

**TESTIMONY OF
SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION

BEFORE THE
HOUSE SUBCOMMITTEE ON COMMERCIAL AND ADMINISTRATIVE LAW

UNITED STATES HOUSE OF REPRESENTATIVES

HEARING ON
“H.R. 3010, THE ARBITRATION FAIRNESS ACT OF 2007”

October 25, 2007**

The Securities Industry and Financial Markets Association (“SIFMA”)¹ is pleased to submit testimony on the Arbitration Fairness Act, H.R. 3010. This legislation would effectively abolish pre-dispute arbitration agreements as a way to quickly, efficiently and fairly resolve consumer disputes. This bill would also undermine arbitration generally as a dispute resolution forum. Moreover, this bill would undermine a unique and highly evolved forum with a proven track record of outstanding service to investors – the securities arbitration forum.

Securities arbitration is a system that works to resolve disputes between investors and securities firms. The system is fair to both investors and to securities firms and their employees. We know this from the weight of both anecdotal evidence and the most up-to-date empirical data. Yesterday, SIFMA, in conjunction with its Compliance and Legal Division, released a comprehensive white paper on arbitration in the securities industry that demonstrates the timely, cost-effective, and fair results that the forum has delivered to investors for over 30 years. The paper also explains the sound public policy that underpins pre-dispute agreements to arbitrate. A copy of our paper is attached to this testimony.²

¹ The Securities Industry and Financial Markets Association brings together the shared interests of more than 650 securities firms, banks and asset managers locally and globally through offices in New York, Washington D.C., and London. Its associated firm, the Asia Securities Industry and Financial Markets Association, is based in Hong Kong. SIFMA's mission is to champion policies and practices that benefit investors and issuers, expand and perfect global capital markets, and foster the development of new products and services. Fundamental to achieving this mission is earning, inspiring and upholding the public's trust in the industry and the markets. (More information about SIFMA is available at <http://www.sifma.org>.)

² See WHITE PAPER ON ARBITRATION IN THE SECURITIES INDUSTRY: *The success story of an investor protection focused institution that has delivered timely, cost-effective, and fair results for over 30 years* (October 2007) (the “White Paper”).

Securities arbitration allows parties to resolve disputes quickly, efficiently and fairly. Arbitration offers significant benefits to all parties – customers and securities firms alike – that may not be achieved through court-based litigation or in other forums.

Securities Arbitration is Faster and Less Expensive Than Court-Based Litigation

The data confirm that securities arbitration continues to be a far more efficient and cost-effective dispute resolution mechanism than traditional court-based litigation. On average, cases filed in securities arbitration are resolved 40 percent faster and at far less cost to customers than cases filed in court.³ The most obvious benefit of the speedy resolution is that successful plaintiffs obtain the relief they seek -- usually money -- more quickly, and all parties are able to move on to more constructive endeavors. In addition, the significant reduction in time to judgment benefits all parties involved in the process: if parties spend less time litigating, they spend less money.

Securities Arbitration is Fair and Effective

Some critics of arbitration claim it delivers inequitable and unfair results to customers. These claims are belied by the facts. First, the percentage of securities arbitration claimants who recover—either by award or settlement—has held steady in recent years, and in 2006 was 66 percent.⁴ Second, between 1995 and 2004, claimants' average inflation-adjusted recoveries in securities arbitration have followed a generally increasing trend.⁵

Nor is there evidence that the presence of a non-public or “industry” arbitrator on a three-member panel in securities arbitrations somehow infuses pro-industry bias into the process. A May 2005 study conducted by Securities Arbitration Commentator, Inc. (“SACI”) on industry bias on arbitration panels found that the presence of non-public arbitrators yielded “no material impact on customer wins” when compared to “win” rates on awards which public arbitrators adjudicated alone.⁶ In that study, SACI also considered 162 arbitrations where a dissent was

³ See White Paper, Appendix B (Arbitration is Faster Than Litigation).

⁴ See White Paper, Appendix D (The Total Percentage of Claimants Who Recover Damages or Other Relief in Arbitration or by Settlement is Favorable).

⁵ See White Paper, Appendix E (Investors' Inflation-Adjusted Recoveries in Arbitration Have Increased).

⁶ *Industry Arbitrator Award Survey: Does the Securities Industry Arbitrator's Presence Create a Discernible Shift in Award Outcomes?*, Securities Arbitration Commentator, Inc. 8 (Vol. 2005, No. 4), available at <http://sec.gov/rules/sro/nasd/nasd2005094/rpryder091905.pdf>.

filed by an arbitrator.⁷ Of those cases, claimants won 63 percent of the time, and more than 70 percent of the dissents were filed by *public* arbitrators.⁸ SIFMA's own review of available decisions from 2005 and 2006 further supports the SACI study's findings: in 2005, arbitration panels, which include an "industry" arbitrator, found for claimants in 60 percent of cases whereas cases decided by a single arbitrator, which by rule must be a "public" arbitrator, found for claimants in 50 percent of cases. Similarly, in 2006 panels found for claimants in 55 percent of cases they heard.⁹

These studies confirm that a claimant's chances in an SRO-sponsored arbitration forum are as good, if not better, than his or her chances in court.

Securities Arbitration Provides Investors a Better Opportunity for a Hearing Than Court-Based Litigation

In addition to the efficiency and fairness benefits described above, significantly more cases brought in arbitration go to hearing and are ultimately heard on the merits than cases brought in court. In fact, 20 percent of all arbitration claims are decided by arbitrators, whereas only 1.5 percent of civil claims are decided by a judge or jury.¹⁰

Unlike in court cases, claimants in arbitration are not held to exacting pleading standards and thus, their claims are far less likely to be dismissed before a hearing. In court, however, a significant percentage of claims are dismissed on pre-hearing motions to dismiss or for summary judgment. Many of these dismissals are on what may be described as technical, or procedural, grounds. This includes dismissals for pleading failures and jurisdictional deficiencies.

A plaintiff in a court case may be faced with a daunting gauntlet of obstacles: a threshold motion attacking the sufficiency of pleading in a complaint; formal document requests with no presumption of anything being properly discoverable; written interrogatories; depositions of fact witnesses; discovery motions; written expert reports; depositions of expert witnesses; formal requests for admissions; a pretrial motion for summary judgment; interlocutory appeals of any decisions rendered before a trial; motions to preclude or allow certain evidence at trial; and

⁷ *Id.* at 5-6. The SACI study noted that of the 7,127 arbitration awards made from 2000-2004, only 186 awards (2.6 percent) included a dissent. *Id.* at 5.

⁸ *Id.* at 6-7.

⁹ See White Paper, Appendix G (The Presence of an "Industry" Arbitrator Has No Material Impact on Customer Wins).

¹⁰ See White Paper, Appendix C (More Cases Are Heard Before a Decision-Maker in Arbitration Than in Court).

then, finally, for the few who make it that far, a trial followed by almost automatic appeals by the losing party. And, if a customer prevails in court after all of that, he or she may have to hurdle additional obstacles just to get that hard-earned judgment enforced. That is the reality facing those who need to resort to the court system.

In contrast, arbitration allows for a simple statement of claim, an answer, focused and limited discovery, and then a full merits hearing. While pre-hearing motions are permitted, they are disfavored and more limited in arbitration versus court. The costs to get to a hearing are a fraction of what they are in traditional litigation. As arbitration practitioners will readily acknowledge, many claims that would otherwise have been dismissed in court on legal grounds are nonetheless presented on the merits to arbitrators, allowing claimants a greater opportunity to be heard. And, as reflected in the significant percentage of cases that settle before a hearing, customers are able to use the leverage of a speedy hearing in negotiating favorable resolutions of disputes through mediation or other settlement negotiations.

Securities arbitration also provides a significant benefit to investors with small claims. Approximately 25 percent of all arbitrations involve claims of less than \$10,000, and another 25 percent involve claims of less than \$50,000, sums for which it may not be cost effective to litigate, whether in federal or state court.¹¹

Multiple Regulators Oversee Securities Arbitration and Ensure It Remains an Investor Protection Focused Institution.

For over 30 years, securities arbitration has been closely regulated by the Securities and Exchange Commission (SEC) and the Financial Industry Regulatory Authority (FINRA). The tight regulation and strict oversight of securities arbitration has resulted in numerous procedural safeguards that protect investors and ensure fairness.¹² A few examples of such safeguards include: arbitrators must provide and update extensive biographical disclosures, including employment history, training, conflicts and associations with industry members, and arbitrators must disclose their awards in prior cases. Investors are involved in selecting arbitrators and arbitration panels. Sanctions are available against securities firms for failure to comply with the Code of Arbitration Procedure, and disciplinary referrals may be made to regulators for potential violations of federal securities laws. Investors are assured that a hearing will take place at a location close to their residence.

¹¹ See White Paper, Appendix F (Many Cases are Small Claims, Which are Better-Suited for Arbitration Than Litigation).

¹² See White Paper, Appendix A (Chronology of Improvements to Securities Arbitration Procedures).

Pre-dispute Arbitration Agreements are Fair to Investors and Serve the Public Interest

Pre-dispute agreements to arbitrate securities disputes are not only fair to investors, but also serve the public interest. If both parties were free to choose their forum after a dispute had arisen, they would rarely reach agreement. As William Paul, former President of the American Bar Association, explained, “The odds of an agreement for binding arbitration being entered into after a dispute has arisen are not great. At that stage one party or the other will have a view that traditional litigation offers some advantage which the party does not choose to relinquish.” Thus, if both parties had the choice, each would attempt to gain tactical advantage by picking one forum or the other. The evidence bears this out and shows that the odds of an agreement to arbitrate being entered into after a dispute has arisen are very low. Thus, the end result of this approach would be that most disputes would end up in the lengthier, costlier, litigation forum.

Moreover, eliminating pre-dispute arbitration would essentially create two separate justice systems – one for wealthy plaintiffs who may want to roll the dice with litigation (thereby driving up transaction costs for everyone), and one for the middle class who would continue to rely on arbitration for their best results. There is no sound public policy reason to eliminate pre-dispute agreements to arbitrate in the securities industry. The current system provides significant benefits that investors have enjoyed for over three decades: It resolves disputes faster and less expensively than litigation. It operates under rules tailored to investor claims. It provides predictability as to process, under rules that are uniform regardless of the state or county in which the case is brought. It is administered by a staff that is familiar with these types of disputes and often can provide greater attention to the cases than clerks in congested courts. It is closely overseen by multiple regulatory agencies, including the SEC and FINRA, and operates under rules designed to maximize protection of investor rights. Prohibiting pre-dispute arbitration agreements would simply produce more protracted, costly litigation. This result would not serve the best interests of investors or the U.S. capital markets.

Conclusion

In conclusion, numerous independent studies, and the most up-to-date statistical data demonstrate that the securities arbitration system has worked well for decades and continues to improve. It is not a perfect system, but nor is any alternative. Inevitably, any system that processes thousands of cases a year may produce the occasional anomalous result. But the point is not to compare securities arbitration to some idealized, utopian version of court-based litigation. Rather, the only useful exercise is to compare arbitration with the real-world court-based litigation as we know it. In that contest, arbitration wins hands-down. Securities arbitration allows investors to pursue small claims, provides a friendly forum for pro se investor claimants, lowers overall costs borne by investors and

securities firms, and secures the oversight of expert regulators, all within a framework that was specifically designed for investor claims and has demonstrated fairness for decades. Congress should not disturb a system that is working.