OPENING STATEMENT OF
DAVID S. RUDER, CHAIRMAN

OPEN MEETING OF THE SEC
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SECURITIES INDUSTRY ARBITRATION

The fairness of the procedures by which disputes between securities customers and their brokers are resolved is of vital concern to the Securities and Exchange Commission. The Commission underscored this concern in September of 1987 when it sent a letter to the Securities Industry Conference on Arbitration and to the securities exchanges and the National Association of Securities Dealers regarding specific ways in which existing arbitration procedures could be improved to make them fairer and more efficient. We are pleased that the industry has made substantial progress in implementing these recommendations.

Nevertheless, the problem of customer choice in the arbitration process remains a serious policy consideration. The Supreme Court, in Shearson/American Express, Inc. v. McMahon, upheld the validity of a customer's agreement, entered into at the time of account opening, to submit all disputes with the broker concerning that account to arbitration.

Since the McMahon decision, it has become increasingly clear that the use of the so-called "predispute arbitration clauses" is widespread. Indeed, predispute clauses are almost universal for options and margin accounts.

The arbitration problem before us today is whether, as a condition of engaging in transactions in the securities markets through a registered broker-dealer, a customer opening an account must agree to submit all disputes with the broker-dealer to arbitration. These predispute arbitration clauses involve extremely important policies of customer choice, efficient dispute resolution, and governance of the securities industry.

On June 1st, the Commission considered recommendations by the Division of Market Regulation (1) that the Commission submit to Congress proposed legislation designed to prevent broker-dealers from forcing customers to sign predispute arbitration clauses and (2) that the Commission urge securities industry self-regulatory organizations to engage in rulemaking designed to meet the serious customer choice problems. Commission members expressed serious concern over the customer choice problem, but decided to seek additional information before acting on the staff recommendations.

Part of our concern stemmed from a report by the staff, based upon information provided by the industry in December 1987, to the effect that firms accounting for 42% of the cash accounts examined by the staff had the current intention, or were considering whether, to employ predispute arbitration clauses in all cash accounts. Following the Commission's June 1st public consideration of the staff's legislative proposal and following the introduction of arbitration legislation by

the House Subcommittee on Telecommunications and Finance, industry statements have been made discounting at least for the present the likelihood that industry members will require predispute arbitration clauses in all cash accounts, but confirming that almost all firms require such clauses in margin accounts and options accounts.

We have also been told that the industry supports the Commission's proposals to increase the effectiveness of arbitration by the self-regulatory agencies and to improve disclosures regarding predispute arbitration clauses. I assume that the industry will give increased indications of its support and that it will also take steps to see that self-regulatory organizations have sufficient resources to cope with increased customer demand for use of the arbitration system.

Because the policy questions regarding all accounts -- options, margin, and cash accounts -- are of such significance, I believe the appropriate current Commission position should be to ask the industry and the self-regulatory organizations to make a careful study regarding current practices with respect to predispute arbitration clauses. It is an appropriate step at this time to look for guidance and information from the self-regulatory organizations. The SROs should develop alternatives to the staff proposal for legislation regarding the use of predispute arbitration clauses, and assess the potential costs and benefits of various approaches to these problems. They should also examine ways to improve disclosures

at the time of account opening. As the staff suggests, the SROs should report their findings to the Commission in October.

I want to make it clear that deferring decision on whether to recommend legislation in this area is not a decision to deemphasize consumer interests in the brokerage industry. Rather, it is a decision based on the understanding that the interests of the customers can best be protected by a continuation of attempts to improve arbitration procedures, to increase disclosure of predispute arbitration clauses, and to avoid elimination of customer choice, particularly in cash accounts. With that understanding in mind, I endorse the recommendation that no legislation be suggested at this time and that the self-regulatory organizations be asked to report to us in mid-October. I hope that the report will include descriptions of remedies as well as descriptions of problems.

Finally, I would like to thank the staff of the Division of Market Regulation for their continuing efforts in this area. The persistent and professional work of Robert Love, Sarah Ackerson, Caite McGuire, Mark Fitterman and Rick Ketchum has lead to improvements in the arbitration process and to the development of the various approaches being considered today. The public, the industry, and the Commission owe them a debt of gratitude for these accomplishments.