RESPONSE TO CONGRESS:

MANDATORY ARBITRATION AMONG SEC-REGISTERED INVESTMENT ADVISERS

AS DIRECTED BY THE HOUSE COMMITTEE ON APPROPRIATIONS

H.R. REPT. NO. 117-393

This is a report by the Staff of the U.S. Securities and Exchange Commission. The Commission has expressed no view regarding the analysis, findings, or conclusions contained herein.

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I. OVERVIEW AND EXECUTIVE SUMMARY

A. Overview

On December 29, 2022, Congress enacted the Consolidated Appropriations Act, 2023,[1] attaching House Report 117-393[2] (the "House Report"). In the House Report, the Committee on Appropriations (the "Committee") expressed concerns about the proliferation of mandatory arbitration clauses among SEC-registered investment advisers.[3] Accordingly, the Committee directed the U.S. Securities and Exchange Commission ("SEC" or the "Commission") to:

> [G]ather detailed information about how such contracts are used by SEC-registered investment advisers and the effect such contracts have on investors who are harmed by the conduct of advisers. When such contracts are used, the SEC shall gather information about whether a dispute resolution forum has been designated; whether particular forum rules are designated; whether a venue is designated; whether a class action waiver is included; whether there are limitations on claims that may be asserted or damages that may be awarded; whether the contract includes any fee shifting provision; whether any complaints have been filed against the advisor [sic] in accordance with the contract; and whether the firm has any arbitration awards or unpaid arbitration awards in the last five years. The SEC is directed to provide a report to the Committee and to the House Financial Services Committee within 180 days of enactment of this Act. [4]

In response to this directive, staff of the Commission ("Staff") reviewed a sample of investment advisory agreements and compiled data regarding the occurrence of mandatory arbitration clauses, as well as the occurrence of terms listed in the House Report, such as designation of forum and inclusion of class action waiver.

Due to the lack of publicly available information about SEC-registered adviser[5] arbitration, Staff could neither review adviser arbitration data nor identify a representative sample of advisory clients to determine the "effect such contracts with mandatory arbitration clauses have on investors that are harmed by the conduct of advisers." Instead, as a proxy for the perspectives of advisory clients, Staff interviewed eight external stakeholder groups identified as having information relevant to the issue of mandatory arbitration, and/or as having publicly expressed opinion on the issue of mandatory arbitration. Their views, while anecdotal, provided insight into the potential harms and benefits of mandatory arbitration clauses for advisory clients.

B. Executive Summary of Findings

1. Occurrence of Mandatory Arbitration Clauses and Other Arbitration Terms

Staff estimated that approximately 61%[6] of SEC-registered advisers that serve retail investors incorporated mandatory arbitration clauses into their investment advisory agreements.

Of the agreements that contained mandatory arbitration clauses, Staff estimated the frequency with which advisers incorporated the terms listed in the House Report as follows:

Table 1. Frequency of specific provisions in mandatory arbitration clauses

Agreement designates a particular dispute resolution forum:	92%
When designating a forum, advisers designated the following fora:	
American Arbitration Association (AAA)	83%
Financial Industry Regulatory Authority (FINRA) Dispute Resolution Services	10%
JAMS	6%
Other	1%
Agreement designates particular forum rules:	37%
When designating forum rules, advisers selected the following rules:	
AAA Commercial Rules	83%
JAMS Streamlined Rules and Procedures	3%
JAMS Comprehensive Rules and Procedures	2%
AAA Securities Arbitration Supplementary Procedures	1%
Agreement designates the arbitration venue:	60%
When designating arbitration venue, percent of agreements that did not consider client's location or place of business:	97%
Agreement precludes participation in class action	6%
Agreement limits claims the client may assert	5%
Agreement limits damages that may be awarded	11%
Agreement includes fee-shifting provision	18%

2. Frequency of Adviser Arbitrations, Unpaid Awards

Advisers are not uniformly[7] required to disclose customer arbitration information. As discussed more fully below, while state-registered advisers and investment adviser representatives are required to disclose certain types of customer arbitration information, SEC-registered advisers must generally disclose information that is "material" to the client relationship. Moreover, private dispute resolution fora do not segregate or track the number of adviser arbitrations. For these reasons, Staff could not obtain reliable data about the frequency of SEC-registered adviser arbitration.

As a related point, private arbitrators lack jurisdiction over the parties after the award is issued. Generally, parties to an arbitration will abide by the terms of the arbitrator's award.[8] However, parties seeking to enforce an arbitration award must do so through the court system, and parties must litigate disputes over unpaid awards. A survey of federal and state case law did not yield results upon which to estimate the frequency of unpaid arbitration awards among advisers.

3. Stakeholder Perspectives

Stakeholders unanimously agreed that mandatory arbitration clauses benefited *advisers* by, among other things, simplifying the dispute resolution process through limited discovery[9] and no right to appeal,[10] maximizing privacy during and after the arbitration, and increasing both predictability and efficiency through the designation of a known venue with familiar rules. Proponents of mandatory arbitration further asserted that clients – like advisers – experienced these same benefits.

In contrast, critics of mandatory arbitration argued advisers experienced these benefits at the expense of clients. Because advisers unilaterally draft their advisory agreements, critics believed advisers often selected the forum, the rules, and the venue that would likely increase costs for the client and favor the adviser. They also asserted that the limited ability to exchange information during discovery might prevent a client from obtaining evidence to prove her claim, and the inability to appeal would preclude review of the arbitrator's decision. Critics also asserted the lack of uniform disclosure requirements for adviser arbitration information would allow recidivist advisers to conceal client allegations of wrongdoing from regulators and prospective clients.

Stakeholders agreed, to varying degrees, that advisers should consistently be required to disclose more complete information about customer arbitrations and unpaid awards. Proponents of mandatory arbitration argued that, while disclosure of all customer allegations might subject advisers to unwarranted reputational harm, full and fair disclosure of allegations the adviser deems material would create a competitive advantage for honest advisers and promote fairer markets. Critics of mandatory arbitration more broadly argued that advisers' fiduciary duty necessitated disclosure of customer arbitration information, irrespective of whether the adviser deemed the information material.

Several stakeholders also stated that differences between the adviser and broker[11] arbitration regimes disadvantaged advisory clients. For instance, some stated that certain provisions that may be used in advisory agreements, such as class action waivers, damage limitations and claim limitations, are impermissible in agreements between brokers and their customers, and argued these terms could negatively affect arbitral outcomes for advisory clients. Others stated that the costs associated with private arbitration with advisers are significantly higher than the costs associated with broker arbitration, and, in some instances, those costs could preclude advisory clients from bringing arbitration claims at all.

4. Conclusions

Based on Staff estimates, a majority of investment advisory agreements contain mandatory arbitration clauses, and some contain restrictive terms that could negatively affect the arbitration process or outcome for clients. Table 1, above, reflects the approximate frequency with which such terms are included in adviser mandatory arbitration clauses. As stated by stakeholders, some of these restrictive terms are impermissible in agreements between brokers and their customers (such as terms prohibiting class actions or specifying certain forum locations), and might also be impermissible in other dispute resolution fora. Stakeholder views regarding the potentially negative impact of these terms on advisory clients might merit further exploration.

Given the absence of publicly available information about adviser arbitration or the number of unpaid awards, a quantitative evaluation of the "effects" of contracts with mandatory arbitration clauses would also require further inquiry. Establishing uniform disclosure requirements for adviser arbitration information could, as some stakeholders suggested, increase public access to this information, as well as regulatory and investor insight into advisory conduct.

II. BACKGROUND

A. Perceived or Actual Rise in Adviser Arbitration

In the House Report, the Committee expressed concern about "the proliferation of mandatory arbitration clauses among SEC-registered investment advisers."[12] However, Congressional concern about mandatory arbitration in the financial services industry is not new, given the longstanding pervasiveness of mandatory arbitration in the industry.[13] Since a pair of Supreme Court decisions in the late 1980s held that mandatory arbitration clauses in brokerage-account agreements were enforceable with respect to certain securities-law claims,[14] mandatory arbitration clauses have essentially become standard in brokerage agreements.[15] The movement toward mandatory arbitration has also been propelled, in part, by the notion that arbitration is a fast, fair and cost-effective alternative to litigation.[16]

Recent anecdotal reports about the growing use of mandatory arbitration clauses in investment advisory agreements[17] have caused investor rights advocates to worry about the implications of widespread mandatory adviser arbitration.[18] Such observations are unscientific, but a measurable increase in the number of SEC-registered investment advisers might predictably give rise to a corresponding increase in mandatory adviser arbitration. In the past ten years, the number of SEC-registered advisers has risen by roughly 44 percent.[19] The number of advisory clients also continues to rise steadily. In 2017, advisers provided services to approximately 39.3 million clients. By 2021, that number had grown to 64.7 million clients.[20] With the population of advisers and clients on the rise, we might expect an accompanying increase in the number of adviser arbitrations. The increased adviser population, on its own, might merit an inquiry into the harms and benefits of adviser arbitration, particularly where the advisory population may continue to grow.

B. Advisers and Brokers: A Comparison

Although the House Report directive relates to adviser arbitration, it is instructive to view adviser arbitration against the backdrop of broker arbitration, as many registered representatives[21] are associated with both advisers and brokers. At the end of 2022, these dually registered representatives accounted for approximately 44% of all registered representatives, compared to only 12 percent of representatives solely registered as advisers.[22] Furthermore, many investors may hold both brokerage and advisory accounts.

1. Basic Differences between Advisers and Brokers

As a threshold matter, investment advisers and brokers structurally differ in the types of services they offer, their means of compensation, and the duties owed to investors. Generally, advisers provide ongoing advice and related services to manage a client's portfolio of investments, and they receive a fixed percentage of those "assets under management" or other fixed fees as compensation.[23] Brokers may make recommendations about specific securities transactions or investment strategies involving securities (including account recommendations), and receive compensation on a transaction-by-transaction basis (such as commissions).[24] With respect to investor relationships, advisers owe their clients an ongoing fiduciary duty that encompasses, among other things, a duty of loyalty and of care, which requires advisers to provide investment advice in the best interest of their clients, based on the client's specific objectives.[25] Brokers are required to act in the "best interest" of their retail customers at the time they make a securities-related recommendation, without placing financial or other interests of the broker or associated person making the recommendation ahead of the interest of the retail customer.[26] The fiduciary duty and the best interest standard impose disclosure obligations on advisers and brokers, respectively.[27]

Notably, differences exist between advisers' and brokers' disclosure obligations regarding arbitration information. SEC-registered advisers are not generally required to disclose information about client arbitrations in their disclosure documents. To register with the SEC, advisers must file a three-part Uniform Application for Investment Adviser Registration ("Form ADV"). Form ADV Part 1 is a standardized form containing general information about the adviser's business, including certain disciplinary information.[28] Form ADV Parts 2 and 3, which must be delivered to clients and filed with the SEC, include disclosures about the adviser's business practices, services offered, fees, conflicts of interest, and disciplinary information.[29] Although disclosure of arbitration information is not required in Form ADV Parts 1, 2 or 3, the General Instructions for filing Form ADV Part 2 state that, as a fiduciary, the adviser is obligated to disclose all "material"[30] facts relating to the advisory relationship and all "material" conflicts of interest that could affect the advisory relationship.[31] The Commission previously considered whether to require advisers to disclose arbitration information in their Forms ADV, but determined not to require disclosure, as arbitration settlements or awards may not actually reflect a finding that the adviser violated the law, and disclosure might cause unwarranted reputational harm to the adviser.[32] However, the Commission suggested that advisers should "carefully consider whether particular arbitration awards or settlements do, in fact, involve or implicate wrongdoing and/or reflect on the integrity of the adviser, and should be disclosed to clients in the brochure or through other means."[33] The Commission also stated it would "continue to assess whether we should require that these events be reported by firms registered with us."[34]

At the individual and state levels, investment adviser representatives[35] and state registered advisers are required to disclose certain arbitration information. In their state Forms ADV, state-registered advisers are required to disclose arbitration claims arising from any investment or investment-related activity with alleged damages exceeding $2,500.[36] They must also disclose certain civil proceedings to which they are currently subject or have been found liable for specific types of claims.[37]

Investment adviser representatives must register with appropriate state jurisdictions by filing a Uniform Application for Securities Industry Registration or Transfer ("Form U4"),[38] in which they must disclose certain investment-related, consumer-initiated arbitrations or civil litigation involving one or more sales practice violations.[39] FINRA collects the information from the Form U4 and publishes it online through BrokerCheck, a free tool to research the background and experience of brokers, advisers and firms.[40] Information about investment adviser representatives is also accessible by online search at the Investment Adviser Public Disclosure (IAPD) website.[41]

Meanwhile, brokers must disclose the same arbitration-related information required in the Form U4.[42] In addition to SEC and/or state-registration, brokers must also register with and obtain membership with FINRA, a self-regulatory organization (SRO) overseen by the SEC,[43] that, in turn, oversees the activity of brokers and their associated persons[44] doing business in the United States.[45] As part of the registration and licensing process, brokers must file a Form U4 with FINRA on behalf of their registered or proposed registered representatives.[46] The information collected, which includes arbitration information, is published online through BrokerCheck. FINRA also publishes aggregated brokerage dispute resolution statistics on its website.[47]

2. Basic Differences between Adviser and Broker Arbitration

Currently, FINRA operates the primary securities industry dispute resolution forum for customer and intra-industry disputes in the United States, subject to SEC oversight.[48] The Commission exercises oversight authority over FINRA and its dispute resolution forum, FINRA Dispute Resolution Services ("FINRA DRS"), pursuant to the Securities Exchange Act of 1934 (the "Exchange Act"). Exchange Act Section 19(b) governs notice, comment, Commission review and consideration of SRO rules, like those of FINRA, including SRO arbitration rules.[49] Exchange Act Section 17(b)(1) authorizes the Commission and its representatives to examine SROs' records, which include their arbitration records.[50] SEC oversight and regulation of SRO arbitration formed the basis, in part, for the Supreme Court's decision to uphold mandatory arbitration clauses in the brokerage context.[51]

FINRA rules impose arbitration-related requirements and restrictions on its members that affect the broker arbitration process. The FINRA Code of Arbitration Procedure for Customer Disputes (the "FINRA Code")[52] requires a broker to arbitrate customer disputes through FINRA DRS if the dispute arises in connection with its business activities, and if: (1) a written agreement requires FINRA arbitration, or (2) the customer requests arbitration.[53] Because nearly all brokerage account agreements include mandatory arbitration clauses, and because FINRA DRS is the primary forum for broker arbitration, FINRA DRS handles virtually all customer/broker arbitrations in the United States.[54] The FINRA Code of Arbitration for Customer Disputes governs all disputes involving customers and their brokers, and requires or prohibits the usage of certain terms in brokerage agreements.[55] Moreover, as an SRO, FINRA may suspend or cancel the FINRA membership of brokers or registered representatives who fail to pay an arbitration or mediation award or settlement.[56]

Unlike brokers, advisers are not required to register with an SRO and do not have a dedicated forum for dispute resolution. An adviser may designate the dispute resolution forum of their choosing in a mandatory arbitration clause, and may invoke the application of specific forum rules. While FINRA, as an SRO, has jurisdiction over its members, arbitrators in other private dispute resolution fora lack jurisdiction over the parties after they issue an award. These arbitrators therefore cannot impose penalties on advisers for non-payment of awards. Generally, parties to an arbitration will abide by the terms of the arbitrator's award.[57] In the event parties do not abide by the terms of the award, parties may confirm or enforce an award through the court system, and must litigate disputes over unpaid awards.[58]

While advisers do not register with FINRA, they may still arbitrate through FINRA DRS if: (1) the parties submit a post-dispute agreement to arbitrate; (2) the adviser or other parties agree to pay all member surcharge and processing fees prior to service of the statement of claim; and (3) the client files a written arbitration submission agreement, signed by all parties after the events occurred that gave rise to the underlying dispute.[59]

C. Broker Arbitration as Referenced in this Report

Brokers and investment advisers have different types of relationships with investors, offer different services, and have different compensation models when providing investment recommendations or investment advisory services to customers.[60] Because many investment adviser representatives are also registered representatives of brokers,[61] and, as noted above and discussed further below, because arbitration is usually mandatory in customer disputes with brokers and advisers,[62] broker arbitration serves as a useful point of comparison with the adviser arbitration regimes discussed in this report. Moreover, given the directive to evaluate advisers' usage of specific terms and clauses that brokers either do not use or use differently in brokerage agreements,[63] we believe a comparison of mandatory arbitration clauses and terms across the adviser and broker context is consistent with the Congressional intent of the House Report.

III. INFORMATION REVIEWED

A. Review of SEC-Registered Investment Advisory Agreements

To respond to Committee questions regarding the usage of mandatory arbitration clauses and other terms, Staff reviewed a sample of advisory agreements of U.S. advisers that were geographically diverse, had a wide-range of assets under management, and at least one "individual" or "high net worth individual" client – suggesting that the firms dealt with retail clients.[64] Advisers with exclusively institutional clients were excluded from the study, as the Commission has previously recognized that institutional clients possess the resources and capacity to better analyze and understand complex advisory agreement terms and their implications.[65] Staff then manually reviewed the agreements for relevant attributes identified in the House Report, such as inclusion of a mandatory arbitration clause, or identification of a dispute resolution forum, and entered the data collected from the review in a searchable, sortable database.

Staff obtained specific information from firms' Form ADV Part 1A,[66] filed December 2022,[67] such as information about firm size,[68] the firm's principal office and place of business,[69] and client type (Form ADV, Item 5.D.(a), (b)).[70]

To address the potential that our sample was not representative of retail advisers, Staff used inverse probability weighting.[71] Weights were based on results from a model that predicted inclusion in the estimated sample using logistic regression, with presence in the agreement data as the dependent variable. The regression model was based on SEC-registered investment adviser data, drawn from Form ADV, including: assets under management, number of individual and high net worth clients, percent of non-institutional clients, registration status, and age. To explore the robustness of the results to the weighting procedure, Staff verified that similar results are obtained with different specifications and when employing a random forest algorithm in the weighting procedure.[72]

To estimate the proportion of retail advisers' agreements containing each of the clauses of interest, Staff applied the weights described above. Staff also calculated the margin of error on each estimate using a non-parametric bootstrap procedure, where each iteration conducts weighting and estimation with a new bootstrapped sample.

The final, weighted sample set consisted of 579 advisory agreements. This weighted set of agreements was used to generate the statistics in Section IV.A., below.

B. Identification and Interview of External Stakeholders

Due to the lack of publicly available information about adviser arbitration, Staff could neither review aggregated adviser arbitration data, nor identify a representative sample of advisory clients to determine the effect of mandatory arbitration clauses in advisory contracts. Instead, Staff identified eight stakeholder groups – including trade associations, non-profit, regulatory and self-regulatory organizations – to serve as proxies for investor views on mandatory adviser arbitration and related issues.[73] Staff sought to obtain a wide range of views by seeking out stakeholders known to possess information relevant to mandatory adviser arbitration, or known to have publicly expressed views through editorials, white papers and/or letters to the SEC comment file about mandatory arbitration. Staff interviewed these groups using a standardized questionnaire to facilitate the comparison of responses across the same questions. A summary of these responses and stakeholder views appears in Section V, below.

C. Accessing Adviser Arbitration Data

1. Frequency of Adviser Arbitration

As noted above, advisers are not required to disclose arbitration information on their Forms ADV, unless such disclosures would be material.[74] Without access to reliable adviser arbitration information, Staff could not determine the number of adviser arbitrations involving specific advisers or advisers in the aggregate in the past five years.

In an effort to gather adviser arbitration information, Staff reviewed consumer arbitration data reported by AAA and JAMS. Both JAMS and AAA provide access to information about consumer arbitrations completed in the last five years.[75] However, neither fora specifically tracks adviser arbitration data. JAMS quarterly publishes online a Consumer Case Information Spreadsheet, for consumer arbitrations completed in the last five years.[76] The information includes the names of the non-consumer party and the result of the arbitration. AAA similarly maintains an online Consumer and Employment Arbitration Statistics report containing information about consumer and employment arbitrations closed within the last five years.[77]

However, neither the AAA nor JAMS report may serve as a basis to estimate the number of client/adviser arbitrations within the past five years. First, neither report clearly identifies which, if any, arbitrations involved disputes between advisers and their clients arising from the advisory business. Second, neither report includes non-consumer arbitrations –such as commercial arbitrations, which might encompass some adviser arbitrations.[78] AAA and JAMS do not publish commercial arbitration information.

Staff also reviewed adviser arbitration information from FINRA DRS indicating that, in the past five years, out of approximately 13,000 customer arbitrations filed in the forum, only 63 – or 0.4 percent – related exclusively to investment adviser activity, or named only advisers or investment adviser representatives as respondents.[79]

To gauge the frequency of adviser arbitration more broadly, the Staff also reviewed state-registered adviser arbitration data from Forms ADV Part 1.B., filed with state securities regulators.[80] As of April 2023, 96 state-registered advisory firms reported an arbitration claim with damages in excess of $2,500 in the past five years.[81] With an estimated 17,371 state-registered advisers, [82] that means roughly 0.5% of advisory firms disclosed an arbitration claim within the past five years.[83]

The limited data available to Staff suggest a noticeably low prevalence of adviser arbitrations, which could be correlated with any number of factors. For instance, advisory clients might not bring claims because arbitration filing fees and other related fees are cost prohibitive. As one stakeholder asserted, clients might not bring arbitration claims against advisers because they abide by their fiduciary duty and do not frequently engage in wrongdoing. Or, as another stakeholder asserted, seasoned attorneys might file arbitration claims against dual registrants in their capacity as brokers to benefit from the rules and lower costs of FINRA DRS.

Alternatively, advisers might not report arbitration claims. To explore this possibility among investment adviser representatives, Staff cross-referenced FINRA DRS arbitration data involving investment adviser representatives with representatives' disclosure reports on IAPD, to confirm whether the arbitrations were disclosed. Based on this limited inquiry, Staff observed that roughly ten per cent of investment adviser representatives did not disclose arbitration data. Given the small sample size, and the fact that the data only included arbitrations in FINRA DRS, however, this finding is not generalizable across the investment adviser representative population or across the adviser population generally.

2. Unpaid Awards

As noted above, private dispute resolution fora do not track information about unpaid awards, and private arbitrators do not have authority over the parties after they issue an award. Parties must litigate disputes over unpaid awards in the court system. Staff's search of state and federal court decisions within the past five years involving unpaid adviser arbitration awards yielded few relevant results. Moreover, this number would only represent situations where a client sued an adviser in court about an unpaid award, and the court issued an opinion about the case. Consequently, Staff could not reliably estimate the number of unpaid adviser arbitration awards.

IV. ANALYSIS AND FINDINGS

A. Results of Analysis

Table 2 displays the results of the Staff data analysis. As shown in the table, an estimated 61% of SEC-registered advisers included a mandatory arbitration clause in their advisory agreements (row 1).[84] The last column of the table provides the results for specific contract terms as a portion of advisers that have a mandatory pre-dispute arbitration contract clause (*i.e.*, as a proportion of the 61 percent). Staff performed this calculation because items 2 through 8 in the table only apply to agreements that have a mandatory arbitration contract clause.[85]

Tables 3 and 4 present the portion of designated fora and rules that correspond to the most common designations, respectively.

Table 2. Frequency of mandatory arbitration clauses and key terms[86]

Term	Estimated proportion among all retail advisers	Estimated proportion among retail advisers that have a mandatory arbitration clause
1. Contains a mandatory arbitration clause	61%	N/A
Specific contract clause terms		
2. Designates dispute resolution forum	56%	92%
3. Designates forum rules	23%	37%
4. Designates a venue	37%	60%
5. Includes class action waiver	4%	6%
6. Limits claims that may be asserted	3%	5%
7. Limits damages that may be awarded	7%	11%
8. Contains fee-shifting provision	11%	18%

Table 3. Proportion of designated dispute resolution forums[87]

Forum	Estimated proportion among retail advisers that designated a dispute resolution forum
1. AAA	83%
2. FINRA	10%
3. JAMS	6%

Table 4. Proportion of designated forum rules[88]

Rules	Estimated proportion among retail advisers that designated forum rules
1. Commercial Rules (AAA)	78%
2. Customer Rules (AAA)	1%

3. Comprehensive Arbitration Rules and Procedures (JAMS)	2%
4. Streamlined Arbitration Rules and Procedures (JAMS)	3%
5. Securities Arbitration Supplementary Procedures (AAA)[89]	3%

B. Discussion of Findings

1. Mandatory Arbitration Clauses

As noted in Table 2, roughly 61 percent of advisers included mandatory arbitration clauses in their advisory agreements. This estimate might be conservative. Some agreements did not feature mandatory arbitration clauses prominently as standalone terms, but incorporated language requiring clients to arbitrate into other agreement provisions. In a number of agreements, the language was ambiguous – referring to the agreement to arbitrate as "voluntary," while stating the client waived the right to pursue remedies in court. A handful of agreements also required clients to arbitrate disputes, but permitted clients to "opt out" of mandatory arbitration by providing written notice by a specified deadline. As a conservative measure, the Staff estimate of mandatory arbitration clauses excludes agreements with "voluntary" or "opt-out" arbitration clauses or that otherwise contain ambiguous language about arbitration.

In some instances, advisory agreements permitted advisers to pursue other legal action in addition to arbitration if the client failed to pay advisory fees:

> *In the event of non-payment of any portion of Adviser's fee pursuant to this Agreement, Adviser, in addition to the aforementioned arbitration remedy, shall be free to pursue all other legal remedies available to it under law, and shall be entitled to reimbursement of reasonable attorneys' fees and other costs of collection.*

Several agreements required clients to arbitrate all disputes, but permitted the adviser to pursue all other legal remedies:

> *Notwithstanding this mandatory arbitration provision, Adviser reserves the right to pursue all legal and equitable remedies that may be available to it.*

2. Forum Designation

Of the agreements that included a mandatory arbitration clause, 92 percent of advisers designated a dispute resolution forum for the arbitration. The designated fora included AAA (83 percent), FINRA DRS (10 percent) and JAMS (6 percent).

The remaining 1 percent of advisers designated a varied group of private dispute resolution fora. For instance, several agreements designated religious-affiliated fora, which required the parties and arbitrators to adhere to certain faith-based principles.

Of the advisers that designated FINRA DRS, 42 percent were solely registered as advisers, 37 percent were dual registrants, and 21 percent had a broker affiliate.

3. Designation of Forum Rules

Advisers that designated AAA as their forum invoked the AAA Commercial Arbitration Rules 78 percent of the time. This designation is significant, as costs associated with AAA commercial arbitration, including filing fees, are higher than those associated with AAA consumer arbitration. The tables below illustrate this point:

Table 5. AAA Consumer Costs of Arbitration[90]

In-Person, Virtual or Telephonic Hearing Arbitration
Single Consumer Case Filing Fee: $225 **Multiple Consumer Case Filing Fee:** $125 or $75 per case depending on tier $0 if Case Filed by Business
Single Consumer Filing Fee: $375 for 1 or $500 for 3 arbitrators is due once the individual claimant meets the filing requirements; $600 for 1 arbitrator or $725 for 3 arbitrators if Case Filed by Business is due at the time the arbitration is filed. **Multiple Consumer Case Filing Fee:** $325, $250, $175, or $100 per case depending on tier, due once the individual claimant meets the filing requirements; Business must pay both the Individual's Filing Fee and Business's Filing Fee if the case is filed by Business, due at the time the arbitration is filed. **Case Management Fee:** $1,400 for 1 arbitrator or $1,775 for 3 arbitrators will be assessed and must be paid prior to the arbitrator appointment process. **Hearing Fee:** $500 **Arbitrator Compensation:** $2,500 per day of hearing* per arbitrator
*The arbitrator compensation encompasses one preliminary conference, one day of in-person, virtual or telephonic hearing, and one final award. For cases with additional procedures, such as multiple telephone conferences, motion practice, post-hearing briefing, interim or partial awards, awards containing findings of fact and conclusions of law, or other processes not provided for in the Rules, the business will be responsible for additional arbitrator compensation. Arbitrator compensation is not subject to reallocation by the arbitrator(s) except as may be required by applicable law or upon the arbitrator's determination that a claim or counterclaim was filed for purposes of harassment or is patently frivolous.

Per Table 5, AAA consumer arbitrations with a single consumer and one arbitrator require a $375 filing fee, or a $500 filing fee for a panel of three arbitrators.[91]

Table 6. AAA Commercial Arbitration Administrative Fee Schedule[92]

Standard Fee Schedule

Amount of Claim	Initial Filing Fee	Final Fee
Less than $75,000	$925	$800
$75,000 to less than $150,000	$1,925	$1,375
$150,000 to less than $300,000	$2,900	$2,200
$300,000 to less than $500,000	$4,400	$3,850
$500,000 to less than $1,000,000	$5,500	$6,825
$1,000,000 to less than $10,000,000	$7,700	$8,475
$10,000,000 and above	$11,000 plus .01% of the claim amount above $10,000,000 up to $65,000	$13,750
Undetermined Monetary Claims	$7,700	$8,475
Nonmonetary Claims*	$3,500	$2,750
Deficient Filing Fee	$500	
Additional Party Fees	If there are more than two separately represented parties in the arbitration, an additional 10% of each fee contained in these fee schedules will be charged for each additional separately represented party. However, Additional Party Fees will not exceed 50% of the base fees contained in these fee schedules unless there are more than 10 separately represented parties. *See below for additional details.*	

As seen in Table 6, filing fees for commercial arbitrations with single arbitrators depend on the amount of the claim. The number of arbitrators presiding over an arbitration also affects the amount of filing fees. For instance, AAA commercial arbitrations with three or more arbitrators are subject to a minimum initial filing fee of $4,400 and a final fee of $3,850.[93]

As illustrated by the two tables, the filing fees associated with AAA commercial arbitration are significantly higher than those associated with AAA consumer arbitration. Furthermore, the amounts above do not reflect attorneys' fees, which ultimately constitute the largest proportion of total arbitration expenses.[94] To the extent a mandatory arbitration clause invokes AAA Commercial Arbitration Rules and requires a three-arbitrator panel, the requisite filing fees alone might deter a client from taking action against their adviser.

A more fundamental question is whether firms should be permitted to designate AAA Commercial Arbitration Rules in disputes between clients and their advisers. AAA Commercial Arbitration Rules apply to "business to business claims."[95] Alternatively, AAA defines a "consumer agreement," to which the Consumer Arbitration Rules would apply, as follows:

> The AAA defines a consumer agreement as an agreement between an individual consumer and a business where the business has a standardized, systematic application of arbitration clauses with customers and where the terms and conditions of the purchase of standardized, consumable goods or services are non-negotiable or primarily non-

> negotiable in most or all of its terms, conditions, features, or choices. The product or service must be for personal or household use.[96]

To note, the parties may dispute the application of specific rules, and AAA may make an initial determination whether the Consumer Arbitration Rules should apply in a given dispute.[97] If either party disagrees with AAA's decision, the objecting party must submit the objection by the due date for filing an answer to the demand for arbitration.[98] The arbitrator will then make the final decision on which AAA rules will apply to the dispute.[99] AAA Commercial Arbitration Rules also permit parties to dispute whether the rules should apply to the arbitration, and, in those circumstances, AAA will also decide which rules should apply.[100]

A substantial difference in cost also exists between JAMS consumer arbitrations and non-consumer arbitrations. In 2009, JAMS established Consumer Arbitration Minimum Standards, under which:

> [W]hen a consumer initiates arbitration against the company, the only fee required to be paid by the consumer is $250…. All other costs must be borne by the company, including any remaining JAMS Case Management Fee and all professional fees for the arbitrator's services.[101]

JAMS Consumer Arbitration Minimum Standards apply "where a company systematically places an arbitration clause in its agreements with individual consumers and there is minimal, if any, negotiation between the parties as to the procedures or other terms of the arbitration clause."[102] JAMS defines a "consumer" as "an individual who seeks or acquires any goods or services, primarily for personal family or household purposes."[103] However, the standards do not apply to disputes arising from "commercial transactions between a lender and commercial borrowers or a company and commercial customers, *other financial services such as investment transactions*, real estate transactions, or to matters involving underinsured motorists" (emphasis added).[104]

If the Consumer Arbitration Minimum Standards would not apply in a two-party matter between a client and adviser, the client would pay a filing fee of $2,000.[105] For matters involving three or more parties (*e.g.*, arbitrations against an adviser and one or more investment adviser representatives), the client would pay a filing fee of $3,500.[106] JAMS requires the filing fee to be paid in full "to expedite the commencement of the proceedings."[107] JAMS also assesses a case management fee of 13 percent against all professional (arbitrator) fees, which the arbitrators set themselves as hourly rates.[108]

4. Venue Designation

Of the 60 percent of mandatory arbitration clauses that designated a venue for the arbitration hearing, 97 percent designated a location that does not consider the client's location or place of business. To the contrary, many of these agreements designed venue locations "of the adviser's choosing" or "wherever the adviser is located."

These terms might foreseeably cause clients to incur travel and lodging costs when attending a distant hearing in person.

5. Class Action Waivers

Staff estimates approximately 6 percent of agreements with mandatory arbitration clauses also include language precluding the client from participating in a class action lawsuit, or requiring the client to pursue action against the adviser as an "individual."

This estimate might also be conservative in practice. Many agreements stated "[p]arties to this Advisory Agreement are giving up the right to sue each other in court, including the right to a trial by jury, except as may otherwise be permitted by this Agreement or as required by law." Clients might construe such language as precluding participation in any court proceeding, including class action litigation.

For purposes of the study, however, Staff included only *explicit* class action prohibitions in this estimate. The clauses below are representative class action waivers identified during the review:

> *The Parties hereby acknowledge that they may only bring claims against the other in arbitration, and only as individuals.*
>
> *You and Adviser waive the right to a trial by jury, to participate in a class action lawsuit, and to assert or participate in any joint or consolidated lawsuit.*
>
> *The Parties hereby give up the right to sue each other in court, including the right to a trial by jury, and the right to litigate on a class basis, except as may otherwise be permitted by this Agreement or as required by law.'*

6. Claim Limitations

Five percent of mandatory arbitration clauses contained language directly limiting the claims clients could assert against their advisers. Such language typically imposed filing deadlines, without regard to the governing statute of limitations for a claim:

> *The Parties must initiate arbitration by written demand within two years of the event or conduct at issue.*

At the same time, many advisory agreements contained language limiting the *liability* of advisers. As discussed further below, this language might cause investors to mistakenly believe they may not assert certain claims against the adviser because the adviser is immune from liability by operation of the language.

7. Damage Limitations

Eleven percent of agreements with mandatory arbitration clauses limited the types of damages available to the investor – such as punitive, exemplary, treble and consequential damages. In such cases, the clauses generally stated either that the arbitrators lacked authority to award such damages, or that the parties agreed not to seek such damages as against one another.

8. Fee Shifting Provisions

Of the advisory agreements containing mandatory arbitration clauses, 18 percent contained fee-shifting provisions that entitled the prevailing party in the arbitration to recoup reasonable attorneys' fees, costs and expenses.

Separately, in disputes over non-payment of advisory fees, many firms shifted attorneys' fees and costs to the client:

> *If the Client does not pay any portion of Adviser's fee pursuant to this Agreement, Adviser shall be entitled to reimbursement of reasonable attorneys' fees and other costs of collection.*

9. Other Notable Provisions

In addition to the provisions above, Staff identified several additional provisions for inclusion in this study. The provisions were included because of the frequency with which they appeared, and/or because of the potential effects of these provisions on advisory clients.

a. Hedge clauses

A number of advisory agreements contained clauses, known as "hedge clauses," that purport to limit the adviser's liability. For example:

> *Adviser will be liable only for losses that are directly caused by the gross negligence or willful wrongdoing of Adviser and the Adviser shall not be liable for the acts of its agents (other than regular employees), including Sub-advisers, provided it uses reasonable care in selecting them, except when the federal securities laws otherwise impose liabilities.*

The Commission has previously expressed concern that such clauses might violate the Adviser's Act antifraud provisions by misleading investors into not exercising their legal rights.[109]

In January 2022, the Commission brought an Enforcement action against an adviser for, among other things, including a hedge clause in its advisory agreement "which could lead a client to believe incorrectly that the client had waived a non-waivable cause of action against the adviser provided by state or federal law."[110] The hedge clause at issue stated:

> CCM [the adviser,] and its [investment adviser representatives ("IARs")], will be liable only for their own acts of gross negligence or willful misconduct. CCM and its IARs will not be liable for any act or omission, or the failure or inability to perform any obligation, of any broker, dealer, investment adviser, sub-custodian or other agent, including affiliates, whom CCM selected with reasonable care. CCM will not be liable for any incidental, indirect, special, punitive or consequential damages.[111]

The SEC stated that the hedge clause violated the adviser's fiduciary duty and the Investment Advisers Act of 1940 ("Advisers Act") because it might "mislead the adviser's retail clients into not exercising their legal rights," and because it inaccurately stated the liability standards applicable to investment advisers under the federal securities laws.[112]

b. Prohibitions on Disclosure and Written Awards

A number of advisory agreements imposed confidentiality provisions onto the parties and the arbitrators, generally preventing them from disclosing information about the arbitration even after it had ended:

> *Except as may be required by law, the existence, content, or results of any arbitration hereunder may not be disclosed without the prior written consent of both Parties.*[113]

Similarly, some advisers prohibited arbitrators from issuing a written award, or making any findings of fact or of law:

> *The award may not contain any findings of fact, conclusions of law or other written explanation for the award.*

Both types of provisions further limit public access to adviser arbitration information.

c. Arbitrator Requirements in Type and Number

A significant number of agreements dictated the type and/or number of arbitrator. For instance, the agreements might require the arbitrator panel to consist of three arbitrators, and/or to contain at least one arbitrator affiliated with the securities industry. Such provisions could increase the cost of the arbitration; as noted above, three-arbitrator panels create substantially higher arbitration costs.

V. EXTERNAL STAKEHOLDER VIEWS ON ADVISER ARBITRATION[114]

To ascertain the harms and benefits of mandatory adviser arbitration, Staff interviewed eight stakeholder groups – including trade associations, non-profit, regulatory and self-regulatory organizations – identified as possessing information or expressing wide-ranging opinion on the issue of mandatory arbitration. While the views expressed in the interviews are anecdotal, they are helpful in identifying areas of disagreement and consensus.

A. Perceived Harms and Benefits of Mandatory Arbitration Clauses

Stakeholders unanimously agreed advisers benefited from mandatory arbitration clauses. On one hand, proponents of mandatory arbitration stated advisers and clients benefited from mandatory arbitration clauses, and that the parties' interests were aligned in arbitration. These groups asserted that the efficiencies and cost-savings in arbitration – attributed in part to limited discovery and lack of an appeal process – benefited both parties. Proponents also believed the parties benefited from the privacy of arbitration, which protected their financial information from disclosure and insulated them from reputational harm. These groups suggested that the ability to resolve disputes in a familiar arbitral forum with predictable rules reduced uncertainty and led to a faster, smoother process for all.

On the other hand, a majority of stakeholders believed advisers benefited from mandatory arbitration at the expense of their clients. These stakeholders frequently expressed the concern that advisers select the fora, rules, and other arbitration terms that increase client costs and favor the adviser. For example, some suggested that advisers inappropriately designated commercial arbitration rules, where filing fees were, in their view, so high as to deter clients from bringing claims against advisers. Others stated the "efficiencies" of abbreviated discovery and lack of appeal disadvantaged clients by making it harder to obtain evidence to support a claim, and by precluding appeal of an arbitrator's decision against the client. Others asserted that use of restrictive terms prevented clients from bringing certain claims or seeking certain damages, and stated that similar terms were impermissible in broker arbitration.

Last, most stakeholders agreed that advisory clients would benefit from having the option to litigate their disputes with an adviser in certain circumstances, and that the lack of an appellate process in arbitration was potentially problematic. However, proponents of arbitration believed the finality of arbitration eliminated lengthy processes and expenses associated with appellate litigation.

B. Views on Disclosure of Adviser Arbitration Information

To varying degrees, stakeholders believed that advisers should disclose at least some information about customer arbitrations and unpaid awards. Arbitration proponents generally argued that disclosure of all customer allegations might subject advisers to needless reputational harm. On the other hand, they expressed the view that full and fair disclosure of allegations the adviser deems material would create a competitive advantage for honest advisers and promote fairer markets.

In contrast, critics of mandatory arbitration argued in favor of disclosing all customer arbitration information, irrespective of whether the adviser deemed the information material. Critics also opined that private arbitration insulated advisers from regulatory scrutiny and concealed previous or ongoing arbitrations from potential clients. They also stated there was a disclosure disparity between adviser arbitration information and broker arbitration information, as brokers must disclose the latter. According to these groups, the lack of consistent disclosure requirements for advisers created further barriers to transparency and oversight of advisers and arbitral outcomes.

C. Comparisons with Broker Arbitration

Several stakeholders expressed concern that differences between the broker and adviser arbitration regimes could disadvantage advisory clients or prospective clients.[115] We address some of those differences and corresponding stakeholder concerns below.

1. Use of Restrictive Terms[116]

Stakeholder concerns about the use of restrictive terms in advisory agreement mandatory arbitration clauses, where such terms would be impermissible in brokerage agreements, were supported by the data in Section IV.A, above, as well as a comparison of relevant rules in the FINRA Code of Arbitration Procedure for Customer Disputes. The FINRA Code applies uniformly to disputes between customers and their brokers or associated persons.[117]

As noted above, 6 percent of advisory agreements with mandatory arbitration clauses included class action waivers, 5 percent of agreements limited the types of claims that could be asserted, and 11 percent limited the types of damages that a client may seek in the arbitration. In contrast, the FINRA Code prohibits usage of class action waivers,[118] prohibits language that limits a party's ability to file "any claim" in arbitration,[119] and prohibits language that limits the ability of arbitrators to make "any award."[120]

Of the 60 percent of mandatory arbitration clauses that designated a venue for the arbitration hearing, 97 percent designated a location that disregarded the client's location. Under the FINRA Code, the default location for the arbitration hearing, or venue, is generally the hearing location nearest the customer's residence at the time of the events leading to the dispute.[121]

A percentage of advisory agreements with mandatory arbitration clauses also imposed requirements on the type and/or number of arbitrator – *e.g.,* requiring a panel of three arbitrators, or requiring arbitrators affiliated with the securities industry. In cases with one arbitrator, the FINRA Code requires a public arbitrator, unaffiliated with the securities industry, to preside over the dispute.[122] In cases with three arbitrators, the FINRA Code guarantees parties the ability to select a panel of all public arbitrators.[123]

Similarly, some advisory agreements prohibited the use of written awards. While FINRA DRS awards must be in writing, arbitrators are not required to write opinions or provide explanations or reasons for their decision.[124]

2. Lack of Transparency or Uniform Disclosure Requirements

The lack of publicly available data about adviser arbitration, and the lack of uniform disclosure requirements for SEC-registered advisers have been documented throughout this report. Both have prevented Staff from evaluating the frequency of adviser arbitrations or unpaid awards.

By comparison, arbitration information about brokers is publicly accessible through BrokerCheck.[125] FINRA DRS also regularly publishes and updates aggregated broker dispute resolution statistics on its website.[126] Further, FINRA makes publicly available information about unpaid customer arbitration awards, and publishes a list of member firms and associated persons with unpaid customer arbitration awards.[127]

3. Cost

Stakeholders suggested the costs associated with adviser arbitration through AAA or JAMS, discussed above, might be cost prohibitive for some clients. In contrast, brokers subsidize the use of the FINRA DRS forum through a surcharge assessed against any member named as respondent or that files a claim or counterclaim.[128] Customers and brokers involved in the dispute pay the direct costs associated with the dispute. The table below lists filing fees required in FINRA customer arbitrations:

Table 7. FINRA Customer Arbitration Filing Fees[129]

Amount of Claim (exclusive of interest and expenses)	Filing Fee
$.01 to $1,000	$50
$1,000.01 to $2,500	$75
$2,500.01 to $5,000	$175
$5,000.01 to $10,000	$325
$10,000.01 to $25,000	$425
$25,000.01 to $50,000	$600
$50,000.01 to $100,000	$975
$100,000.01 to $500,000	$1,425
$500,000.01 to $1,000,000	$1,740
$1,000,000.01 to $5,000,000	$2,025
Over $5,000,000	$2,300
Non-Monetary/Not Specified	$1,600

Per Table 7, in FINRA DRS, the maximum amount a customer must pay to file a claim – valued in excess of $5,000,000 – is $2,300.

The FINRA Code also sets the amount of arbitrator payment.[130] In other private dispute resolution fora, arbitrators may set their own rates.[131]

VI. CONCLUSIONS

The number of SEC-registered advisers has increased steadily over the past decade, along with the number of clients they serve, and may continue to increase. It would therefore be reasonable to expect the number of advisory agreements with mandatory arbitration clauses might increase as well. Where an estimated 61 percent of advisers with at least some retail clients already require clients to arbitrate disputes, it is important that regulators and advisory clients understand the potential harms and benefits of mandatory advisory arbitration.

Due to the absence of information pertaining to adviser arbitration, Staff was unable to quantitatively evaluate the "effects" of mandatory arbitration clauses on advisory clients. Such a quantitative evaluation would require further study. However, data obtained from this study support stakeholder views that: (1) certain restrictive terms limiting the claims and/or damages available to advisory clients are sometimes included in advisory agreements; (2) other terms in advisory agreements might increase arbitration expenses for advisory clients; and (3) many of these terms are impermissible in agreements between brokers and their customers, and might also be impermissible in other dispute resolution fora.

Various factors, including the lack of an express, uniform disclosure requirement for advisers, and the lack of arbitrators' jurisdiction over the parties after award, prevented Staff from measuring the frequency of adviser arbitration or unpaid awards. While investment adviser representatives must disclose certain arbitration information, the opaque nature of adviser arbitration and difficulty accessing adviser arbitration information raises questions about the ability of regulators to evaluate adviser conduct in the context of client disputes. An SEC staff report previously noted that, when selecting a financial professional, investors should consider pertinent information, including a financial professional's current and historic arbitrations and civil litigation, "to better avoid fraud and potential investment losses."[132] Nevertheless, investors cannot generally access SEC-registered adviser arbitration information under the current disclosure regime.

For many advisory clients, the use of mandatory arbitration clauses in advisory agreements means that arbitration is the only avenue to obtain remedy for financial harm caused by their advisers. Further evaluation may be warranted to help ensure that arbitration is an accessible and affordable means of dispute resolution for advisory clients.

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[1] *See generally* U.S. House of Representatives, CONSOLIDATED APPROPRIATIONS ACT, H.R. 2617, Pub. Law No: 117-328 (Dec. 29, 2022).

[2] U.S. House of Representatives, House Report 117-393, FINANCIAL SERVICES AND GENERAL GOVERNMENT APPROPRIATIONS BILL, 2023, at 104 (June 28, 2022), ("House Report").

[3] *Id.*

[4] *Id.*

[5] Throughout this report, the term "adviser(s)" refers to SEC-registered investment advisory firms, unless otherwise noted. Investment advisers with $110 million or more in assets under management must register with the SEC, while advisers with under $100 million in assets under management are generally prohibited from registering with the SEC and so must register with one or more states. Advisers with $100 million to $110 million in assets under management generally may register with either the SEC or one or more states. *See, generally,* SEC Staff Report, Regulation of Investment Advisers by the U.S. Securities and Exchange Commission at 8-10 (March 2013), https://www.sec.gov/about/offices/oia/oia_investman/rplaze-042012.pdf. *See also* https://www.finra.org/investors/investing/working-with-investment-professional/investment-advisers.

[6] As discussed in Section IV.A, below, the margin of error for a 95% confidence interval on these estimates varies, but is no greater than +/- 6 percentage points.

[7] As discussed below in Section II.B.1, investment adviser representatives are required to disclose certain arbitration information. *See* Uniform Application for Securities Industry Regulation or Transfer ("Form U4"), Item 14.I. In contrast, SEC-registered advisory firms must disclose "all material facts relating to the advisory relationship." *See* Uniform Application for Investment Adviser Registration, Part 2, Uniform Requirements for the Investment Adviser Brochure and Brochure Supplements ("Form ADV Part 2"), General Instruction 3, https://www.sec.gov/about/forms/formadv-part2.pdf.

[8] *See* AAA, "What Happens after the Arbitrator Issues an Award," at 1 ("Many parties will voluntarily follow the arbitrator's decision; however, the AAA and the arbitrator do not have the authority to actually make a party do what the award says."), https://www.adr.org/sites/default/files/document_repository/AAA229_After_Award_Issued.pdf.

[9] *See, e.g.*, FINRA, The Neutral Corner, Vol. 2-2011 (2011), at 1, https://www.finra.org/sites/default/files/Publication/p123535.pdf ("Discovery in FINRA arbitration is more limited than discovery under the Federal Rules of Civil Procedure or state discovery rules.")

[10] *See* AAA, What Happens after the Arbitrator Issues an Award, at 2, https://www.adr.org/sites/default/files/document_repository/AAA229_After_Award_Issued.pdf, ("There is no right to appeal in arbitration like there is in court").

[11] Unless otherwise noted, throughout this report the term "broker" refers to broker-dealers required to register with the SEC and with FINRA, the self-regulatory organization for brokers overseen by the SEC. For a fuller discussion about FINRA and its role in broker arbitration, *see infra* Section II.B.2.

[12] House Report at 104.

[13] *See, e.g.,* U.S. Senate, S. 1171, Investor Choice Act of 2021, at 2 (Apr. 15, 2021); U.S. House of Representatives, H.R. 2620, Investor Choice Act of 2021, at 2 (Nov. 16, 2021) ("Issuers, brokers, dealers, and investment advisers hold powerful advantages over investors, and mandatory arbitration clauses, including contracts that force investors to submit claims to arbitration or to waive the right of investors to participate in a class action lawsuit, leverage those advantages to severely restrict the ability of defrauded investors to seek redress.").

[14] *See Rodriguez de Quijas v. Shearson/American* Express, 490 U.S. 477 (1989) (holding that the Securities Act of 1933 does not categorically prohibit arbitration of claims arising under the statute); *Shearson/American Express v. McMahon*, 482 U.S. 220 (1987) (holding that neither the Securities and Exchange Act of 1934 nor the Racketeer Influenced and Corrupt Organization Act categorically prohibit arbitration of claims arising under those statutes).

[15] *See* FINRA Rule 12200. *See also* SEC, Investor Bulletin: Broker-Dealer/Customer Arbitration ("SEC Investor Arbitration Bulletin"), (June 14, 2022) ("[M]ost account opening agreements between broker-dealers and their customers contain terms requiring customers to arbitrate any disputes with their broker-dealers."), https://www.sec.gov/oiea/investor-alerts-and-bulletins/broker-dealercustomer-arbitration-investor-bulletin.

[16] *See, e.g.,* FINRA, FINRA Dispute Resolution Services Arbitrator's Guide, at 9 (Apr. 2023) ("In short, arbitration is a quick, fair, and relatively inexpensive alternative to litigation."), https://www.finra.org/sites/default/files/arbitrators-ref-guide.pdf; AAA, Consumer Related Disputes – Supplementary Procedures, at 4 ("Arbitration is usually faster and cheaper than going to court."), https://www.adr.org/sites/default/files/Consumer-Related%20Disputes%20Supplementary%20Procedures%20Sep%2015%2C%202005.pdf.

[17] *See, e.g.,* Congressional Research Service, Legislation to Repeal Mandatory Arbitration (Apr. 5, 2022), https://crsreports.congress.gov/product/pdf/IF/IF12076/2 ("Virtually all securities broker-dealers and reportedly most investor advisors [sic] require their customers to agree that disputes that may arise between them must be resolved through arbitration rather than through lawsuits filed in federal or state courts.").

[18] *See, e.g.,* Letter to Hon. Gary Gensler, Chairman, SEC, Re: Request to Investigate RIA Mandatory Arbitration (May 17, 2022), https://consumerfed.org/wp-content/uploads/2022/05/Groups-urge-SEC-to-Investigate-Registered-Investment-Advisers-Use-of-Forced-Arbitration-Clauses-5.17.22.pdf; Christine Lazaro and Michael S. Edmiston, Public Investors Arbitration Bar Association, "Costly forced arbitration against advisers harms investors," https://www.piaba.org/piaba-newsroom/oped-costly-forced-arbitration-against-rias-harms-investors-christine-lazaro-and (Jan. 14, 2022). *But see* Kevin M. Carroll, Managing Director and Associate General Counsel, Securities Industry and Financial Markets Association, "Securities Arbitration System Works Effectively and Benefits Investors," (Oct. 5, 2021), https://www.sifma.org/resources/news/securities-arbitration-system-works-effectively-and-benefits-investors/ ("Securities arbitration rules, first created in 1972, are based on the belief – true then and still true nearly five decades later – that many customers would prefer to arbitrate and benefit from arbitration.")

[19] In April 2023, there were over 15,300 SEC-registered investment advisers. In April 2013, that number was just over 10,600. *See* SEC, Information about Registered Investment Advisers and Exempt Reporting Advisers, April 2023, https://www.sec.gov/help/foiadocsinvafoia.

[20] *See* Investment Adviser Association and National Regulatory Services, Investment Adviser Industry Snapshot 2022, at 26 (2022), https://investmentadviser.org/wp-content/uploads/2022/06/Snapshot2022.pdf.

[21] Throughout this report, the term "registered representative" generally refers to an individual licensed to buy and sell securities, registered with FINRA and/or the appropriate state securities regulator as a representative of a broker and/or adviser.

[22] *See* FINRA, 2023 FINRA Industry Snapshot, Figure 1.1.6, Registered Individuals by Type of Registration, 2023, https://www.finra.org/sites/default/files/2023-04/2023-industry-snapshot.pdf.

[23] *See* SEC Release No. 34– 86031, File No. S7-07-18, Regulation Best Interest: The Broker-Dealer Standard of Conduct (June 5, 2019); 84 Fed. Reg. 33318, at 33319 (July 12, 2019) ("Regulation BI Release").

[24] *Id*.

[25] SEC Release No. IA–5248, File No. S7–07–18, Commission Interpretation Regarding Standard of Conduct for Investment Advisers, (June 5, 2019); 84 Fed. Reg. 33669 (July 12, 2019). ("Adviser Standard of Conduct Release"). The investment adviser's fiduciary duty is broad and applies to the entire adviser-client relationship. An investment adviser's fiduciary duty under the Advisers Act comprises a duty of care and a duty of loyalty. This fiduciary duty requires an adviser "to adopt the principal's goals, objectives, or ends." This means the adviser must, at all times, serve the best interest of its client and not subordinate its client's interest to its own. The duty of care requires an investment adviser to provide investment advice in the best interest of its client, based on the client's objectives. Under its duty of loyalty, an investment adviser must eliminate or make full and fair disclosure of all conflicts of interest which might incline an investment adviser— consciously or unconsciously—to render advice which is not disinterested such that a client can provide informed consent to the conflict. *See generally id.* at 33670-71.

[26] Regulation BI Release, 84 Fed. Reg. at 33319 -20. The "best interest" standard of conduct is satisfied if the broker or associated person complies with four specific component obligations: (1) providing certain prescribed disclosure before or at the time of the recommendation, about the recommendation and the relationship between the retail customer and the broker; (2) exercising reasonable diligence, care, and skill in making the recommendation; (3) establishing, maintaining, and enforcing policies and procedures reasonably designed to address conflicts of interest; and (4) establishing, maintaining, and enforcing policies and procedures reasonably designed to achieve compliance with Regulation Best Interest. *Id.* at 33320.

[27] For a discussion of broker disclosure obligations, s*ee generally id*. at 33346-48. For a discussion of adviser disclosure obligations, *see* Adviser Standard of Conduct Release, 84 Fed. Reg. at 33675-78.

[28] *See* SEC, Form ADV, https://www.investor.gov/introduction-investing/investing-basics/glossary/form-adv#:~:text=Part%202%20requires%20investment%20advisers,be%20delivered%20to%20advisory%20clients.

[29] *See id.*

[30] For a definition of materiality, *see* SEC Release No. IA–3060, File No. S7–10–00, Amendments to Form ADV, ("Form ADV Release"), 75 Fed. Reg. 49233, 49237, n. 35 (Aug. 12, 2010) ("The standard of materiality under the Advisers Act is whether there is a substantial likelihood that a reasonable investor (here, client) would have considered the information important….This is a facts and circumstances test, requiring an assessment of the 'total mix of information'….Given that materiality depends on the factual situation, which may vary with each situation, we do not believe that it is appropriate to specifically define or provide any bright line tests for what is and is not material."). *See also* Form ADV Part 2, Item 9 (explaining four factors that an adviser should consider in determining whether a disciplinary event is material).

[31] *See* Form ADV Part 2, General Instruction 3.

[32] *See* Form ADV Release, 75 Fed. Reg. at 49240.

[33] *Id.*

[34] *Id.*

[35] Generally, the term "investment adviser representative" means a supervised person of an investment adviser. *See* 17 C.F.R. § 275.203A-3(a)(1).

[36] *See* Uniform Application for Investment Adviser Registration, Part 1B ("Form ADV Part 1B), Item 2E, https://www.nasaa.org/wp-content/uploads/2011/08/Form-ADV-Part-1B.pdf.

[37] *See* Form ADV Part 1B, Item 2F.

[38] *See* FINRA, Form U4, https://www.finra.org/registration-exams-ce/broker-dealers/registration-forms/form-u4.

[39] *See* Form U4, Item 14I.

[40] *See* BrokerCheck by FINRA, https://brokercheck.finra.org/.

[41] *See* Investment Adviser Public Disclosure website, https://adviserinfo.sec.gov/.

[42] *See* Form U4, Item 14I.

[43] *See* 15 U.S.C. § 78s(b) (2006).

[44] The definition of "associated person" is broader than the definition of "registered representative." Under FINRA Rule 1011(b), the term "associated person" includes, among other things, registered representatives as well as owners, partners, officers, directors, branch managers, and certain employees of the broker.

[45] *See generally* FINRA Rule 1000, Member Application and Associated Person Registration, and subsequent rules.

[46] *See* FINRA Rule 1013. *See also generally* https://adviserinfo.sec.gov/.

[47] *See* FINRA Dispute Resolution Statistics, https://www.finra.org/arbitration-mediation/dispute-resolution-statistics.

[48] *See generally* FINRA, FINRA Dispute Resolution Services, https://www.finra.org/arbitration-mediation.

[49] Securities Exchange Act of 1934 § 19(b), 15 U.S.C. § 78(s)(b).

[50] Securities Exchange Act of 1934 § 17(d), 15 U.S.C. §78(q)(b)(1).

[51] *See Shearson/American Express,* 482 U.S. at 233-34 ("In short, the Commission has broad authority to oversee and to regulate the rules adopted by the SROs relating to customer disputes, including the power to mandate the adoption of any rules it deems necessary to ensure that arbitration procedures adequately protect statutory rights.").

[52] FINRA Rule 12000 *et seq.*

[53] FINRA Rule 12200.

[54] *See* FINRA, "FINRA Dispute Resolution: Arbitration, Mediation and the Neutrals Who Serve," (2014) at 1, https://www.finra.org/sites/default/files/14_0289%201_DR%20Promo%20Brochure.pdf.

[55] FINRA Rule 12101(a). *See also, generally*, FINRA Rule 12000, *et seq.*

[56] FINRA Rule 9554.

[57] *See* AAA, "What Happens after the Arbitrator Issues an Award," at 1 ("Many parties will voluntarily follow the arbitrator's decision; however, the AAA and the arbitrator do not have the authority to actually make a party do what the award says."), https://www.adr.org/sites/default/files/document_repository/AAA229_After_Award_Issued.pdf.

[58] *See id.* at 1 ("[T]he AAA and the arbitrator do not have the authority to actually make a party do what the award says…. [T]he court can enforce it like it was any other court judgment. The AAA and the arbitrator are not involved in the case anymore after the final award is sent to the parties. Because of that, we cannot give advice to the parties about how to make sure the award is enforced.").

[59] FINRA DRS, Guidance on Disputes between Investors and Advisers that are Not FINRA Members, https://www.finra.org/arbitration-mediation/guidance-disputes-between-investors-and-investment-advisers-are-not-finra-members.

[60] Regulation BI Release, 84 Fed. Reg. at 33319.

[61] *See supra* n. 20, FINRA 2022 Industry Snapshot, Figure 1.4, Registered Individuals by Type of Registration.

[62] *See* Section II.B.2, *supra,* and Section IV.A, *infra.*

[63] *See* Section V.C, *infra.*

[64] Institutional investors are typically companies or organizations that pool their clients' money and make investments on behalf of their clients. For instance, under FINRA Rule 2111(b), institutional accounts include banks, savings and loan associations, insurance companies, registered investment companies, state and Federal Registered investment advisers, and other persons with total assets of at least $50 million. Similarly, under FINRA Rule 2210(a)(4) institutional investors include, in addition to persons with institutional accounts, government entities and their subdivisions, employee benefit plans, qualified plans as defined in Exchange Act Section 3(a)(12)(C), brokers and registered representatives, and persons acting solely on behalf of such institutional investors.

[65] *See, e.g.,* Adviser Standard of Conduct Release, 84 Fed. Reg. at 33677 ("Full and fair disclosure for an institutional client (including the specificity, level of detail, and explanation of terminology) can differ, in some cases significantly, from full and fair disclosure for a retail client because institutional clients generally have a greater capacity and more resources than retail clients to analyze and understand complex conflicts and their ramifications.").

[66] *See* Uniform Application for Investment Adviser Registration and Report by Exempt Reporting Advisers, Part 1A, ("Form ADV Part 1A"), https://www.sec.gov/about/forms/formadv-part1a.pdf.

[67] Available at https://www.sec.gov/foia/docs/form-adv-archive-data.

[68] Form ADV Part 1A, Item 2A.

[69] Form ADV Part 1A, Item 1B.

[70] Form ADV Part 1A, Item 5D(a), (b).

[71] Specifically, the weighting procedure corrects for the non-representativeness of the sample of advisers for which we reviewed agreements (based on the factors that we included in our weighting procedure). It does not correct for potential within-adviser heterogeneity, such as variation between clients that would arise from, for example, advisers negotiating contract-specific terms with individual clients. For more information on inverse probability weighting, *see also* Jeffery M. Wooldridge, *Inverse Probability Weighted Estimation for General Missing Data Problems*, 141 J. Econometrics 1281-1301 (2007).

[72] We use Wager and Athey's version of random forests, which provides consistent estimates of the inclusion probabilities. Since Wager and Athey's consistency results may not extend to data-driven hyperparameters, we set hyperparameters for the random forest to the values used by Susan Athey and Stefan Wager, *Estimating Treatment Effects with Causal Forests: An Application, Observational Studies* 5, No. 2, 37-51 (2019). For more information on this method, *see* Stefan Wager and Susan Athey, *Estimation and Inference of Heterogeneous Treatment Effects Using Random Forests. Journal of the American Statistical Association* 113, No. 523, 1228-1242 (2018).

[73] Staff interviewed the following external stakeholders for this report: American Association of Individual Investors (AAII); Better Markets, Inc.(BM); Financial Industry Regulatory Authority (FINRA); Financial Services Institute, Inc. (FSI); Investment Adviser Association (IAA); North American Securities Administrators Association (NASAA); Public Investors Advocate Bar Association (PIABA); and Securities Industry and Financial Markets Association (SIFMA).

[74] *See generally* Form ADV Part 2, General Instruction 3.

[75] JAMS and AAA provide quarterly-updated information on consumer arbitrations completed in the last five years in accordance with Section 1281.96 of the California Code of Civil Procedure, Maryland Commercial Law Sections 14-3901 – 3905, and New Jersey Statutes Section 2A:23B-1, *et. seq*.

[76] *See* JAMS Consumer Case Information Spreadsheet, https://www.jamsadr.com/consumercases/.

[77] *See* AAA Consumer and Employment Statistics report, https://www.adr.org/consumer.

[78] To note, advisers that designated forum rules in their mandatory arbitration clauses typically designated the rules applicable to commercial arbitration. *See* Section IV.B.2.

[79] *See* Letter from Richard Berry, Executive Vice President, FINRA Dispute Resolution Services, to Ms. Stacy A. Puente, Ombudsman, U.S. Securities and Exchange Commission, ("FINRA Letter) (May 22, 2023), attached as Appendix A to this Report.

[80] Unlike SEC-registered advisers, as noted above, state-registered advisers must disclose certain arbitration information in Form ADV Part 1B, Item 2.E. *See* https://www.nasaa.org/wp-content/uploads/2011/08/Form-ADV-Part-1B.pdf.

[81] *See* Letter from Vince Martinez, General Counsel, NASAA, to Stacy A. Puente, Ombudsman, U.S. Securities and Exchange Commission ("NASAA Letter") (May 5, 2023), attached as Appendix B to this Report.

[82] *See* NASAA, NASAA 2022 Investment Adviser Section Annual Report, Highlighting 2021 Section Activities, at 2 (April 2022), https://www.nasaa.org/wp-content/uploads/2022/06/2022-IA-Section-Report-FINAL-updated-05192022.pdf.

[83] *See* NASAA Letter.

[84] Data did not support major differences in the prevalence of mandatory arbitration clauses across firms as measured by assets under management or by firm type.

[85] Staying to a conservative, yet practical reading of the Congressional directive, Staff did not estimate the frequency of Items 2-8 in Table 2, or the frequency of items in Tables 3 or 4, unless the items were included in an advisory agreement that contained a mandatory arbitration clause.

[86] As noted above, the margin of error for a 95% confidence interval on these estimates varies, but is no greater than +/- 6 percentage points.

[87] The margin of error for a 95% confidence interval on these estimates varies, but is no greater than +/- 5 percentage points. The other fora constitute about 1% of the sample.

[88] The margin of error for a 95% confidence interval on these estimates varies, but is no greater than +/- 9 percentage points. These are the five most common designated forum rules.

[89] To note, the AAA Securities Arbitration Supplementary Procedures were in effect from July 1, 1999 to April 11, 2017. *See* https://www.adr.org/sites/default/files/Securities%20Arbitration%20Supplementary%20Procedures%20Jul%2001%2C%201999.pdf.

[90] AAA, Consumer Arbitration Rules, Costs of Arbitration, Amended and Effective January 1, 2023, https://www.adr.org/sites/default/files/Consumer_Fee-Schedule.pdf.

[91] As noted in Table 5, AAA also assesses a $1,400 case management fee for one arbitrator, or a $1,775 case management fee for three arbitrators, which must be paid before the arbitrators are appointed. Additional costs include a $500 hearing fee, as well as $2,500 per arbitrator for every day of a hearing.

[92] AAA, Commercial Arbitration Rules and Mediation Procedures, Administrative Fee Schedules, (Amended and Effective May 1, 2018), https://www.adr.org/sites/default/files/Commercial_Arbitration_Fee_Schedule_1.pdf.

[93] *Id.*

[94] AAA estimates that, in commercial arbitrations, attorney fees constitute 84 percent of arbitration costs, arbitrator fees constitute 11 percent of costs, and AAA fees constitute 5 percent of costs. *See* AAA, Commercial Arbitration – Understand and control your arbitration costs, https://www.adr.org/sites/default/files/document_repository/AAA173_Commercial_Arbitration_Infographic.pdf.

[95] AAA, Practice Areas - Commercial, https://www.adr.org/commercial, ("The AAA provides efficient, effective alternative dispute resolution (ADR) case administration for business-to-business (B2B) claims. Our goal is to get

parties back to business. In addition to the AAA's Commercial Arbitration Rules, we offer specialized rules and supplements tailored for specific types of business disputes.").

[96] AAA, Consumer Arbitration Rules, Rule R-1(a) at 9, (Rules Amended and Effective Sept. 1, 2014, Cost of Arbitration Effective Since January 21, 2016), https://www.adr.org/sites/default/files/Consumer-Rules-Web_0.pdf.

[97] AAA Consumer Arbitration Rules, R-1(e) at 11, https://adr.org/sites/default/files/Consumer%20Rules.pdf.

[98] *Id.*

[99] *Id.*

[100] *See* AAA, Commercial Arbitration Rules, Rule R-1(a), https://www.adr.org/sites/default/files/CommercialRules_Web_0.pdf ("Any disputes regarding which AAA rules shall apply shall be decided by the AAA.").

[101] *See* JAMS, Consumer Arbitration Minimum Standards, at n.1 (July 15, 2009), https://www.jamsadr.com/consumer-minimum-standards/.

[102] *Id.*

[103] *Id.*

[104] *Id.*

[105] *See* JAMS, Arbitration Schedule of Fees and Costs, https://www.jamsadr.com/arbitration-fees.

[106] *Id.*

[107] *Id.*

[108] *Id.*

[109] *See* Adviser Standard of Conduct Release, 84 Fed. Reg. at 33672, n.1 ("Such a hedge clause generally is likely to mislead those retail clients into not exercising their legal rights, in violation of the [Adviser's Act] antifraud provisions, even where the agreement otherwise specifies that the client may continue to retain its non-waivable rights.").

[110] *In the Matter of Comprehensive Capital Management, Inc*., SEC Admin. Proc. File No. 3-20700, Rel. No. 5943, Order Instituting Administrative Cease and Desist Proceedings Pursuant to Sections 203(e) and 203(k) of the Investment Advisers Act of 1940, Making Findings and Imposing Remedial Sanctions, and a Cease and Desist Order, at 4 (Jan. 11, 2022) (settled matter), https://www.sec.gov/litigation/admin/2022/ia-5943.pdf.

[111] *Id.* at 5.

[112] *Id.*

[113] Such provisions might violate AAA confidentiality principles regarding disclosure of awards. *See* AAA Statement of Ethical Principles - Confidentiality ("The parties always have a right to disclose details of the proceeding, unless they have a separate confidentiality agreement."), https://www.adr.org/StatementofEthicalPrinciples.

[114] For a list of stakeholders interviewed, *see supra* n.63. To encourage candor, Staff agreed not to attribute specific views to specific stakeholders in this report.

[115] Staff expresses no opinion on the merits or effectiveness of FINRA DRS as a provider of dispute resolution services. Nevertheless, various characteristics of FINRA DRS serve as a useful point of comparison for the adviser arbitration regime, particularly where most registered representatives are dually registered as advisers and brokers, and investors may hold both types of investment accounts. In such circumstances, dual-registrants and/or investors might have to contend with divergent arbitration rules and procedures, and should likely be aware of differences between the two arbitration regimes.

[116] We note that AAA has adopted a Consumer Due Process Protocol to establish protections for consumers in disputes involving, among other things, financial services for personal or household use. *See* AAA, Consumer Due

Process Protocol, Statement of Principles, at 5, https://www.adr.org/sites/default/files/document_repository/Consumer%20Due%20Process%20Protocol%20(1).pdf. Various of these principles would seemingly prohibit certain contractual terms used by advisers. *See, e.g,* Principle 14 ("The arbitrator should be empowered to grant whatever relief would be available in court under law or in equity.") JAMS Consumer Arbitration Minimum Standards would also appear to prohibit certain contractual terms used by advisers. *See* JAMS, Consumer Arbitration Minimum Standards, https://www.jamsadr.com/consumer-minimum-standards/. However, as noted above, it is unclear whether the Consumer Arbitration Minimum Standards would apply to disputes between investors and financial service providers.

[117] FINRA Rule 12101.

[118] FINRA Rule 12204(a).

[119] FINRA Rule 2268(d)(2).

[120] FINRA Rule 2268(d)(4).

[121] FINRA Rule 12213.

[122] FINRA Rule 12402(a). For the definition of a "public arbitrator," *see* FINRA Rule 12100(aa).

[123] FINRA Rule 12403.

[124] *See* FINRA DRS, Decision and Award, https://www.finra.org/arbitration-mediation/decision-award#:~:text=Arbitration%20Award,date%20the%20record%20is%20closed.

[125] *See* BrokerCheck by FINRA, https://brokercheck.finra.org/.

[126] *See* FINRA Dispute Resolution Statistics, https://www.finra.org/arbitration-mediation/dispute-resolution-statistics.

[127] *See* Statistics on Unpaid Customer Awards in FINRA Arbitration, https://www.finra.org/arbitration-mediation/statistics-unpaid-customer-awards-finra-arbitration.

[128] FINRA Rule 12901.

[129] FINRA Rule 12900(a).

[130] FINRA Rule 12214.

[131] *See, e.g.,* JAMS, U.S. Domestic Professional Fees, https://www.jamsadr.com/arbitration-fees ("Hourly rate is set by the individual arbitrator(s)"); American Arbitration Association (AAA), "Costs of Arbitration," at 2, https://www.adr.org/sites/default/files/document_repository/AAA228_Costs_of_Arbitration.pdf ("Depending on the rules and case, this rate may be set in the applicable fee schedule or by the arbitrator. The rate might be per hour, per day, or per hearing.").

[132] *See* SEC Staff Report, Study and Recommendations on Improved Investor Access to Registration Information about Investment Advisers and Broker-Dealers, at 8-9 (Jan. 2011) (stating that, when selecting a financial professional, investors should consider "pertinent information" including the financial professional's current and historic arbitrations and civil litigation "to better avoid fraud and potential investment losses"), https://www.sec.gov/files/919bstudy.pdf.

Appendix A

Richard W. Berry
Executive Vice President and Director
FINRA Dispute Resolution Services

Via Email

May 22, 2023

Stacy A. Puente
Ombudsman
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-8041

Re: FINRA Dispute Resolution Services Investment Adviser Data

Dear Ms. Puente:

This letter responds to your March 23 and May 3, 2023, requests to the Financial Industry Regulatory Authority, Inc. (FINRA) for information regarding the number of arbitrations filed in the FINRA arbitration forum by customers where the claim relates exclusively to investment adviser activity or that name only investment adviser firms or investment adviser representatives as respondents.

Based on a review of our records, during the period January 1, 2017, through March 23, 2023, customers filed approximately 13,000 arbitrations in FINRA's arbitration forum. Out of those approximately 13,000 customer-initiated arbitrations there were 63 customer-initiated arbitrations in which the claims related exclusively to investment adviser activity, or all of the named respondents were investment adviser firms or investment adviser representatives.

FINRA is not aware of any specific regulatory requirements governing the use of predispute arbitration agreements by investment adviser firms. However, many investment adviser firms require customers opening accounts to agree in writing to arbitrate disputes concerning the account, including at private dispute resolution forums (*e.g.,* AAA, JAMS). These private dispute resolution forums might have additional data and statistics regarding customer disputes with investment adviser firms and investment adviser representatives.

*   *   *

Brookfield Place
200 Liberty Street
New York, NY
10281

t 212.858.4307
f 301.527 4828
richard.berry@finra.org

If you have any questions regarding the information provided above, please contact me at (212) 858-4307.

Sincerely,

Richard Berry
Executive Vice President
Dispute Resolution Services

Appendix B

NASAA

NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, INC.
750 First Street, NE, Suite 990
Washington, DC 20002
202-737-0900
www.nasaa.org

May 5, 2023

Submitted by Email

Stacy A. Puente
Ombudsman
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: <u>Arbitration Disclosures for State-Registered Investment Adviser on Form ADV</u>

Dear Ms. Puente:

This letter memorializes NASAA's response to your recent data request. On March 24, 2023, you asked for certain disclosures made on Form ADV, Part 1B, Item 2, Question E. Specifically, you asked if we could "identify the number of state-registered advisers that responded 'Yes' to any of Question E, subparts 1-5 of the Form ADV, within the past five years?"

The requested information is kept on the Investment Adviser Registration Depository, which is maintained by the Financial Industry Regulatory Authority ("FINRA"). NASAA's CRD/IARD Steering Committee asked FINRA to run a report responsive to your request.

On April 15, we relayed to you FINRA's response that "as of April 12, 2023, 96 firms have an arbitration disclosure reported on Form ADV with a date initiated in the last five years," and that "the total number of arbitration disclosures in the last five years for those firms is 159."

Please accept this letter as NASAA's permission to include this information in your report on investment adviser arbitration practices. As we discussed, we would appreciate the opportunity to review the report before publication. Please reach out if you have any questions. Thank you.

Sincerely,

Vince Martinez
General Counsel
North American Securities
Administrators Association

President: Andrew Hartnett (Iowa)
President-Elect: Claire McHenry (Nebraska)
Past-President: Melanie Senter Lubin (Maryland)
Executive Director: Joseph Brady
Secretary: Diane Young-Spitzer (Massachusetts)
Treasurer: Tom Cotter (Alberta)
Directors: Marni Gibson (Kentucky)
Eric Pistilli (Pennsylvania)
Andrea Seidt (Ohio)
Leslie Van Buskirk (Wisconsin)