

A Fair Dispute Resolution Process for Retail Investors Begins with the Ending of the Abuse by Registered Investment Advisors of Draconian Arbitration Clause Provisions

Issue: The framework for arbitration is straightforward for claims involving broker-dealers (BDs), as customer agreements are regulated by FINRA rules, and FINRA provides an arbitration forum. Unlike BDs, Registered Investment Advisors (RIAs) are not subject to FINRA's oversight or the rules. Accordingly, a comparable arbitration framework does not exist to resolve disputes between RIAs and clients. Because investment advisory agreements between RIAs and clients are not limited or regulated by any self-regulatory organization (SRO) or regulator, the mandatory arbitration clauses often include provisions that harm investors, including the selection of the forum, rules, and venue (without consideration of the client's location) that increase costs for the client in favor of RIAs. These provisions often make it cost-prohibited for retail investors to file claims.

For instance, FINRA arbitration claims have a maximum \$2,300 filing fee, and additional arbitrator compensation is regulated and paid at the end of the proceeding. In contrast, under its commercial rules, an arbitration hearing in AAA requires a claimant to pay at least \$4,400 upfront and a final fee of \$3,850 before the first hearing. Upfront administrative fees and deposits can run in the tens of thousands of dollars, deterring claimants from bringing viable claims against their RIAs. If the RIA refuses to pay its share, the investor must bear the full cost of arbitration or have the case dismissed.

Other provisions, like class action waivers, damage limitations, and claim limitations, found in RIA-client agreements but not in BD-customer agreements by rule, negatively impact investors. In some instances, investment advisory agreements require clients to arbitrate all disputes but permit the RIA to pursue all other legal remedies. The lack of constraints on RIA's use of draconian arbitration provisions and a uniform arbitral forum for RIA disputes raises questions about consistency, fairness, and access to justice.

Background: Section 921(b) of the Dodd-Frank Act amended the Investment Advisers Act of 1940, extending the Securities and Exchange Commission's rulemaking authority to regulate arbitration between investment advisers and their clients. Under this authority, the House Appropriations Committee expressed concerns about mandatory arbitration clauses in SEC-registered investment adviser contracts and directed the SEC to study their impact on investors.

The [study](#) found that there is little transparency regarding forced arbitration clauses, which limited the study's scope. However, the SEC concluded that most investment advisory agreements contain mandatory arbitration clauses, some of which could negatively affect the arbitration process or outcome for clients. The overwhelmingly clear conclusion from the report is that investors who use RIAs do not have the same protection as those who use BDs because RIAs are free to choose from a set of restrictive arbitration rules that are unfair to retail investors. In December 2023, the SEC Office of the Investor Advocate published a [report](#) suggesting that the use of forced arbitration in RIA contracts be prohibited.

Solutions

In its simplest act, the SEC could mandate various changes to arbitration clauses through Commission interpretations regarding the standard of conduct by RIAs.

Alternatively, Congress has empowered the SEC in the Dodd-Frank Act to regulate arbitration agreements for broker-dealers and RIAs. The SEC has not yet exercised this statutory authority but could do so to limit or restrict the enforceability of arbitration agreements in these contexts.

Finally, regulators and congressional representatives can encourage private arbitration providers to adopt rules promoting fairness and cost structures that don't price investors out of justice through regulatory pressure and a safe harbor rewarding providers for investor protection.