Public Investors Arbitration Bar Association

To: The SEC Office of Investment Management: Robert Shapiro, Thoreau Bartmann, Anna Sandor, Aaron Ellias
From: Joe Peiffer, President of PIABA
Date: July 29, 2024
Re: Reforming Abusive Investment Adviser Arbitration Contracts

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PIABA[1] has long been concerned with the use of mandatory pre-dispute arbitration agreements ("PDAAs") in contracts that are potentially abusive to the clients of broker-dealers or investment advisers ("RIAs").[2] The concept of "forced arbitration" raises significant policy concerns about investors' access to justice. In many consumer contexts, the existence of a pre-dispute arbitration agreement tends to deter the filing of claims because of the high costs relative to traditional court proceedings. Investors may also feel taken advantage of by their financial adviser if forced into a dispute resolution forum that lacks investor-protective features.[3]

As discussed below, the Commission has ample existing statutory authority under § 921 of The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank") to

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[1] The Public Investors Advocate Bar Association ("PIABA") is an international, not-for-profit, voluntary bar association of lawyers who represent investors in securities and commodities arbitration and litigation. PIABA's mission 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; make securities arbitration as just and fair as systematically possible; and educate investors concerning their rights.

[2] *See* PIABA Comment Letter on DF Title IX – Pre-Dispute Arbitration (Dec. 3, 2010), (Peter J. Mougey, President of PIABA from 2010 to 2011, stated "[the SEC] has always had the ability to regulate firms with regard to state law claims. To the extent the [SEC] enacts rules limiting a firm's use of pre-dispute arbitration clauses, it should be clear that these rules affect both federal and state law claims, as have the other SRO rules governing pre-dispute arbitration clauses."); PIABA Press Release, *PIABA Urges SEC To Weigh CFPB Study Faulting Mandatory Arbitration Agreements* (Mar. 10, 2015), (Quoting Joseph C. Peiffer, President of PIABA from 2014 to 2015, ""The SEC has been studying for five years whether investors should continue to be subject to mandatory arbitration. PIABA has urged the SEC to conclude that more choices for investors is the best way to proceed. Investors should have the choice of going to arbitration or court and not be forced into an industry sponsored arbitration process that is tilted in favor of Wall Street."); Written Testimony of Christine Lazaro, Hearing before the House Financial Services Committee; Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets: Putting Investors First: Reviewing Proposals to Hold Executives Accountable (April 2, 2019), (Christine Lazaro, President of PIABA from 2018 to 2019, "True investor choice returns the investor's ability to choose between court and arbitration to resolve any disputes that arise. There are costs and benefits to both arbitration and court resolution of disputes, and investors should be given the ability to weigh those costs and benefits and chose the forum best fitted to address any concerns."); Hugh Berkson and David P. Meyer, *FINRA Arbitration's Persistent Unpaid Award Problem: PIABA's Third Report Concerning FINRA's Refusal to Tackle the Unpaid Arbitration Award Problem Head-On* (Sep. 29, 2021), (Hugh Berkson, PIABA President-elect, and David P. Meyer, former President of PIABA from 2020 to 2021, "The problem of unpaid arbitration awards is only growing, thanks in large part to the increasing role of investment advisers, and their common use of commercial and for-profit arbitration forums other than FINRA Dispute Resolution for which there is no public reporting and little regulatory accountability."); Tracey Longo, *New Bill Would Ban Forced Securities Arbitration Clauses* (Mar. 9, 2022) (Michael Edmiston, current PIABA President, stated "There are no regulators overseeing arbitration for registered investment advisors, so there are no statistics about client wins in private arbitration forums.").

[3] See Christine Lazaro and Michael S. Edmiston, Op Ed: Costly Forced Arbitration against RIAs Harms Investors, (January 14, 2022) (hereinafter PIABA Op Ed), ("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.").

condition or limit the use of pre-dispute arbitration agreements by broker-dealers and investment advisers. This language indicates a broad and flexible regulatory mandate, allowing the Commission not only to outright prohibit PDAAs but also to impose a range of conditions or limitations shy of a complete ban.

PIABA urges the Commission to use this authority to "condition" RIA arbitration agreements by requiring any selected dispute resolution forum meet certain minimum standards for fairness. To facilitate efficient dispute resolution, PIABA proposes that the Commission create a regulatory category of "arbitration provider," with one of two possible options. First, dispute resolution forums could apply to be an eligible "arbitration provider" upon showing that their rules meet or exceed the regulatory thresholds for investor-protection fairness. Second, the Commission could specify the minimum thresholds without requiring application and certification. In either case, the arbitration provider would be eligible for "safe harbor" treatment, such that RIAs selecting the forum would be deemed to have selected one consistent with the fiduciary duty of loyalty and the prohibition against hedge clauses. Adopting these rules would ensure that RIAs do not take advantage of their customers by requiring them to arbitrate in an unfair forum.

I. THE CURRENT ARBITRATION FORUM PROBLEM

A. Cost-Prohibitive Arbitration Forum Provisions Have Proliferated

The Office of the Investor Advocate published findings about RIA arbitration in June of 2023.[4] It found that about 61% of SEC-registered RIAs require retail clients to sign a PDAA.[5] These agreements often require RIA clients to resolve disputes through privately run dispute resolution forums such as the AAA or JAMS.[6] Approximately 37% of these agreements designate the arbitration forum's rules to be used.[7] When that happens, 83% of the agreements elect AAA's expensive Commercial Rules.[8] That report also stressed other concerning aspects of RIA arbitration agreements. Investors may not be able to readily attend arbitration hearings because 97% of the arbitration clauses selecting venues do not consider the investor's domicile.[9] Eleven percent include limitations on damages which may be awarded, and eighteen percent include fee-shifting provisions.[10]

At the end of 2023, the Office of the Investor Advocate again raised concerns about the use of PDAAs by RIAs. In its annual report, it expressed "concerned that a number of characteristics of these clauses in advisory agreements are not in the best interest of retail investors."[11] It found that while FINRA's filing fees maxed out at $2,300, a AAA arbitration under

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[4] Office of the Investor Advocate, Mandatory Arbitration among SEC-Registered Investment Advisers (June 2023), https://www.sec.gov/files/2023-oiad-ria-mandatory-arbitration-report.pdf.
[5] *Id.* at 3.
[6] *Id.*
[7] *Id.*
[8] *Id.*
[9] *Id.*
[10] *Id.*
[11] Office of the Investor Advocate, Fiscal Year 2023, Report on Activities (Dec. 2023), https://www.sec.gov/files/2023-oiad-annual-report.pdf?.

commercial rules could cost a *minimum* of $4,400 simply to file the claim if three arbitrators would be used.[12]

RIAs may enjoy unfair advantages under these dispute resolution processes. The well-known "repeat player" effect in arbitration means that there is a financial incentive to act so as to be selected or re-hired by the RIA.[13] The high direct costs of arbitration illustrate that arbitration is ineffective at avoiding "litigation costs."[14] The Commission has yet to establish any regulatory requirements for RIAs, and the content and format of arbitration clauses in advisory agreements and the procedures and fees that will be applied to such forum.

B. Abusive Arbitration Provisions Violate Adviser Fiduciary Duties

Arbitration provisions pose a significant challenge to the fiduciary relationship between RIAs and their clients, as *abusive* provisions will almost always violate the fiduciary duty of loyalty's principle of acting in the best interests of clients.[15] Fiduciary duty obligates advisers to prioritize their clients' interests.[16] Where the client has not waived the duty of loyalty—and under the Advisers Act, it can't, as discussed below—the adviser's agreements must be fair and transparent, including any dispute resolution mechanisms. Yet as just discussed, some arbitration clauses select providers that have rules that are neither fair nor transparent, and that stack the deck in favor of the RIA. For instance, the provider's rules might include limitations on the right to present evidence, provide extensive limitations on discovery, or impose excessive costs. These "abusive" arbitration provisions can severely restrict an investor's ability to seek redress.[17] And by deterring the filing or vindication of claims, these abusive provisions in RIA arbitration agreements have the effect of putting the adviser and customer in direct, zero-sum conflict over whether the adviser will pay out or not on a legitimate claim the client has. What's more, such provisions not only harm the client but also erode trust in financial advisers generally, ultimately damaging client confidence in markets and impeding the securities' laws policies favoring capital formation.

The prohibition on abusive arbitration provisions can be likened to the Advisers Act's prohibition on hedge clauses.[18] Advisers Act §§ 206(1) and (2) prohibit advisers from defrauding clients, and the Commission has interpreted these prohibitions as "prohibit[ing] the use of certain hedge clauses that imply or suggest that a client has waived a fundamental and nonwaivable cause

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[12] *Id.* at 42.
[13] Press Release, Sen. Jeff Merkley (D-OR) & U.S. Rep. Bill Foster, (D-IL), Foster, Merkley Lead Bicameral Investor Choice Act (Dec. 6, 2019) ("[W]hen an investment advisor or broker chooses the judge, pays the judge, and promises future business to the judge, you know that the system is rigged against you.") (quoting Sen. Jeff Merkley).
[14] *See* PIABA Op Ed, supra note 3.
[15] *See id.*
[16] *See*, *e.g.*, Restatement (Third) of Agency § 8.03 cmt. b ("As a fiduciary, an agent has a duty to the principal to act loyally in the principal's interest in all matters in connection with the agency relationship").
[17] *See*, *e.g.*, *Munro v. Univ. of S. California*, No. CV166191VAPCFEX, 2017 WL 1654075, at *6 (C.D. Cal. Mar. 23, 2017) (noting that making arbitrable certain ERISA § 502(a)(2) actions by retirement plan participants against fiduciaries would "guarantee fiduciaries would essentially never be held to account for their potential wrongdoings in court" and "give fiduciaries many procedural advantages at the outset of any § 502(a)(2) action that they would not be entitled to in a court proceeding"), aff'd on other grounds, 896 F.3d 1088 (9th Cir. 2018).
[18] *See* PIABA Op Ed, supra note 3.

of action under state or federal securities laws."[19] Those hedge clauses are themselves also void under Advisers Act § 215(a), which provides that "[a]ny condition, stipulation, or provision binding any person to waive compliance with any provision of [the Advisers Act] or with any rule, regulation, or order thereunder shall be void."[20] Contracts containing invalid hedge clauses can also be deemed void under § 215(b).

In its best interest rulemaking in 2019, the Commission adopted the fiduciary interpretation related to the duties of investment advisers. In that interpretation, the Commission concluded that a hedge clause's consistency (or not) with the Advisers Act depends on the circumstances. But it concluded that "there are few (if any) circumstances in which a hedge clause in an agreement with a retail client would be consistent with those antifraud provisions, where the hedge clause purports to relieve the adviser from liability for conduct as to which the client has a non-waivable cause of action against the adviser provided by state or federal law."[21] The Commission likewise focused on the risk that this contract term would be "mislead[ing]," as retail investors would mistakenly "not exercise[e] their legal rights, … even where the agreement otherwise provides that the client may continue to retain its non-waivable rights."[22]

Hedge clauses attempt to limit an RIA's liability for negligence or misconduct, directly conflicting with the fiduciary duty to act with loyalty and care. Similarly, abusive arbitration clauses that disadvantage clients in dispute resolution are at odds with the fiduciary duty to ensure fair treatment. By drawing this analogy, it becomes clear that ensuring fairness in arbitration provisions is as crucial as prohibiting hedge clauses, both of which aim to uphold the integrity and trust essential to the fiduciary relationship. In the fiduciary interpretation, the Commission warned that, "[t]o the extent that a hedge clause creates a conflict of interest between an adviser and its client, the adviser must address the conflict as required by its duty of loyalty."[23] By the same token, an arbitration agreement that deters the filing of claims and prevents the vindication of those non-waivable rights can (and should) be deemed to operate as a hedge clause that creates a conflict of interest that cannot simply be disclosed away.

Balancing fiduciary duty with the business imperative to reduce costs presents a complex policy challenge. While arbitration can be a cost-effective dispute resolution mechanism compared to litigation, it must not come at the expense of fairness and transparency. The Commission should carefully consider whether the purported cost savings *to RIAs* justify potential detriments to investor confidence and protection. It is especially important to carefully scrutinize claims by the RIA industry, in this respect, that the cost savings are being passed on to customers. The integrity of the fiduciary relationship hinges on maintaining a balance where cost-efficiency does not compromise the RIA's obligation to act in the best interests of their clients.

II. THE COMMISSION'S STATUTORY AUTHORITY TO REGULATE ARBITRATION FORUMS

A. Specific Statutory Authority

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[19] 15 U.S.C. § 80b-6(1), (2).

[20] *Id*. § 80b-15(a), (b).

[21] *Commission Interpretation Regarding Standard of Conduct for Investment Advisers*, Advisers Act Release No. 5248 (June 5, 2019), 84 Fed. Reg. 33,669, 33,672 n.31 (July 12, 2019).

[22] *Id.*

[23] *Id.*

Statutory authorities and regulatory interventions regarding arbitration for retail investors have seen various approaches over the years. Congress passed Section 921 of Dodd-Frank Act[24] in response to concern that mandatory pre-dispute arbitration agreements were unfair to investors.[25] Specifically, Congress included paragraph (b) of Section 921, which amended Section 205 of the Investment Advisers Act of 1940,[26] by providing the Commission with the explicit authority to restrict mandatory pre-dispute arbitration for customers or clients of any investment adviser:

> (f) AUTHORITY TO RESTRICT MANDATORY PREDISPUTE ARBITRATION.—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[27], 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.[28]

This provision specifically addresses concerns that pre-dispute arbitration agreements were "unfair to the investors."[29] Although the Commission has this authority, it has not yet exercised it to conduct rulemaking relating to the growing RIA PDAA problem.[30]

In PIABA's view, this grant of statutory authority provides ample basis for the Commission to regulate mandatory PDAAs between customers or clients and their RIAs. This authority allows the Commission to address concerns that such agreements may disadvantage investors by directing them into unsuitable arbitration forums like JAMS and AAA. By being able to condition or limit

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[24] Dodd-Frank Act, Pub. L. No. 111–203, 124 Stat. 1376 (2010).

[25] As the Committee Report accompanying the Dodd-Frank Act noted: "For too long, securities industry practices have deprived investors of a choice when seeking dispute settlement, too. In particular, pre-dispute mandatory arbitration clauses inserted into contracts have limited the ability of defrauded investors to seek redress. Brokerage firms [hold] powerful advantages over investors. Brokerages often hide mandatory arbitration clauses in dense contract language. Moreover, arbitration settlements generally remain secret, preventing other investors from learning about the performance of a particular brokerage firm. If arbitration truly offers investors the opportunity to efficiently and fairly settle disputes, then investors will choose that option. But investors should also have the choice to pursue remedies in court." H. Rep. No. 111-687, Part 1, at 50.

[26] 15 U.S.C. § 80b–5.

[27] "Federal securities laws" as defined under Section 3(a) of the Securities Exchange Act of 1934 ("Exchange Act") "means the Securities Act of 1933 (15 U.S.C. 77a et seq.), the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.), the Sarbanes-Oxley Act of 2002 [15 U.S.C. 7201 et seq.], the Trust Indenture Act of 1939 (15 U.S.C. 77aaa et seq.), the Investment Company Act of 1940 (15 U.S.C. 80a–1 et seq.), the Investment Advisers Act of 1940 (15 U.S.C. 80b et seq.) [15 U.S.C. 80b–1 et seq.], and the Securities Investor Protection Act of 1970 (15 U.S.C. 78aaa et seq.)." 15 U.S.C. 78c(a)(47).

[28] *Pezza v. Invs. Cap. Corp.*, 767 F. Supp. 2d 225, 229 (D. Mass. 2011). *See also* Dodd-Frank provisions on pre-dispute arbitration clauses, 23A BROKER-DEALER OPERATIONS SEC. & COMM. LAW § 12:14.50 ("Section 921 of the Dodd-Frank Act amended the Securities Exchange Act and the Investment Advisors Act to authorize the SEC to restrict mandatory pre-dispute arbitration agreements between broker-dealers and customers.").

[29] S. Rep. No.111-176, at 77 (Apr. 30, 2010) (recognizing concerns that mandatory pre-dispute arbitration clauses are unfair to investors).

[30] *See* Written Testimony of Melanie Senter Lubin, Putting Investors First: Reviewing Proposals to Hold Executives Accountable (April 3, 2019).

the use of these agreements, the Commission can ensure that investors access equitable avenues for redress, thereby reinforcing the fiduciary duty of financial professionals to act in their clients' best interests.

Dodd-Frank § 921 and Advisers Act § 205(f) empower the Commission to prohibit, or impose conditions or limitations on, such arbitration agreements if it deems these measures to be in the public interest and for the protection of investors. Congress authorized the Commission to take two different courses with respect to PDAAs.

To begin with, Congress expressly authorized the Commission to prohibit these PDAAs. As a result, this complements, and is not constrained by, the Federal Arbitration Act (FAA). The FAA generally promotes the enforceability of arbitration agreements and preempts conflicting state laws. As the Court has explained, there is a clear policy favoring arbitration, so when "Congress did intend to limit or prohibit waiver of a judicial forum for a particular claim, such an intent will be deducible from the statute's text or legislative history."[31] In recent years the Court has "rejected every … effort to date" to identify these sorts of "conflicts between the Arbitration Act and other federal statutes."[32] But Advisers Act § 205(f)'s specific authorization for the Commission to regulate these agreements introduces a potential exception to this preemption. As an objective matter, the textual authority to "prohibit" arbitration is about as strong a basis as one can get for deducing Congress's intent to permit the Commission to limit waiver of a judicial forum for these claims.[33]

As Congress has authorized the Commission to *prohibit* arbitration, that power should also be understood to give meaning to the parallel authority to place "conditions or limitations" on arbitration agreements instead. The authority to prohibit it entirely includes the lesser power to place conditions. The "best" reading of the statute is that this lesser power also reflects the "intent to limit waiver of a judicial forum" contemplated in the Court's doctrine. Although that power is limited by other law, the choice to intervene in the baseline pro-arbitration baseline means that Dodd-Frank should be read to change the meaning of the FAA, not the other way around. Altogether this conveys that the Commission has the power to regulate the terms under which PDAAs are implemented, meaning that the Commission may take a nuanced approach. Commission rules enacted under this authority would supersede the FAA's broad mandate, creating a more tailored regulatory environment for securities-related disputes.

Taking this idea seriously would mean that the Commission could require various measures designed to enhance fairness and transparency in the arbitration process as a "condition" or "limit" on the use of that arbitration agreement. A regulation might provide that arbitration agreements are enforceable if they meet certain criteria or conditions of fairness. For instance, it might require that arbitration clauses be written in plain language that is easily understood by retail investors, ensuring that they are fully informed of their rights and the implications of agreeing to arbitration.

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[31] Shearson/Am. Exp., Inc. v. McMahon, 482 U.S. 220, 227 (1987).

[32] Cedeno v. Sasson, 100 F.4th 386, 408 (2d Cir. 2024) (Menashi, J., dissenting) (quoting Epic Sys., Inc. v. Lewis, 584 U.S. 497, 516 (2018)); *see Epic Sys.*, 584 U.S. at 502; *Am. Express Co. v. Italian Colors Rest.*, 570 U.S. 228, 234 (2013); *Gilmer v. Interstate/Johnson Lane Corp*., 500 U.S. 20, 27 (1991).

[33] But of course, as discussed below, just because Congress has explicitly and directly authorized the Commission to prohibit arbitration does not mean the current federal courts will uphold that authorization or any regulation flowing from it.

Or a "limit" might focus on an outer boundary, taking the form of a prohibition on the use of arbitration clauses that do not meet or exceed some threshold of fairness.

Conditions or limitations could also straightforwardly pertain to the procedures of the arbitration itself. The Commission might require that arbitration be conducted by neutral arbitrators who have no financial ties to the broker-dealer or RIA. It could condition the availability of arbitration to those agreements selecting arbitration forums that provide robust pre-hearing discovery, or equal opportunities for both parties to present their case. Likewise, the Commission could condition arbitration on rules setting filing and other fees that are not so high that they deter the filing of claims. Finally, the Commission could limit arbitration agreements that either on their face, or through the selection of a particular arbitration provider's rules, provide for the waiver of class, collective, consolidated, or otherwise mass treatment.

A final potential condition could help promote oversight and transparency through disclosure and reporting requirements. The Commission could condition the use of PDAAs on the selection of arbitration forums that publicly disclose their decisions and reasoning, creating a body of precedent that can guide future disputes and enhance public trust in the arbitration process.[34] This would also give the Commission the ability to specifically address erroneous legal conclusions in future releases. The Commission could even limit the types of claims that can be subject to PDAAs, allowing certain disputes—particularly those involving significant allegations of fraud or misconduct—to be resolved in court instead.

By granting the Commission the authority to regulate mandatory pre-dispute arbitration agreements, Congress acknowledged the potential drawbacks of arbitration for retail investors and the need for regulatory oversight to ensure that arbitration processes are fair and just.

B. The Commission's Authority After *Loper Bright Enterprises v. Raimondo*

It is impossible to discuss the Commission's statutory authority, and make predictions about how statutes will be interpreted, without discussing the Supreme Court—and how its recent caselaw impacts the Commission. The trend of recent Supreme Court cases reflects a deep and abiding hostility to the administrative state and to the Commission's programs. Recent Supreme Court cases like *Loper Bright Enterprises v. Raimondo*,[35] which curbed *Chevron* deference, create significant uncertainty about how a court will interpret the statutory grant of authority and the Commission's regulatory position here.

Chevron deference allowed agencies like the SEC to interpret ambiguous statutory provisions within their expertise, with courts deferring to these interpretations. With *Chevron* deference now weakened, courts will no longer automatically uphold the Commission's reasonable, permissible interpretations of ambiguous statutory language under *Chevron* "step 2." Though the implications remain to be worked out, a fair guess is that courts will evaluate regulatory opinions based on their persuasiveness in a form of *Skidmore* deference. This shift will place a higher burden on the Commission and staff to justify its regulatory actions through robust legal

[34] Jill I. Gross, *Bargaining in the (Murky) Shadow of Arbitration*, 24 HARV. NEGOT. L. REV. 185 (2019).
[35] Loper Bright Enters. v. Raimondo, 144 S. Ct. 2244 (2024).

reasoning and comprehensive evidence, potentially complicating efforts to implement new regulations.

It also raises the increasingly likely possibility that, no matter how robust the reasoning or comprehensive the evidence, courts hostile to regulation in the public interest will find a way to rule against the Commission. From a legal realist perspective, the current composition of the Supreme Court and influential circuits like the Fifth Circuit, which lean conservative, are likely to present challenges for the Commission's regulatory initiatives absent changes to the composition or structure of the judiciary. Conservative courts tend to favor limited government intervention and may scrutinize Commission regulations more rigorously, especially those perceived as expanding agency authority or imposing significant burdens on industry participants. These courts might be less inclined to support expansive interpretations of the Advisers Act.[36] Despite these potential legal hurdles, pursuing policy that protects investors and serves the public interest remains central to the Commission's mandate to safeguard investors and maintain orderly markets.

III. THE COMMISSION MAY PROCEED BY REQUIRING ARBITRATION FORUMS TO MEET CONSISTENT MINIMUM STANDARDS FOR BROKERS AND INVESTMENT ADVISERS

As dispute resolution plays a critical role in investor protection, the Commission cannot abdicate the field. With the growing participation of retail investors in the market, ensuring that investors have access to fair and transparent arbitration processes is more important than ever. Recent economic volatility and high-profile cases of misconduct in the financial industry have highlighted vulnerabilities in the current arbitration framework, reinforcing the urgency for the Commission to strengthen protections. By acting now, the Commission may address these issues, bolster investor confidence, and maintain the integrity of the financial markets.

The Commission has a long history of overseeing the fairness of arbitration agreements. Even before Dodd-Frank gave the Commission explicit authority to prohibit, condition, or limit arbitration agreements for broker-dealers and investment advisers, the Commission had overseen the fairness of arbitration forums under its authority to oversee self-regulatory organization ("SRO") rulemaking. The Commission would traditionally look at whether rules governing pre-dispute arbitration agreements were consistent with Exchange Act §§ 6(b)(4)-(5) and 15A(b)(5)-(6), which among other things requires that FINRA's rules be "designed to prevent fraudulent and manipulative acts and practices, promote just and equitable principles of trade, provide for an equitable allocation of fees, and, in general, protect investors and the public interest."[37] The National Association of Securities Dealers ("NASD") relied upon this statutory authority in its

[36] See, e.g., Benjamin P. Edwards, *Supreme Risk*, 74 FLA. L. REV. 543 (2022); Kyle Langvardt & James Fallows Tierney, *On "Confetti Regulation": How Not to Regulate Gamified Investing*, 131 YALE L. J. F. 717, 733 (2022) (noting that given other recent changes in doctrine, it "would be unwise" for the Commission "to expect [the same] solicitude" or "wide[] constitutional berth" it has received in the past on judicial review).
[37] *See Order Approving Proposed Rule Changes by the New York Stock Exchange, et al., Relating to the Arbitration Process and the Use of Predispute Arbitration Clauses*, Exchange Act Release No. 26805, 54 Fed. Reg. 21,144 (May 16, 1989) (hereinafter 1989 Exchange Approval Order).

1999 proposed rulemaking to amend then-NASD Rule 3110(f) governing the use of PDAAs with customers.[38]

The Commission's authority to review SRO rules for compliance with these requirements gave it power to influence the rules and degree of procedural fairness. The Commission has used this power repeatedly in the past to promote greater procedural protections in the arbitration forums. For instance, in September 1987, the Commission, as part of its oversight of the SROs, sent a letter to each of the SROs with recommended changes to the arbitration procedures.[39] While the Commission endorsed the continued use of mixed public/industry panels, it indicated that "[t]he absence of clear guidelines for qualifying public arbitrators … and the inclusion in the pool of public arbitrators of persons with clear affiliations with the securities industry is a source of great concern."[40] The Commission also recommended narrowing the definition of public arbitrator to include only individuals "who are not so connected with the industry that it may hinder their ability to make independent judgments with respect to specific industry practices."[41] In response, the SROs developed rule proposals that included making standards for classifying public arbitrators more stringent, because of concerns about the impartiality of arbitrators with industry ties.[42] In 1989, the Commission reviewed the procedural fairness of the SROs proposed arbitration rules and approved them.[43]

Exchange Act § 15A mandates that FINRA must ensure its arbitration forum meets minimum fairness standards, making it a model for other arbitral forums. The use of the FINRA forum as a safe harbor would provide a benchmark for these standards.

IV. THE COMMISSION SHOULD CERTIFY ARBITRATION PROGRAMS MEETING MINIMUM STANDARDS

The Commission's long history of using its statutory authority to promote fairness in the use of PDAAs for broker-dealers predates the Dodd-Frank-era authority to condition or limit those PDAAs. But the consequence of this long history is that there is already an arbitration forum—FINRA dispute resolution—that has evolved in an investor-friendly direction and that would be a showcase example of an investment arbitral forum meeting the required standards of fairness. PIABA and its members are familiar with the FINRA forum, and encourage the Commission to adopt minimum fairness standards so as to encourage the use of this forum or to encourage other arbitration providers to adopt similarly consumer-friendly rules.

Designing a regulatory system to ensure minimum standards of fairness in arbitration for retail investors would involve establishing clear and comprehensive guidelines that arbitral forums must meet to be deemed compliant. A regulation might have six operative components:

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[38] *Notice of Filing of Proposed Rule Change by the National Association of Securities Dealers, Inc. Relating to Amendments to NASD Rule 3110 Governing Use of Predispute Arbitration Agreements with Customers*, Exchange Act Release No. 34,42160, 64 Fed. Reg. 66,681 (Nov. 29, 1999).
[39] 1989 Exchange Approval Order, *supra* note 37, at 21,146.
[40] *Id.*
[41] *Id.*
[42] *Id.*
[43] *Id.*

1. The **definition** of an "arbitration provider" would be the forum or individual selected in a pre-dispute arbitration agreement between a registered investment adviser and its client, while the definition of a client would be like in Reg BI—one who uses for household purposes.
2. The **arbitration condition** would provide that an RIA may not adopt or enforce a PDAA in a written customer agreement with a retail customer, but only if the PDAA on its face or through the selection of arbitration-provider rules meets certain standards of minimum fairness.
3. The **minimum fairness standards** could involve any number of substantive requirements, such as low filing fees, robust pre-hearing discovery, no class waivers, fair forum selection provisions, and the like.
4. The **hedge clause provision** could add a deterrent angle, deeming not just invalid but a violation of the fiduciary duty of loyalty any PDAA that does not meet the "arbitration condition."
5. The **safe harbor** would provide that FINRA's dispute resolution forum necessarily meets the minimum fairness standards.
6. Outside the safe harbor, the Commission could keep a list of qualifying alternate arbitration forums or provide staff **guidance** on which arbitration providers have rules meeting the fairness standards.

A regulation structured this way would encourage RIAs to select the FINRA as the arbitral forum, which is widely recognized for its fairness and effectiveness. By designing regulatory requirements that mirror the standards of the FINRA arbitration forum, the regulation would ensure a high level of fairness and trust in the arbitration process. It would also provide a strong positive incentive for other arbitral forums to adopt or adhere to standards similar to those upheld by FINRA. For example, AAA or JAMS might adopt rules for RIA arbitration that provide equivalent protections to FINRA's rules. The use of the FINRA forum as a safe harbor (and the possibility that other forums would be added to the safe harbor list) would incentivize other arbitral forums to adopt similar standards, thereby creating a more consistent and equitable system of arbitration for retail investors.