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Chairman Baker, Ranking Member Kanjorski and members of the subcommittee, thank you very much for the opportunity to share my experiences with you. I am an attorney representing investors who are victims of broker misconduct. My extensive first-hand experience inspired me to write a book entitled, "*Does Your Broker Owe You Money?*" to educate investors about the industry's mandatory arbitration system and to help them avoid becoming victims of broker misconduct. I am also in the process of completing a detailed statistical analysis of all awards issued by NASD and NYSE arbitration panels for the past ten years.

Mandatory arbitration in the securities industry is a system that takes away two fundamental rights of American citizens: access to the courtroom and trial by a jury of their peers. This is a system that has neither the appearance nor the reality of impartiality, since it requires that a victim of misconduct must submit his or her claim to a tribunal administered by the very industry that he or she is suing. Worse, the arbitration rules insist on a stacked jury: one of the three arbitrators deciding the case must be from within the industry, and the other two "public" arbitrators often have some past association with it.

The panel of potential arbitrators, which is carefully screened by the NASD and the NYSE, is a demographic that is hardly representative of the hapless investors who

appear before them. A 1994 study conducted by the U.S. General Accounting Office found that 97 percent of the arbitrators were white, 0.9 were black and 0.6 were Asian. The same study found that 89% were white men over the age of 60.

This lack of racial, gender, age and ethnic diversity stands in stark contrast to our jury system. Our laws require that juries be drawn from all demographics, representing a cross section of the communities in which they serve. The fact that the industry-administered tribunals are so homogeneous in their make-up leads to both the perception and the reality of a pro-industry bias.

The 1992 and 2000 Reports by the General Accounting Office on the fairness of the mandatory arbitration system shed little light on this issue and were very misleading. While the methodology in the Reports was accurate, the findings were fatally incomplete. The GAO Reports did not:

- Differentiate between cases where the arbitrators award only a small fraction of an investor's losses and those in which the investor is fully compensated for his or her losses. Instead, the GAO Reports treated both results as a "win";
- Analyze the records of arbitrators appointed by the SRO's to sit on panels, as contrasted with those selected by the respective parties. There is anecdotal evidence that appointed arbitrators are rewarded for their pro-industry awards by receiving more appointments to sit as panelists on additional cases;
- Analyze the record of any particular arbitrator; and
- Analyze or compute the likelihood of a Claimant prevailing on any particular type of claim or the likelihood of any particular arbitrator issuing an award in favor of a Claimant, in whole or in part.

My experience, the experience of many of my colleagues who represent investors before these tribunals, and the limited statistical analysis I have completed to date, all support my view that investors have an exceedingly small statistical possibility of

receiving any meaningful award from these tribunals, regardless of the merit of their claims.

The case of Mary Jane Schwartz provides a perfect example. Ms. Schwartz is a 62 year-old, divorced, retired nurse, living in Massachusetts. She had nearly her entire life savings – approximately $1.3 million dollars – invested with her broker. Orally and in writing, Ms. Schwartz advised her broker that she wanted her investments to achieve capital preservation and income because she needed to live on that money for the rest of her life. She clearly stated that she did not want a risky portfolio. Ignoring Ms. Schwartz's objectives and without disclosing the risks, the broker inappropriately invested as much as 98% of Ms. Schwartz's portfolio in aggressive equity investments, including volatile technology stocks. The portfolio had no diversification. As a result of the broker's completely unsuitable investment decisions, Ms. Schwartz lost more than $915,000.

I represented Ms. Schwartz who pursued her claim for damages against the brokerage firm through mandatory arbitration, as she was required to do (NASD Dispute Resolution Arbitration Number 03-07760). After a week of hearings, the NASD panel technically found in favor of Ms. Schwartz, while in reality handing her a devastating loss. The NASD panel awarded Ms. Schwartz only $4,994.77 and then assessed $5,625.00 in NASD forum fees against her. While the NASD and the GAO Reports would count the Schwartz case as a "win" for her, Ms. Schwartz did not even recover the pathetically small amount of her award, because she ended up owing the NASD more money than she actually was awarded.

From the very beginning of her case, Ms. Schwartz never had a chance of getting justice at the NASD. The pool of potential arbitrators for her case, which had been screened and provided by the NASD, had an abysmal record of awards to aggrieved investors.

The 15 arbitrators in her pool had presided over 27 cases in which investors requested damages greater than $100,000. Claimants "won" only 8 of those 27 cases. More telling is the fact that in those cases "won" by Claimants, the potential arbitrators in the Schwartz case awarded only 16.8% of the damages claimed by the prevailing Claimants. When you factor in the 19 cases that Claimants lost with the arbitrators in Ms. Schwartz's NASD pool, Ms. Schwartz had a statistical probability of recovering only ***7.1%*** of her damages.

Under the current securities industry mandatory arbitration system, the "deck is stacked" against investors. This appalling situation yields only one rational conclusion: The only appropriate course of action is to eliminate the role of the securities industry entirely from adjudicating disputes involving the misconduct of its members.

This could be easily accomplished by requiring that a completely impartial organization (like the American Arbitration Association or any number of private dispute organizations) administer securities arbitration cases and by requiring that these impartial organizations appoint a panel of arbitrators that is neutral, unbiased and totally unaffiliated with either party to the dispute. In addition, investors should be given the option of bringing their claims in court, before juries, as is their constitutional right.

The securities industry, whose blatant misconduct has caused trillions of dollars of losses to investors from all walks of life, is hardly worthy of the free pass that the cozy

mandatory arbitration system, administered by its brethren at the NASD and the NYSE, presently gives it. I entitled the chapter in my book on this subject: *Mandatory Arbitration—A National Disgrace*. I stand by that description of this shameful process.

I urge this Committee to give investors the right to a fair and impartial hearing by reforming this system without delay.