For Immediate Release
May 18, 2022

Leading Worker, Consumer and Investor Advocates Urge SEC to Investigate RIA Mandatory Arbitration

RIA's Increasingly Forcing Retail Investors Into Expensive Dispute Resolution Forums

WASHINGTON, D.C. (May 18, 2022) — A broad coalition of leading worker, consumer and investor advocates has urged the U.S. Securities and Exchange Commission (SEC) to investigate the growing use of pre-dispute arbitration clauses by registered investment advisers (RIAs).

In a letter to SEC Chairman Gary Gensler, the coalition requested the investigation because of its concerns "that RIAs are not adequately disclosing their use of pre-dispute arbitration clauses, and may be disadvantaging investors by designating expensive forums, and otherwise limiting investors' rights to pursue their claims." The coalition's May 17 letter also expressed its concerns about the lack of transparency in how mandatory arbitration affects, often negatively, clients of registered investment advisers (RIAs). "This lack of transparency is particularly troubling in the context of recent trends in the securities industry, which show mass migration of assets from FINRA-registered broker-dealers to SEC- and state-registered RIAs," the coalition wrote.

Currently, there are more than 31,000 federal- and state-registered investment advisers, compared with 3,400 brokerage firms that are members of and regulated by FINRA. Following the lead of the brokerage industry, RIAs now regularly include forced pre-dispute arbitration clauses in their account agreements. However, unlike brokerage firms, which, pursuant to FINRA rules, must include FINRA Dispute Resolution Services as an available forum, RIAs are not subject any similar requirements. Often, RIAs designate privately run dispute resolution forums such as the American Arbitration Association or JAMS in their arbitration clauses. "These forums are far more expensive than the FINRA forum and require the investor to make a sizable deposit to proceed with their claims," the coalition wrote. "These exorbitant expenses are often far too much for retail investors who have already lost much of their savings.

"When an RIA intentionally names an expensive private dispute resolution provider in an arbitration agreement to act as a shield against client claims, that is the RIA putting its interests ahead of its client. That is a breach of the RIA's fiduciary duty," said Michael Edmiston, President of the Public Investors Advocate Bar Association (PIABA). "An RIA should have the courage to disclose the client's share of cost of an arbitration may range between $20,000 and $40,000. The duty to disclose extends to the RIA's efforts to inappropriately shield itself from claims. The fiduciary obligations owed by an RIA to a client remain in good times and bad. An RIA that names an expensive dispute resolution provider, uses an illegal hedge clause to limit

claims and damages, and picks a hearing location far from the investors' residence is acting solely in the best interest of the RIA."

The coalition also spotlighted the lack of public information about RIA arbitrations; the lack of uniform disclosure of RIA arbitration clauses; investor complaints and their outcome. This lack of public information makes it virtually impossible to know how many investor complaints have been made against an RIA, whether the complaint resulted in an arbitration, and the outcome of the arbitration including whether any arbitration award has been paid. "As a result, there is no clear picture on whether investors doing business with RIAs actually have access to justice," the coalition wrote.

Signatories to the letter include the following organizations: American Federation of Labor and Congress of Industrial Organizations (AFL-CIO); Americans for Financial Reform Education Fund; American Association for Justice; Better Markets; Center for American Progress; Consumer Action; Consumer Federation of America; Public Citizen; Public Investors Advocate Bar Association; Revolving Door Project; and 20/20 Vision. A full copy of the letter is available here and below.

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May 17, 2022

Chair Gary Gensler
U.S. Securities Exchange Commission
100 F Street, NE
Washington, DC 20549
Chair@sec.gov

Re: Request to Investigate RIA Mandatory Arbitration

Dear Chairman Gensler:

The undersigned comprise a coalition of stakeholders who each represent and advocate for retail investor rights. Our coalition is concerned about the lack of transparency in how mandatory arbitration affects, often negatively, clients of registered investment advisers (RIAs). This lack of transparency is particularly troubling in the context of recent trends in the securities industry, which show mass migration of assets from FINRA-registered broker-dealers to SEC- and state-registered RIAs.

Pre-dispute arbitration clauses in investor account agreements have been consistently enforced since the United States Supreme Court's decision in *Shearson/American Express v. McMahon*, 482 US 220 (1987). During the 1990s and early 2000s, when brokerage firms held an iron grip on retail investors, the securities industry forced investors into arbitration through several industry-sponsored forums including FINRA's predecessor, the NASD, and other arbitration forums run by the stock exchanges.

Today, FINRA's Dispute Resolution arbitration program is the only securities industry-sponsored forum remaining. FINRA rules mandate that FINRA-registered firms use the forum if requested by the investor, regardless of other forum selection language in an investor account agreement. FINRA rules provide certain protections and prohibitions regarding dispute resolution provisions. For example, FINRA member firms must provide clear, prominent disclosures about the presence and terms of the arbitration clause. FINRA rules also specifically prohibit the use of class action waivers, thereby allowing investors to ban together should they so choose, to vindicate their rights. FINRA firms are also prohibited from specifying a hearing location for any claims, limiting the ability of an arbitrator to award damages, including any waiver of FINRA or SEC rules, and utilizing class action waivers. Earlier this year, FINRA issued a "Regulatory Notice" to its members reminding them to abide by these standards.

FINRA member firms also subsidize the bulk of FINRA arbitration forum fees by paying various fees and surcharges. While additional forum fees may be assessed against the investor at the end of a FINRA hearing, investors can proceed with their FINRA arbitration claim by paying only the initial filing fee. The investor's filing fee is based on a graduated scale depending on the size of the damages claim, and ranges from $50 to $2,300. The Director of FINRA Dispute Resolution may also waive the initial filing fee for investors. Even if the FINRA member firm or associated person does not timely pay their share of

forum fees, FINRA allows the case to proceed. As described below, this is a significant difference from private arbitration forums.

Over the past decade, there has been a colossal shift in the industry. Retail investors have moved a significant amount of their assets from brokerage firms to RIAs. Currently, there are more than 14,000 SEC-registered advisers and more than 17,000 state-registered advisers. These numbers dwarf the ever-shrinking 3,400 brokerage firms that are members of and regulated by FINRA.

Following the lead of the brokerage industry, RIAs now regularly include forced pre-dispute arbitration clauses in their account agreements. However, unlike brokerage firms, which, pursuant to FINRA rules, must include FINRA Dispute Resolution Services as an available forum, RIAs are not subject any similar requirements. Often, RIAs designate privately run dispute resolution forums such as the American Arbitration Association or JAMS in their arbitration clauses. These forums are far more expensive than the FINRA forum and require the investor to make a sizable deposit to proceed with their claims. For example, it is not uncommon for a single arbitrator in JAMS (where arbitrators set their own fees in addition to what the forum charges for its administrative fees) to charge $8,000 or more for a single day's work. The arbitrator's fees alone can easily exceed $64,000 for five days of hearings and three days of pre-hearing and post-hearing work. Imagine being required to front $32,000 for the opportunity to try to recover your losses. If there are three arbitrators hearing the dispute, the fees can be triple that amount. These exorbitant expenses are often far too much for retail investors who have already lost much of their savings.

If an investor wants to pursue their claims before an arbitration panel under the AAA Commercial Arbitration Rules, or with JAMS, they must deposit tens of thousands of dollars. In addition to requiring a retainer from the investor, these forums also require that the respondent firms and individuals deposit their portion of the fees before the forum will proceed with the claims. If the firm or adviser has not paid their share, the forum typically gives the investor the option of paying the respondent's share of the deposit to be allowed to proceed. The investor may incur the full cost of the arbitration just to be able to pursue their rights. RIAs know that the forum fees are cost-prohibitive for most clients and also name expensive arbitration providers in their arbitration clauses as a shield against liability for their misconduct. In addition, non-FINRA arbitration forums may dictate more limited discovery, fewer hearing days, dispositive pre-hearing motion practice or other procedural rules that can be significantly unfavorable to the investor.

Presently, there is no public information about RIA arbitrations. RIAs do not uniformly disclose their arbitration clauses. Even when an RIA has disclosed their clause in the Form ADV, a significant amount of information is missing because there is a lack of uniformity in the clauses. For example, to assess the impact of an arbitration clause on an investor's ability to pursue a claim, one must know the likely fees to initiate and pursue the claim, the hearing location, any limitations on the ability to make claims, and any limitations on the dispute resolution process such as limits to discovery and the length of a hearing.

In addition to not uniformly disclosing the use of a pre-dispute arbitration clause, RIAs do not uniformly disclose investor complaints or their outcome. Therefore, it is virtually impossible to know how many investor complaints have been made against an RIA, whether the complaint resulted in an arbitration, and the outcome of the arbitration including

whether any arbitration award has been paid. As a result, there is no clear picture on whether investors doing business with RIAs actually have access to justice.

The securities laws are based upon meaningful disclosure. Presently, the undersigned are concerned that RIAs are not adequately disclosing their use of pre-dispute arbitration clauses, and may be disadvantaging investors by designating expensive forums, and otherwise limiting investors' rights to pursue their claims. Accordingly, we request that the SEC gather and publish data about RIAs' use of pre-dispute arbitration clauses, and their key terms including:

- What dispute resolution forum has been designated;
- Whether particular procedural rules have been designated;
- Whether a venue is designated, and if so, whether the venue is the same as the investor's residence or principal place of business;
- Whether a class action waiver is included;
- Whether there are limitations on the type of claims that may be asserted or damages that may be awarded;
- Whether there are any fee shifting provisions;
- Whether any claims have been filed against the RIA subject to the clause;
- Whether the firm has been found liable in any arbitration claims in the last five years; and
- Whether the firm has failed to pay any arbitration awards in the last five years.

As recognized by the United States Supreme Court and pursuant to the Investment Advisers Act of 1940, RIAs are fiduciaries. The unchecked use of pre-dispute arbitration clauses by RIAs has created significant and unfair barriers for investors seeking nothing more than to exercise their legal rights after a dispute with their financial professional. The unfair burden on investors means that unknown millions of dollars of otherwise recoverable investment losses and retirement savings may be effectively shielded from adjudication by these unfair practices. We question whether the use of clauses that raise these concerns is consistent with an adviser's fiduciary duty. The SEC can and should take the first steps in gathering information in its examinations of SEC-registered firms regarding their use of arbitration clauses and providers to determine the scope of the issues.

Respectfully submitted,

American Federation of Labor and Congress of Industrial Organizations (AFL-CIO)

Americans for Financial Reform Education Fund

American Association for Justice

Better Markets

Center for American Progress

Consumer Action

Consumer Federation of America

Public Citizen

Public Investors Advocate Bar Association

Revolving Door Project

20/20 Vision

CC: The Honorable Allison Herren Lee
The Honorable Hester Peirce
The Honorable Carolyn Crenshaw
The Office of the Investor Advocate