From the Director of Legislative Affairs
272-2500

July 8, 1988

Attached for your information is a copy of the letter on arbitration to be sent the SRO's pursuant to a 5-0 vote of the Commission on July 7, 1988.

Nina Gross

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

July xx, 1988

[This letter will be sent to each SRO that administers an arbitration facility.]

Dear :

As you are aware, the Commission has for some time been reviewing the operation of arbitration programs sponsored by self-regulatory organizations ("SRO"). In September 1987, following an extensive review of SRO arbitration rules and procedures, the Commission authorized its staff to write to each of the SROs, as well as to other participants in the Securities Industry Conference on Arbitration ("SICA"), to advise them of the results of that review. In that letter, the staff stated that "the Commission believes that securities industry arbitration generally operates fairly." The letter also proposed a number of changes to arbitration rules and procedures designed to improve the process while at the same time maintaining the speed, efficiency and finality which are the hallmarks of an effective dispute resolution system.

Since September 1987, the Commission, , and the other SROs have worked closely together through SICA to begin to implement changes that are necessary to improve SRO arbitration systems. The Commission continues to believe that the provision of SRO arbitration forums for the resolution of broker-customer disputes is an important service offered to investors by the securities industry. We are committed to promoting the continued use of arbitration by investors through our common efforts in this area.

Since the Supreme Court decisions in Dean Witter Reynolds v. Byrd, 470 U.S. 213 (1985) (upholding the validity of broker-dealers' predispute arbitration clauses as applied to state law claims and rejecting the "intertwining" doctrine), and in Shearson/American Express, Inc. v. McMahon, 107 S. Ct. 2332 (1987), (upholding the validity of predispute arbitration clauses as applied to disputes involving provisions of the Securities Exchange Act of 1934), broker-dealer firms increasingly are requiring predispute clauses as a condition for opening any type of account. At my request, the Division of Market Regulation undertook an examination by written questionnaire of 65 broker-dealer firms that account for approximately 90% of all customer trading accounts in the United States. As noted in the attached summary of those examinations, 96% of the margin accounts, 95% of the options accounts and 39% of the cash accounts at the firms examined currently are subject to predispute arbitration clauses.

In the Commission's view, for the brokerage industry generally to condition access to its services on the execution of a mandatory arbitration clause, as appears to be the case at least for margin and option accounts, raises serious policy issues. Among the firms our staff examined, opportunities for public customers to negotiate the exclusion of arbitration clauses from their account opening agreements appeared to be limited and often not meaningful. Further, based on the staff's examination, it appears that many customers are not provided with clear and informative disclosure of the meaning of these clauses, which are signed upon account opening. Each of these matters concerning public customer agreements to arbitrate future disputes raises serious issues that need to be addressed by the .

Accordingly, I request on behalf of the Commission that the review the issues raised by the current use of mandatory predispute arbitration agreements by your member firms. In light of the importance of our common efforts, I ask that the study these issues and report back to the Commission by October 15, 1990 on your conclusions. Please feel free to contact me, or Richard Ketchum, to discuss this matter.

Sincerely yours,

David S. Ruder
Chairman