STUDY: INDUSTRY-RUN FINRA ARBITRATOR POOL LACKS DIVERSITY AND FAILS TO DETECT, COMMUNICATE POTENTIAL BIASES

As Win Rates for Investors Decline, New PIABA Report Shows 80 Percent of Arbitrators Are Male and the Average Age of Those Deciding Fate of Investors is 69; FINRA Claims Its Arbitrator Roster Is Diverse But Now Admits That It Has Not Conducted Any Studies To Measure Diversity

WASHINGTON, D.C.//October 7, 2014//Contrary to claims made by the Financial Industry Regulatory Authority (FINRA), its pool of arbitrators that decide virtually all investor disputes with financial professionals in the U.S. lacks diversity, according to a new report released today by the Public Investors Arbitration Bar Association (PIABA). This diversity problem in arbitration is made worse by the almost total lack of transparency in how the FINRA arbitrators are recruited and what disclosures they make, said the report.

Available online at http://www.piaba.org, the PIABA analysis of the information provided by FINRA to parties in proceedings involving 5,375 arbitrators, found that:

- FINRA has made a number of public claims that its arbitrator roster is diverse but also admits that it has not conducted any studies to measure diversity. The reality is that the FINRA arbitrator pool is approximately 80 percent male, meaning that women investors are significantly underrepresented in the pool.

- The advanced age of many of FINRA's arbitrators raises serious concerns about their ability to effectively and fairly participate in arbitration proceedings. The average age of arbitrators is 69 years old, with 40 percent of the arbitrator pool aged 70 or older and 17 percent of the arbitrator pool is 80 years or older. In two documented cases, FINRA provided the names of deceased arbitrators as being available for selection.

- FINRA's arbitrator disclosure process fails to ensure that it provides updated and accurate background information and information related to potential conflicts of interest and bias to parties. In many cases, arbitrators are unable to indicate when they last updated their disclosure documentation and do not appear to be urged by FINRA to do so on a regular basis. In addition, FINRA fails to have adequate and verifiable procedural safeguards in place to ensure that impartial and neutral arbitrators are added to the arbitrator pool.

The issue of arbitrator fairness is of paramount concern for investors. A 1992 federal study found that 60 percent of investors who submitted claims to industry-sponsored arbitration forums, such as the NASD (the predecessor of FINRA) and the NYSE, received an award in some amount, and that the average award was about 60 percent of the amount claimed. Since 1992, the win rate for investors has fallen as low 37 percent in 2007 and was approximately 42 percent in 2013. Claimants' percentage recovered has also sharply declined.

PIABA President Jason R. Doss, an Atlanta attorney, said: **"There is no question that having a pool of arbitrators with diverse backgrounds and experiences will result in improved decision making. FINRA states that the cornerstone of the integrity of its entire arbitration forum depends on FINRA having an effective and reliable process to detect and disclose arbitrators' biases and conflicts of interest to the parties. PIABA has showed that FINRA's arbitrator disclosure process fails at every step. Therefore, investors have no other choice but to conclude that arbitration is unfair. The sad state of FINRA arbitration today is the most powerful argument that can be made for Congress to give investors the option to go to court."**

Rep. Keith Ellison (D-MN), sponsor of "The Investor Choice Act of 2013," said: **"PIABA's report, The Importance of Arbitrator Disclosure, demonstrates that there are fundamental problems with the**

arbitration system. I'm thankful for PIABA's continued analysis of what is broken in the system and suggestions to make it fairer for investors."

PIABA President-Elect Joseph Peiffer, a New Orleans attorney, said: **"As basically the only remaining game in town, FINRA owes the public a duty to ensure a level playing field in arbitration, which includes providing parties with neutral and impartial arbitrators as well as a transparent arbitrator disclosure process. Because FINRA has failed to provide this the need for independent oversight over FINRA's arbitration forum is even greater today."**

Dr. Akshay Rao, professor, Carlson School of Management, University of Minnesota, said: **"Based on my review of FINRA's arbitrator disclosure process and its questionnaire, it is my opinion that the process is illusory and especially harms claimant public investors because the system is not designed to elicit meaningful or timely disclosures about actual or potential conflicts of interest and/or biases. FINRA's flawed arbitrator disclosure process provides respondent broker-dealers with an unfair advantage over public investors in securities arbitration disputes in part, because broker-dealers are repeat participants in securities arbitration proceedings and therefore have more information about arbitrators in the pool, due to experience."**

Susan MacPherson, senior litigation consultant and vice president, National Jury Project (NJP) Litigation Consulting/Midwest, said: **"FINRA has had over 20 years to develop a system of recruiting, screening and selecting arbitrators that fulfills its claim of providing a diverse pool. FINRA maintains it has created a diverse pool by making an effort to reach out to women and minorities. We can now see that what FINRA defines as diverse is a pool of arbitrators largely comprised of older men. FINRA's skewed perception of diversity, coupled with its refusal to disclose important information about the way in which applicants are targeted and selected, cannot instill any confidence in FINRA's current system … FINRA's refusal to evaluate the diversity of its pool with respect to race further undermines its claim of a commitment to diversity. A system that is not transparent cannot be held accountable. Investors need access to the courts in order to obtain access to a dispute resolution system that ensures fairness through transparency and accountability."**

In 1987, the Supreme Court decided *Shearson/American Express, Inc. v. McMahon*, and held that pre-dispute arbitration agreements in the brokerage industry were fully enforceable. At the time *McMahon* was decided, there were at least ten industry-operated arbitration forums. Since then, pre-dispute arbitration agreements have become pervasive, and customers are compelled to arbitrate virtually every dispute they have with the brokerage industry. As a result, arbitration has become the mandatory form of dispute resolution. Today, FINRA resolves virtually all securities arbitration disputes.

RECOMMENDED REFORMS

The PIABA report outlines eight far-reaching recommendations for ensuring that investor dispute resolution is a fair process:

1. A viable alternative would do much to clean up FINRA's arbitration system and, thus, urges Congress to pass the Investor Choice Act of 2013 making securities arbitration optional for investors.
2. Because a lack of transparency appears to be at the core of many of the problems described in PIABA's report, PIABA recommends that the Securities Exchange Commission (SEC) take action to ensure that an independent group be commissioned to assist in the oversight of FINRA's entire arbitration process. PIABA recommends that, if possible, the SEC require FINRA Dispute Resolution to be governed by a new independent board of directors that it is separate, distinct and that does not report to FINRA's current board of directors.
3. The SEC should take action to restore the status of the Securities Industry Conference on Arbitration (SICA) as a meaningful participant in the oversight of the securities arbitration process. In the alternative, PIABA recommends that a new independent group with a similar mission as SICA be created.

4. The SEC should improve the transparency of FINRA's arbitration forum by making documents relating to its supervision of FINRA arbitration be subject to the Freedom of Information Act (FOIA).
5. The SEC should commission an independent study about how FINRA's past and current arbitrator recruiting practices have impacted the demographics of its arbitration roster and whether these practices have impacted arbitration outcomes.
6. The SEC should the SEC examine FINRA's arbitrator recruitment practices and develop a transparent recruitment process that ensures that FINRA's arbitrator roster is diverse and that it includes neutral and impartial arbitrators.
7. The SEC commission an independent study to determine whether requiring two years of college credits or five years of business or professional experience equates to highest quality of arbitrators. PIABA recommends that this study analyze and propose other alternative criteria.
8. The SEC should require FINRA to take action on the identified problems with the arbitrator application process and other failures of disclosure.
9. The SEC should ensure that FINRA has adequate and verifiable procedural safeguards in place to ensure that FINRA's arbitrator disclosure process results in the recruitment and selection of quality, neutral and impartial arbitrators.

ABOUT PIABA

The Public Investors Arbitration Bar Association is an international, not-for-profit, voluntary bar association of lawyers who represent claimants in securities and commodities arbitration proceedings and securities litigation. The mission of PIABA is to promote the interests of the public investor in securities and commodities arbitration, by seeking to protect such investors from abuses in the arbitration process, by seeking to make securities arbitration as just and fair as systemically possible and by educating investors concerning their rights. For more information, go to http://www.piaba.org.

EDITORS NOTE: A streaming audio replay of the news event will be available on the Web at http://www.piaba.org as of 3 p.m. EDT on October 7, 2014. The PIABA report is available now at http://www.piaba.org.

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