

Executive Summary

It is axiomatic that any arbitration forum can only be as fair as the arbitrators who decide disputes in this forum. In this case, aggrieved investors have only one choice if they have a dispute with their brokers or brokerage firms – that is, FINRA Dispute Resolution. FINRA agrees with PIABA that FINRA has a duty to ensure that its arbitrator roster consists of impartial and neutral arbitrators. In fulfilling that duty, it correctly states in its Arbitrator Guide that “arbitrator disclosure is the cornerstone of FINRA arbitration.”¹ This report demonstrates that there are serious flaws in this disclosure “cornerstone,” which render the system itself unsound.

This Summary Section will distill the problems uncovered and the solutions proposed in the attached 50-page report. The report analyzes the background information provided by FINRA to the parties for over 5,000 FINRA arbitrators. It also recounts the history of FINRA’s ongoing lack of transparency with respect to arbitrator recruitment and disclosure process. To support its conclusions, PIABA obtained the opinion of a prominent, tenured professor, Dr. Akshay Rao, to examine the reliability of FINRA’s arbitration disclosure process. Dr. Rao concluded that FINRA’s arbitrator disclosure process is “illusory” and fails to elicit meaningful and reliable information about arbitrators’ bias and conflicts of interest. Dr. Rao concluded that FINRA’s arbitrator disclosure process is flawed at every stage. Unreliable and incomplete information is communicated to the parties, which gives FINRA members an unfair advantage over investors because they are repeat players.

In addition, PIABA used the background information described above to analyze the demographics of FINRA’s arbitrator roster. This study determined that contrary to FINRA’s public statements that its arbitrator roster is diverse, FINRA’s undisclosed targeted arbitrator recruiting practices have resulted in a non-diverse pool. PIABA consulted with Susan MacPherson, a jury consultant expert, who explained that arbitrators with diverse backgrounds and experiences are better at decision-making than homogenous groups of arbitrators (e.g. FINRA’s arbitrator pool that predominantly consists of older male attorneys who are similarly trained in evaluating and solving problems.)

Problems with FINRA’s Arbitrator Recruitment and Disclosure Process

Below is a list of problems highlighted in the Report:

¹ FINRA Arbitrators Guide (2014), p. 17.

1. Since 1992, FINRA's f/k/a NASD has made its arbitrator eligibility standards more stringent and engaged in targeted recruiting practices that have resulted in an arbitrator roster that is homogenous. (pages 12-21)
2. FINRA fails to disclose to the public (and even to the parties using its system) how and why it targets certain categories of individuals to become FINRA arbitrators even though it collects this data. Information about how and why arbitrators are recruited is important to parties trying to identify potential conflicts of interest and bias. (page 22)
3. FINRA claims that its arbitrator roster is diverse but also admits that it has not conducted any studies to measure diversity. (pages 22-24)
4. PIABA's demographics study found that FINRA's targeted recruiting practices that have resulted in an arbitrator roster that is homogenous. (pages 24-31) Based on a review of analysis of 5,375 arbitrators, a summary of the results is as follows:
 - The arbitrator pool consists of approximately 80% males and 20% females meaning that women are underrepresented in the pool.
 - The average age of arbitrators is 69 years old.
 - Approx. 40% of the arbitrator pool is 70 years or older.
 - Approx. 17% of the arbitrator pool is 80 years or older.
 - The advanced age of FINRA's arbitrators raises concerns about their ability to effectively participate in deciding cases.
 - Approx. 70% of arbitrators have advanced degrees.
 - Approx. 75% of arbitrators in the public pool have advanced degrees whereas only 25% of industry arbitrators have advanced degrees. This supports that FINRA's targeted recruiting practices have contributed to a homogenous arbitrator pool, especially in the public pool.
5. After reviewing FINRA's arbitrator disclosure process, Dr. Akshay Rao concluded that FINRA's arbitrator disclosure process is illusory. While FINRA may say the right things about disclosure, its actual implementation of disclosure policies fail to elicit meaningful or reliable information about arbitrators' conflicts or biases. (pages 31-42)

6. In addition, FINRA's procedural safeguards to ensure that only impartial arbitrators are added to the arbitrator pool are inadequate and not verifiable. (pages 17-21)

7. 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. (Examples provided on pages 42-47)

Solutions to the Identified Problems

Below is a list of proposed recommendations to correct the problems identified in this Report:

1. If investors had a choice to seek justice in a forum other than FINRA, then many of the problems in this report would be alleviated. Unfortunately, as Professor Katsoris states in the Forward to this Report: FINRA "is basically the only remaining game in town." Right now, investors are forced into FINRA's flawed system to seek justice. PIABA believes that 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 this Report, PIABA recommends that the 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 is separate, distinct and that does not report to FINRA's current board of directors. Making the securities arbitration process independent from FINRA's regulatory body would likely improve the fairness of the arbitration forum for investors. It would also likely improve the perception of fairness about FINRA's industry-sponsored dispute resolution process.

3. PIABA recommends that the SEC take action to restore SICA's status 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. This group should not report to the FINRA Board of Directors. And, this independent group should be given the power to obtain documents and information from FINRA related to its arbitration forum.

4. PIABA recommends that the SEC 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. PIABA recommends that SEC 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. PIABA recommends that 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. PIABA recommends that 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. PIABA recommends that the SEC require FINRA to take action on the identified problems with the arbitrator application process and other failures of disclosure.

9. PIABA recommends that the SEC 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.