitrators, resulting in industry-friendly arbitration outcomes.”).

A variety of sources confirm the point.<sup>13</sup> For example, the Consumer Financial Protection Bureau (CFPB) analyzed the complexity of arbitration clauses found in credit card contracts by measuring the clauses' length, readability, and grade level.<sup>14</sup> The CFPB found that the average arbitration clause comprised 14.1% of the words in the contract and consisted of 1,108.8 words.<sup>15</sup> The average grade level (which translates total words, total sentences, and total syllables into the level of education required to understand the text) for the arbitration clauses averaged 15.6,<sup>16</sup> indicating that the text is best understood by those with some college education. In contrast, the average grade level for the remainder of the contract was 11.6, which roughly corresponds to a high school-level education.<sup>17</sup>

The pervasive use of mandatory pre-dispute arbitration provisions in investment adviser and broker-dealer contracts, exacerbated by people's difficulty understanding them, is especially troubling because the provisions are written by and for the benefit of investment advisers and broker-dealers, at the expense of investors.<sup>18</sup> Because of their "extreme inequality of bargaining power,"<sup>19</sup> along with the difficulties in understanding these clauses, investors lack the ability to meaningfully consent to the arbitration provisions. And once investors become bound, the contracts typically do not allow the investor to opt out of the arbitration provisions or provide a limited opportunity to do so.

### **III. Mandatory pre-dispute arbitration agreements, especially those imposed by registered investment advisers, harm investors in multiple ways: through class action waivers, biased arbitrators, high costs, and limits on recovery.**

Mandatory arbitration inflicts a variety of harms on investors. Although FINRA has improved the process in many respects for arbitration with broker-dealers, serious concerns remain in both the broker-dealer and investment adviser space. The problems are especially acute with respect to arbitration involving registered investment advisers.

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<sup>13</sup> See Roseanna Sommers, *What Do Consumers Understand About Predispute Arbitration Agreements? An Empirical Investigation* (July 25, 2023), <https://ssrn.com/abstract=4521064> or <http://dx.doi.org/10.2139/ssrn.4521064>.

<sup>14</sup> CFPB, *ARBITRATION STUDY, REPORT TO CONGRESS 2015*, at 27–29, [https://files.consumerfinance.gov/f/201503\\_cfpb\\_arbitration-study-report-to-congress-2015.pdf](https://files.consumerfinance.gov/f/201503_cfpb_arbitration-study-report-to-congress-2015.pdf).

<sup>15</sup> *Id.*

<sup>16</sup> *Id.*

<sup>17</sup> *Id.*

<sup>18</sup> See generally Barbara Black, *How To Improve Retail Investor Protection After The Dodd-Frank Wall Street Reform And Consumer Protection Act*, 13 U. PA. J. BUS. L. 59 (2010); Suzanne Barlyn, *Do Arbitration Pacts Go Against Clients' Best Interests?*, CHICAGO TRIBUNE (Feb. 13, 2013), <https://www.chicagotribune.com/news/ct-xpm-2013-02-13-sns-rt-us-arbitration-advisersbre91c1fj-20130213-story.html>.

<sup>19</sup> Madden, 2019 MICH. ST. L. REV. at 1058.

The arbitration process is a private dispute resolution mechanism, typically run by or favoring the industry. Arbitrators serving on panels are often industry friendly; the governing rules provide for limited discovery, even though much of the evidence is in the hands of the broker or adviser; there is typically no decision explaining the findings; and rights of appeal, no matter how egregious the misapplication of the law may have been, are extremely limited. Indeed, “[a] June 2007 study of more than 14,000 FINRA arbitration awards over a ten-year period (1995–2004) found that investors with significant claims suing major brokerage firms could expect to recover only *twelve percent* of the amount claimed.”<sup>20</sup> While a number of factors may contribute to these outcomes, we highlight some special concerns below.

**A. Class action waivers impose special burdens on investors in complex cases or those involving small claims shared by many people.**

Many mandatory pre-dispute arbitration clauses both deprive investors of the right to seek relief in court and, often, foreclose investors’ right to pursue their claims collectively, as in class actions. Class actions are often a vital tool for seeking relief from wrongdoing that affected a large number of investors. “Where it is not economically feasible to obtain relief within the traditional framework of a multiplicity of small individual suits for damages, aggrieved persons may be without any effective redress unless they employ the class action device.”<sup>21</sup> Individual investors often lack the resources to bring complex securities claims on their own. As a result, “the effectiveness of the securities laws may depend in large measure on the application of the class action device.”<sup>22</sup>

Nonetheless, firms routinely use arbitration provisions containing class-action waivers to force their clients to pursue claims individually if a dispute arises. Class-action waivers disempower would-be litigants from bringing claims, thereby insulating firms from accountability to investors. While FINRA does not allow broker-dealer members to impose class-action

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<sup>20</sup> Nelson, 17 U. PA. J. BUS. L. at 575 (emphasis in original); *see also* AMERICAN ASSOCIATION FOR JUSTICE, THE TRUTH ABOUT FORCED ARBITRATION 6 (Sept. 2019), <https://facesofforcedarbitration.com/wp-content/uploads/2019/09/Forced-Arbitration-2019-FINAL.pdf> (reviewing 30,000 consumer arbitrations conducted by AAA and JAMS between 2014–2018 and finding that only 6.3% resulted in consumers winning a monetary award); CFPB, ARBITRATION STUDY: REPORT TO CONGRESS 2015, *supra* note 14, at 11–12 (finding that in business-initiated cases in which arbitrators reached a decision on the merits, companies won relief in 93% of cases and were awarded 98¢ for every dollar claimed; by contrast, arbitrators sided with consumers in only 27% of cases and awarded them an average of 13¢ for every dollar claimed). By contrast, the CFPB’s 2015 report on arbitration found that between 2008 and 2012, 422 consumer class action settlements returned over \$440 million (after deducting attorneys’ fees and court costs) to an average of 6.8 million consumers each year, on average. CFPB, ARBITRATION STUDY: REPORT TO CONGRESS 2015, *supra* note 14, at 16.

<sup>21</sup> *Deposit Guaranty National Bank v. Roper*, 445 U.S. 326, 339 (1980).

<sup>22</sup> *Eisenberg v. Gagnon*, 766 F.2d 770 (3d Cir. 1985) (quoting *Kahan v. Rosenstiel*, [424 F.2d 161, 169 \(3d Cir. 1970\)](https://www.courts.gov/casereports/424_F.2d_161_169_3d_Cir_1970)).

waivers,<sup>23</sup> investment advisors continue to use them. In those cases, class-action waivers foreclose a key means of seeking relief for wronged investors, while also eliminating “the deterrent effect of class actions . . . in accomplishing the objectives of the securities laws.”<sup>24</sup> Where an arbitration provision incorporates a waiver of class actions and class arbitration, the “only redress of the relatively powerless is often an economically irrational option to proceed with sole arbitration for de minimis individual wrongs that, in the aggregate, may yield tens or hundreds of millions of dollars for the wrongdoer.”<sup>25</sup> In that circumstance, “the aggregate check on large scale wrongdoing affecting individuals in minimal ways, yet reaping quite sizeable unjust rewards, is dead.”<sup>26</sup>

**B. Arbitration also inflicts harm on investors through the designated venue for the arbitration, the selection of the arbitrator, and the lack of written opinions.**

The arbitrations that result from mandatory pre-dispute arbitration agreements disadvantage investors in a variety of other ways.<sup>27</sup> For example, the recent SEC Staff Study on arbitration among investment advisers found that, when designating a forum for dispute resolution, “97 percent designated a location that does not consider the client’s location or place of business. To the contrary, many of these agreements designed venue locations ‘of the adviser’s choosing’ or ‘wherever the adviser is located.’”<sup>28</sup> These venue provisions can impose huge and potentially insurmountable financial burdens on investors with claims against advisers in distant locations.

Firms also “hold an informational advantage over consumers in selecting arbitrators, resulting in industry-friendly arbitration outcomes.”<sup>29</sup> An arbitrator’s background has a significant impact on arbitration outcomes,<sup>30</sup> and many arbitrators come from an industry-friendly

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<sup>23</sup> FINRA, *Regulatory Notice 21-16, Pre-dispute Arbitration Agreements in Customer Agreements* (Apr. 21, 2023) (“FINRA rules do not allow class action claims in FINRA arbitration. Accordingly, FINRA rules prohibit member firms from incorporating provisions that would prevent customers from bringing or participating in judicial class actions by adding waiver language into customer agreements (class action waivers) and prohibit member firms from enforcing arbitration agreements against members of a certified or putative class action.”), <https://www.finra.org/sites/default/files/2021-04/Regulatory-Notice-21-16.pdf>.

<sup>24</sup> *Blackie v. Barrack*, 524 F.2d 891, 903 (9th Cir. 1975).

<sup>25</sup> Madden, 2019 MICH. ST. L. REV. at 1058.

<sup>26</sup> *Id.*

<sup>27</sup> See generally Michael S. Barr, *Mandatory Arbitration in Consumer Finance and Investor Contracts*, 11 NYU J. L. & BUS. 793 (2015); Catherine Moore, *The Effect of the Dodd-Frank Act on Arbitration Agreements: A Proposal for Consumer Choice*, 12 PEPP. DISP. RESOL. L.J. 503 (2012).

<sup>28</sup> SEC 2023 Arbitration Report, at 17.

<sup>29</sup> Edward S. O’Neal & Daniel R. Solin, *Mandatory Arbitration of Securities Disputes—A Statistical Analysis of How Claimants Fare* (2007), <http://www.sleg.com/pdf/workingpapers/Mandatory%20Arbitration%20Study.pdf>.

<sup>30</sup> See Stephen J. Choi *et al.*, *The Influence of Arbitrator Background and Representation on Arbitration Outcomes*, 9 VA. L. & BUS. REV. 43 (2014).

background.<sup>31</sup> Investors often may not appreciate the significance of an arbitrator’s industry connection. These facts reinforce the growing public perception that arbitration forums are fundamentally unfair to consumers and investors.<sup>32</sup>

The process through which arbitrators issue decisions also harms investors. Arbitrators are not required to issue written opinions explaining their decisions.<sup>33</sup> This lack of transparency prevents parties and the public from understanding how the arbitrator made its decision, makes it harder to seek judicial review of an adverse arbitration award, and renders awards unpredictable and inconsistent since arbitrators lack of a body of precedent to guide their decisions.<sup>34</sup>

### **C. Mandatory pre-dispute arbitration agreements harm investors because arbitration is costly and limits investors’ ability to recover damages.**

Arbitration can be very costly, especially in disputes with registered investment advisers (RIAs). Indeed, the fees paid by plaintiffs in arbitrations against investment advisers can be so exorbitantly high as to effectively prevent plaintiffs from bringing a claim in the first place:

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<sup>31</sup> See Barr, 11 NYU J. L. & BUS. at 802 (“There has long been some concern about the process by which FINRA selects its arbitrators. . . . Generally speaking, the pool of arbitrators has close ties to the financial industry, lacks diversity, and is infrequently updated.”); Moore, 12 PEPP. DISP. RESOL. L.J. at 511 (noting the alleged bias of FINRA arbitration panels because at least one member of those three-member panels is a FINRA member and therefore part of the securities industry because FINRA members are securities traders and brokers).

<sup>32</sup> See Jill I. Gross & Barbara Black, *When Perception Changes Reality: An Empirical Study of Investors’ Views of the Fairness of Securities Arbitration*, 2 J. DISP. RESOL. 349, 389–91 (2008); Jill Gross, *The End of Mandatory Securities Arbitration?*, 30 PACE L. REV. 1174, 1177–78 (2010); Cheryl Nichols, *Arbitrator Selection at the NASD: Investor Perception of a Pro-Securities Industry Bias*, 15 OHIO ST. J. ON DISP. RESOL. 63 (1999); see also Moore, 12 PEPP. DISP. RESOL. L.J. at 511 (“It is significant that FINRA is the only arbitration provider for consumer-broker disputes given the nature of FINRA arbitration and what some consumers feel is a biased system that favors the interests of industry defendants over the interests of consumers.”). FINRA has established some requirements surrounding the participation of “public” arbitrators, see FINRA Rule 12000, Code of Arbitration Procedure for Customer Disputes, but that hasn’t solved the problem of industry bias, on the face of the rule or as a result of some practices in the arbitration arena.

<sup>33</sup> See *O.R. Sec., Inc. v. Prof’l Planning Assocs.*, 857 F.2d 742, 747 (11th Cir. 1988) (citing *Wilko v. Swan*, 346 U.S. 427 (1953), *overruled on other grounds by Rodriguez de Quijas v. Shearson/Am. Express, Inc.*, 490 U.S. 477 (1989)); Lynn Katzler, Comment, *Should Mandatory Written Opinions Be Required in All Securities Arbitrations?: The Practical and Legal Implications to the Securities Industry*, 45 AM. U. L. REV. 151, 193–94 (1995). Under FINRA rules, parties can jointly request an explained decision, which the arbitrator must provide, though this rule only applies when *all* parties join in the request. See FINRA Rules 12904(g) & 13904(g). Arbitrators may also exercise discretion to issue an explanation of the decision on their own, even absent such a request. See FINRA Rule 12904(f) (“The award *may* contain a rationale underlying the award.”) (emphasis added).

<sup>34</sup> Barr, 11 NYU J. L. & BUS. at 809–10; see also Moore, 12 PEPP. DISP. RESOL. L.J. at 515 (“Should the SEC limit the enforcement of arbitration agreements, investors will have greater access to the court system which, unlike arbitration, allows for robust discovery, use of juries, precedent, and judicial review.”).

Unlike brokerage firms, which must designate FINRA as the arbitration forum, RIAs often require clients to file arbitration claims with privately run dispute resolution forums such as the American Arbitration Association or JAMS, where arbitrators set their own fees. It is not uncommon for an arbitrator to charge \$8,000 or more for a day's work. Arbitration costs can easily exceed \$64,000 for five days of hearings and three days of pre-hearing and post-hearing work. Triple that amount if there are three arbitrators hearing the dispute. Unlike FINRA, the privately run forums require the expected fees to be deposited prior to the case proceeding. This means that an investor may have to deposit tens of thousands of dollars just to have their claim move forward. RIAs, knowing the forum fees are cost-prohibitive for most clients use these types of arbitration clauses to shield themselves from liability for their misconduct.<sup>35</sup>

In addition, mandatory pre-dispute arbitration agreements often include “loser pays” provisions that create a significant disincentive for an individual to bring a claim out of fear that they will be on the hook for the firm's attorney's fees if they do not prevail.<sup>36</sup> Those fees may be substantial. Furthermore, those potential fees come on top of the fees that the investor must pay their own attorneys. Although originally “intended to be a less costly, less time-consuming, less complex, just alternative to civil litigation, present-day arbitration in the big versus small context of employment, consumer finance, and investment contracts is largely a failure.”<sup>37</sup> “It has become ever more expensive, more time-consuming, and more like the civil litigation it was intended to avoid.”<sup>38</sup>

In addition, arbitration limits investors' ability to recover damages in several ways. For instance, “[o]ftentimes, arbitration clauses preclude the award of punitive damages or consequential damages, or both. Alternatively, they may specify strict guidelines for the arbitrator to follow in calculating the award.”<sup>39</sup> As the SEC found in its 2023 report to Congress, “eleven percent of agreements with mandatory arbitration clauses limited the types of damages available

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<sup>35</sup> Christine Lazaro & Michael S. Edmiston, *Costly forced arbitration against RIAs harms investors*, PIABA (Jan. 14, 2022), <https://piaba.org/piaba-newsroom/oped-costly-forced-arbitration-against-rias-harms-investors-christine-lazaro-and>; see also Press Release, PIABA, “*It's A Broken System*”: Investment Fraud Victims Speak Out About Industry-Favored System of RIA-Forced Arbitration (July 25, 2023), <https://piaba.org/piaba-newsroom/press-release-its-broken-system-investment-fraud-victims-speak-out-about-industry>.

<sup>36</sup> See JERRY W. MARKHAM & THOMAS LEE HAZEN, *BROKER-DEALER OPERATIONS UNDER SECURITIES AND COMMODITIES LAW* § 12:30 (“Arbitration agreements may authorize the award of attorney fees to the prevailing party.”).

<sup>37</sup> Madden, 2019 MICH. ST. L. REV. at 1056.

<sup>38</sup> *Id.*

<sup>39</sup> Barr, 11 NYU J. L. & BUS. at 811.

to the investor—such as punitive, exemplary, treble and consequential damages.”<sup>40</sup> These damages limitations insulate firms from liability and limit investors’ ability to be made whole from the arbitration process.<sup>41</sup> According to FINRA’s 2022 statistics, claimants were awarded damages in only 36% of cases.<sup>42</sup>

#### IV. Conclusion and Recommendations

For the reasons discussed above, investors experience unfairness and dissatisfaction in arbitration.<sup>43</sup> Indeed, a 2008 survey of over 3,000 individuals who participated in an arbitration found that “seventy-one percent of investors were dissatisfied with the outcome of the arbitration.”<sup>44</sup>

As the Department of the Treasury stated in its 2009 report *Financial Regulatory Reform, A New Foundation: Rebuilding Financial Supervision and Regulation*, “[a]lthough arbitration may be a reasonable option for many consumers to accept *after a dispute arises*, mandating a particular venue and *up-front* method of adjudicating disputes — and eliminating access to courts — may unjustifiably undermine investor interests.”<sup>45</sup> Importantly, the issue is *not* that investors may choose to arbitrate their claims *after* a dispute arises. Where arbitration provisions are forced upon investors at the outset, however, before any dispute arises, as a condition of establishing an investment adviser or broker-dealer relationship, those provisions effectively deprive investors of meaningful choice, in contravention of Congress’s concerns reflected in the Dodd-Frank Act. And

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<sup>40</sup> SEC 2023 Arbitration Study, at 18.

<sup>41</sup> We recognize that FINRA has partially restricted firms’ ability to limit the types of relief available under FINRA arbitration. See *FINRA Regulatory Notice 21-16* (Apr. 21, 2021) (noting several restrictions upon firms’ ability to limit the authority of arbitrators to issue an award), <https://www.finra.org/rules-guidance/notices/21-16>; *FINRA Rule 2268(d)* (“No predispute arbitration agreement shall include any condition that . . . limits the ability of arbitrators to make any award.”); *FINRA Notice to Members 95-16* (Mar. 01, 1995), <https://www.finra.org/rules-guidance/notices/95-16>; *FINRA Notice to Members 95-85* (Oct. 01, 1995), <https://www.finra.org/rules-guidance/notices/95-85>.

<sup>42</sup> FINRA, Dispute Resolution Statistics, *Results of Customer Claimant Arbitration Award Cases*, FINRA.ORG, <https://www.finra.org/arbitration-mediation/dispute-resolution-statistics#howcasesclose>.

<sup>43</sup> See Madden, 2019 MICH. ST. L. REV at 1042-43 (2019).

<sup>44</sup> Nelson, 17 U. PA. J. BUS. L. at 576 (citing Jill I. Gross & Barbara Black, *When Perception Changes Reality: An Empirical Study of Investors’ Views of the Fairness of Securities Arbitration*, 2008 J. DISP. RESOL. 349, 386 (2008).

<sup>45</sup> DEP’T OF TREAS., FINANCIAL REGULATORY REFORM, A NEW FOUNDATION: REBUILDING FINANCIAL SUPERVISION AND REGULATION 72 (2009) (emphasis added), <https://fraser.stlouisfed.org/title/financial-regulatory-reform-5123>.

although FINRA has partially addressed some of arbitration's shortcomings, its forum remains problematic on a number of levels.<sup>46</sup>

We therefore urge the Commission to exercise its authority under Section 921 of the Dodd-Frank Act to prohibit the inclusion of mandatory pre-dispute arbitration provisions in investment adviser and broker-dealer contracts. This prohibition, limited to *pre*-dispute arbitration provisions, would preserve investors' and firms' ability to choose arbitration *post*-dispute, while preserving all parties' right to access the civil justice system. "If [investors] are given the choice between arbitration or litigation, this competition could have the effect of correcting some of what [they] feel are shortcomings in the arbitration process."<sup>47</sup>

In addition, we urge the Commission to prohibit investment adviser and broker-dealer contracts from restricting investors' ability to pursue class or collective actions. The prohibition should apply irrespective of whether the claims are pursued in court or in arbitration.

Thank you for your prompt consideration of our petition. If you have any questions or comments regarding this petition, please contact Brady Williams at [bwilliams@bettermarkets.org](mailto:bwilliams@bettermarkets.org) or Martha Perez-Pedemonti at [mperezpedemonti@citizen.org](mailto:mperezpedemonti@citizen.org).

Respectfully,

American Federation of State, County and Municipal Employees (AFSCME)

Americans for Financial Reform

Better Markets

Center for Justice & Democracy

Consumer Action

Consumers for Auto Reliability and Safety

Consumer Watchdog

Earthjustice

Essential Information

Impact Fund

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<sup>46</sup> We note that while FINRA has addressed some of the concerns about arbitration in the broker-dealer context, FINRA arbitration still suffers from a number of features that disadvantage investors, including, for example, the absence of transparency, juries, reliance on precedent, and meaningful rights of appeal.

<sup>47</sup> Moore, 12 PEPP. DISP. RESOL. L.J. at 523.

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National Association of Consumer Advocates

National Consumer Law Center (on behalf of its low income clients)

National Employment Law Project

People's Parity Project

Public Citizen

Public Justice

Revolving Door Project