# Chapter 12
# Become a FINRA Arbitrator

Excerpted from *How Wall Street Rips You Off and What You Can Do to Defend Yourself*
by Dale Ledbetter and Connie Becker

There has been an ongoing chorus of complaints about the lack of impartiality on the part of FINRA arbitrators. No matter how horrific the abuse, or how compelling a claim may be, investors have little chance of fully recovering lost funds if forced before a biased panel which favors industry arguments and positions.

It is as critical to have impartial arbitrators hear a case as it is to have impartial jurors sitting in judgment of their peers in a courtroom. Wall Street firms expend a lot of time, energy and money recruiting arbitrators favorable to their positions. One of the authors was told by the partner of a major law firm which represents several Wall Street firms that he was pressured to recruit arbitrators. He indicated that he was told by one of his clients to "find time to recruit a few favorably inclined arbitrators," or the firm could easily find another lawyer.

Investors need to fight back. They need to aggressively seek (and become) truly impartial arbitrators who can hear arbitration claims with an open mind. The process of becoming an arbitrator is not easy. In order to sit as a juror, you don't have to meet any qualifications other than to demonstrate impartiality. FINRA insists that their arbitrators be first screened, and then, if found to be "qualified," they must then be "trained."

There are no such "qualifying" or "training" requirements for jury members. FINRA justifies this process because the industry, and the products sold by the member firms, are complex and require specific training to be able to understand the case presentations. The contradictory nature of this thinking is underscored by the fact that, in the vast majority of cases, brokerage firms defend the case by claiming that the wronged consumer was a "sophisticated investor" and fully understood the risks of the complex product being sold to them.

It is frustrating to sit in a hearing and have a broker with many years of experience in the industry be exposed as having little or no knowledge of a particular product he had been selling. However, in the same hearing, the brokerage firm will brand a full time surgeon with the label of "sophisticated investor" because he has "been investing in stocks for 20 years." As one doctor client put it, "After sitting through this hearing, I assume what they want me to do is stop seeing patients and spend all of my time overseeing my investments. I thought that's what I hired them to do!" The idea that a full-time brain surgeon can be a part-time financial expert is almost as absurd as having the full-time broker be a medical expert in his spare time. Yet, this argument is made successfully, time after time, before the FINRA "screened," "qualified" and "trained" arbitrators.

The rest of this chapter is devoted to how you, the reader, can become an arbitrator and help balance the scales of financial justice. We urge you to take the step, if it is possible in your personal life, to actively recruit scores of others willing to offer themselves for public service to protect investors, pensioners and retirees. FINRA arbitrators have the power to make Wall Street accountable.

Given the make-up of most current FINRA panels, the brokerage firms, based on a long history, go into a hearing knowing that, even if a finding is rendered in favor of the Claimant, a small percentage of the losses will be awarded. The most helpful thing an investor can do to help not only themselves, but all investors, is to become a FINRA Arbitrator. FINRA Dispute Resolution has a serious deficit of non-biased arbitrators. There is no organized effort on the part of any investor group to recruit arbitrators.

The authors of this book were inspired to continue the process of recruiting arbitrators by a recent story. One of the authors was approached by an individual who had recently been recruited to become an arbitrator. Her comments were both revealing and shocking, but sadly, not at all surprising.

She first expressed her thanks for help in becoming an arbitrator. She then said:

> **"I just finished my FINRA training and am officially an arbitrator. I see, now, why you work so hard to recruit arbitrators and try to level the playing field. In the group of new recruits I was part of, I frankly cannot imagine a single one of them ever being sympathetic toward the plight of an investor. They all commented that the investors had a duty to monitor their accounts closely and to order the broker to stop any activity which was detrimental to their financial interest. I tried to explain to them that their position was not a standard that would be applied in any other field. I also mentioned that most investors wouldn't know they were being abused until well after the fact. However, I didn't seem to make any progress in denting their solidly entrenched feelings."**

In truth, this kind of thinking would not be normal or acceptable in any other field or profession. Patients would not be held liable for failing to prevent a surgical mistake. Clients would not be held responsible for failing to remind an attorney to avoid having the statute of limitations expire prior to the filing of a cause of action.

Imagine a lawsuit against a plumber in which the defense is that the pipes belong to the homeowner and it is, therefore, the homeowner's responsibility to protect themselves from any mistakes the plumber might make. The same homeowner would not be held liable for failing to tell the roofer how to prevent future leaks. Absurd examples you say? Indeed, the examples are absurd because no one would ever suggest that such responsibilities would fall to users, customers or clients. Yet, in the field of arbitration, given the kinds of arbitrators so aggressively recruited by the securities industry, this kind of thinking sadly represents the norm, not the exception.

Some background on the FINRA arbitration process is necessary in order to paint an accurate picture of exactly why it is so important to have more (a lot more) public arbitrators.

## Background

As previously mentioned, all disputes between investors and their securities firms, or broker dealers, are required to be tried before a FINRA arbitration panel. Every investor, when opening an account, waives their right to have any potential dispute heard in court and submits themselves to the FINRA Dispute Resolution arbitration forum.

As pointed out earlier, FINRA is a securities industry trade organization that is largely funded by its members, who are all registered securities dealers.

For investor cases where the amount in controversy exceeds $100,000, FINRA assembles a panel of three arbitrators. There are some distinctions in the types of FINRA arbitrators who hear investor dispute cases. First, there are public arbitrators. These individuals are not required to have prior knowledge of the securities industry, but have been pre-approved by FINRA and have gone through the training required by FINRA. Second, there are Chair-qualified arbitrators. These arbitrators must be public arbitrators who have demonstrated enough experience to serve as the Chairperson of a Panel during the arbitration process. Many of the Chair-qualified arbitrators are attorneys, but not all.

The third category is that of the non-public arbitrator (often referred to as an "industry" arbitrator). Non-public arbitrators, by definition, have an extensive securities industry background. They work or have worked directly for a FINRA member.

Interestingly, registered financial advisors (RIAs) are not allowed to be FINRA arbitrators. This is the height of hypocrisy. An RIA is defined by The Investment Advisors Act of 1940 as a "person or firm that, for compensation, is engaged in the act of providing advice, making recommendations, issuing reports or furnishing analyses on securities, either directly or through publications." Investment advisors have a fiduciary duty to their clients, which means that they have a fundamental obligation to provide suitable investment advice and always act in the clients' best interests.

RIAs are also called "money managers" or "financial planners." RIAs are not FINRA members, although FINRA is now seeking authority to regulate RIAs. RIAs have different licensing requirements, different standards of duty, and do not work for FINRA members. They are regulated by the states and by the SEC, but not FINRA (at least not yet). They do provide financial advice to investors and obviously have knowledge of the industry, so logic would dictate that they would be ideal candidates for the non-public arbitrator positions. However, this is not the case. Why not?

RIAs and registered representatives are often at odds with one another. Time and again it is the RIA who first notices the wrongdoing of a broker when the customer switches

from a registered broker dealer to an RIA. RIAs are held to a higher standard of fiduciary duty (by federal regulators) than registered brokers, but they are not securities salespeople.

RIAs are often paid hourly or on a fee basis, but they are generally not paid on commission, as is usually the case with a registered FINRA member. If FINRA sincerely wants arbitrators who understand the industry and the products sold by broker dealers, then RIAs would seem to be much in demand. For whatever reasons, however, despite their clear-cut appropriate credentials, RIAs are not allowed to serve as even non-public arbitrators for FINRA arbitrations. As an investor, this practice by FINRA should be a red flag as to what investors face when they attempt to go against the Wall Street firms in their own forum.

For years, until protest from investor groups were successful in abolishing the practice, FINRA panels, in cases brought by investors, required the inclusion of two public arbitrators and one industry arbitrator. The parties can still agree to have an industry arbitrator but it is no longer a requirement. The inclusion of an industry arbitrator is now determined by the investor. The practice of the mandatory inclusion of an industry arbitrator on every panel was very controversial due to the obvious bias, or at least the appearance of bias, of the non-public arbitrator. The professed purpose of an industry arbitrator was to provide the arbitration panel with expert knowledge of the industry. In practice, however, to provide a comparison, it was like being forced to have a medical malpractice case heard by the American Medical Association rather than by a jury, and at least one of three panelists deciding the case being a doctor.

Investors can now use the new panel selection method which is known as the Optional All Public Panel rule, or the previous panel selection method which is the Majority Public Panel rule. Customers (investors) choose the panel selection method; the brokerage firms do not have a vote on the method selected. The All Public Panel option includes all customer cases (whether the customer is a claimant or a respondent). FINRA is to be applauded for making this change, although it clearly came about as a result of public pressure, not because FINRA, without pressure, initiated the change. The largest and most effective pressure was put forth by the Public Investors Arbitration Bar Association (PIABA), an organization of securities arbitration attorneys, which lobbied for years to eliminate the industry arbitrator.

The option for the all public arbitration panel is great news for investors, but the new rule has also created increased demand for public arbitrators. Due to the demand for public arbitrators, it is even more important for individuals to come forward and become an arbitrator. As of May 16, 2012, there were 3,572 public arbitrators and 2,878 non-public arbitrators.

The available arbitrator pool, which was already in need of additional public arbitrators, is now in serious need of additional candidates due to the elimination of the non-public arbitrators from the pools for Optional All Public panels. Every investor who becomes an arbitrator takes a giant step toward more transparency in the securities industry and more accountability for the brokerage firms.

The general lack of public arbitrators is not the only problem. Within the available "public" arbitrator pools sit many seasoned, veteran arbitrators who are still not truly impartial. Many of the arbitrators who serve on cases thoroughly enjoy being an arbitrator and, as such, do what they believe is necessary to serve as often as possible on as many cases as possible. Many arbitrators are retirees who rely on the extra income. Arbitrators are paid substantially more than jurors, earning $200 to $400 a day (or more) for their service.

The parties to FINRA arbitration select the arbitrators from a "random" list of qualified arbitrators provided by FINRA. The parties are supplied with a disclosure report (information sheet) for each potential panelist. This report lists the arbitrator's education, employment history, conflicts of interest, and access to the outcome of every case in arbitration they have previously decided. Each party has the opportunity to rank the potential panelists from each category (Chair, Public and Non-Public) in order of preference. The parties may also disqualify or strike up to four arbitrators on each list. The investor party may now strike every non-public or industry arbitrator, but they are offered the opportunity to rank any of them if they choose to do so.

The problem for investors is that the brokerage firms are always the repeat customers in arbitration. Investors are rarely (and thankfully) involved in more than one FINRA arbitration in a lifetime. This places investors, again, at a huge disadvantage. Since the brokerage firms find themselves involved in multiple arbitrations at any given time, they are routinely selecting arbitrators. The brokerage firms will select the arbitrators who demonstrate records that are favorable to the industry, thus, increasing their odds of victory at every arbitration hearing. This practice also influences the pre-hearing settlements, since they are always negotiated on the basis of the likely outcome at arbitration.

If the pool of arbitrators can be balanced out with more impartial arbitrators, investor disputes are likely to achieve a much more favorable percentage of awards for investors. For investors to win less than half of the cases taken to a hearing is shocking. It would suggest that investors and their legal representatives are bringing many claims that lack merit. Given the pressure placed on claimants, and that their attorneys almost always work on a contingency basis, it defies common sense to suggest that false claims would be regularly brought before FINRA panels.

## Requirements for Becoming an Arbitrator

The requirements for becoming an arbitrator are challenging, but not overwhelming. FINRA requires five years of full-time, paid business or professional experience (inside or outside of the securities industry), and at least two years of college-level credits. This education requirement would eliminate many self-made and or self-educated individuals who would NOT be stricken from the jury pool for the courts. The FINRA arbitration program seeks arbitrators from varied backgrounds. FINRA arbitrators are not FINRA employees, but serve as independent contractors who serve at FINRA's discretion. We have actively recruited arbitrators from many walks of life.

The authors encourage those who are interested in becoming a FINRA arbitrator to take the first step by completing the application which can be found by going to the FINRA website at www.finra.org.

Do not let the length of the application be intimidating. Although the application may appear daunting, it is actually seeking only the following information:

- Biographical information (name, address, date of birth, etc.)
- Educational background
- Employment information, and
- Professional affiliations, if any.

The rest of the application is simply requesting disclosure information for determining conflicts of interest. For example, if an arbitrator has had a brokerage account at Morgan Stanley for 10 years, that arbitrator could be asked to recuse himself (remove himself from the Panel), or FINRA could remove the arbitrator upon a request from either party. That arbitrator would not be disqualified for a case against any firm where there are no ties, however. For someone who has employment experience with the securities industry, the questions will be familiar. For anyone who does not have considerable experience with the securities industry, most of the questions will not be applicable.

The application requires two letters of recommendation. These need not be lengthy. A sample letter, which was part of a successful application, is set out below:

> FINRA Dispute Resolution
> Department of Neutral Management
> One Liberty Plaza
> 165 Broadway, 27th Floor
> New York, NY 10006
>
> Re: Arbitrator application of Robert E. Jones
>
> To Whom It May Concern:
>
> I am writing this letter in support of Mr. Robert E. Jones' application to serve as an arbitrator. I have known Mr. Jones for approximately 4 years through our mutual involvement in securities litigation. As a FINRA arbitrator and as one who has worked with attorneys who represent parties in numerous arbitration proceedings, I can say that Mr. Jones is well qualified to serve as an arbitrator, both as a matter of intellect and as a matter of temperament.
>
> I know Mr. Jones to be fair, open minded, patient, and courteous. I have no doubt that he will be willing to consider all points of view and to give all decisions the time and deliberation that they deserve. In short, he has the

character and fitness to serve as an arbitrator.

Sincerely,

Connie J. Becker
Paralegal
FINRA Arbitrator
#A55762

This sample letter can be used as a guide for anyone who would like to apply to be an arbitrator.

## Required Basic Arbitrator Training

It is not necessary to have specific knowledge about the arbitration process, or the securities industry, prior to submitting an application to become an arbitrator. All required arbitrator training is provided by FINRA, free of charge, and is conveniently available online. FINRA has suspended all fees for arbitrator training indefinitely. Beware that FINRA may reinstate the fees at a later date.

Once FINRA approves the arbitrator candidate's application, the individual must complete the Basic Arbitrator Training Program to become eligible to serve on arbitration cases. The Basic Arbitrator Training Program covers the arbitration process and reviews the procedures that arbitrators must follow to successfully complete an arbitration case. Most candidates find this training to be interesting and beneficial as well as educational.

## What Do Arbitrators Do?

Arbitrators hear all sides of the issues as presented by the parties, study the evidence, and then decide how to resolve the matter.

Arbitrators, as the sole decision makers on securities cases, wield significant power. Arbitrator decisions are final and binding within the FINRA Dispute Resolution process. The only way to overturn an arbitrator decision is to appeal to an appellate court. The appeal process offers only limited options and most awards appealed are upheld by the courts.

## Where do the Arbitrations Take Place?

Arbitrations normally take place in the city where the investor (Claimant) lived at the time the dispute arose. FINRA has offices throughout the United States. If the investor does not live within a reasonable distance to a FINRA office, the hearings often take place in a local hotel conference room. Likewise, in most cases, the arbitrators are selected from the geographic area nearest to where the Claimant resides, which is normally where the hearing will take place.

All pre-hearing conferences take place over the telephone and are coordinated by FINRA. There is no need to travel prior to the final arbitration. In addition, the parties and

each arbitrator are all involved in setting the hearing date. The dates for the hearing will be set for a time when the parties, every attorney, and every arbitrator is available. The arbitrations are usually planned at least six months in advance, so that fitting an arbitration hearing into one's schedule is convenient for everyone involved. Arbitrators can volunteer to make themselves available to travel to other cities based on FINRA's demand for arbitrators in certain areas. When arbitrators do travel, FINRA reimburses the costs of travel to the arbitrators.

## Benefits of Being a FINRA Arbitrator

In addition to helping improve the arbitration process for all investors, there are other benefits to being a FINRA arbitrator. Arbitrators enjoy the benefits of added knowledge about the industry, which makes them more informed and successful investors. Arbitrators can take satisfaction in knowing they are adding a valuable service to an industry that is need of more fair-minded decision makers. While no one is getting rich as an arbitrator, the fees can provide supplemental income, especially for retirees.

Stressing the importance of becoming a FINRA arbitrator is a high priority to the authors. If any questions arise when reviewing the application to become an arbitrator, feel free to direct an e-mail to the authors for assistance.

www.dlsecuritieslaw.com
dledbetter@dlsecuritieslaw.com

The authors have been successfully recruiting arbitrators for many years and are aware that the process is not simple. They are willing to review applications and answer questions for anyone willing to take on the task of becoming a FINRA arbitrator.

Potential candidates can also seek help from PIABA at www.piaba.org or contact FINRA directly through www.finra.org.

As readers consider their own role in FINRA arbitration, it is hoped that the following excerpt from a commencement address, by author Michael Lewis,[1] to the 2012 Princeton University graduates will provide inspiration to anyone who is concerned about making a difference:

**"Don't Eat Fortune's Cookie"**

> **"I called up my father. I told him I was going to quit this job that now promised me millions of dollars to write a book for an advance of 40 grand. There was a long pause on the other end of the line. "You might just want to think about that," he said.**
>
> **"Why?"**

[1] Michael Lewis is the best-selling author of *Liar's Poker, Moneyball, The Blind Side, and Home Game.*

**"Stay at Salomon Brothers 10 years, make your fortune, and then write your books," he said.**

**I didn't need to think about it. I knew what intellectual passion felt like — because I'd felt it here, at Princeton — and I wanted to feel it again. I was 26 years old. Had I waited until I was 36, I would never have done it. I would have forgotten the feeling."**

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The authors urge you to make a great public service to abused investors by becoming a FINRA arbitrator and recruiting other eligible friends and family members to join you.

So now you know what you are up against. You have learned that the primary goal of many brokers and all full-service brokerage firms is to get as much of your hard-earned money as possible. Against this harrowing background, we offer 41 suggestions on how to defend yourself, and your money, against the highly organized and well financed efforts of the brokerage firms claiming to be there to help you.

If you use the suggestions on this list it will be difficult for the brokerage industry predators to victimize you. A wise sage once shared with me a lesson that should guide your financial decision making:

Discipline by others is tyranny.
The only true freedom is self-discipline.

Use this list to guard your precious assets. Have the discipline necessary to protect yourself.

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**HORROR STORY**

A retired teacher was sold a VRA by a representative of a Wall Street broker. As time went by, she suspected that the VRA was the wrong investment for her. It was so wrong, in fact, that after losing over $200,000 in two years she complained to the Wall Street broker. An internal investigation was supposedly undertaken and she was advised that the market went down and "things happen." According to the internal investigation, the firm itself and the representatives who sold the products had done nothing wrong.

After complaining to the SEC, NASD and the State Department of Securities with no success, she hired an attorney to bring an arbitration claim against the brokerage house involved in the sale of the VRAs. The securities arbitration process was initiated and three supposedly neutral, unbiased and non-conflicted arbitrators were chosen to hear the case.

Suddenly, within a few weeks before the securities arbitration hearing on this dispute was scheduled to take place, the parties were advised that one of the "chosen" arbitrators on the panel was being replaced by what is referred to as a "cram down" arbitrator. A short two page

disclosure about the cram down arbitrator was sent to the parties. The disclosure contained little, or no, information which would address the cram down arbitrator's bias, ethics or conflicts with the case. At that point, settlement negotiations broke down with no explanation from the brokerage firm.

The arbitration started and was scheduled to last five days. The first day of arbitration was routine with one minor exception. The cram down arbitrator, who was also a member of the securities industry, and was, at the time, employed by a major brokerage house, asked some questions of the Claimant's first witness which reflected a thorough knowledge about the sale of VRAs.

In preparing for the second day of hearing, early that morning, co-counsel for the Claimant briefly discussed the questions asked the previous afternoon by the cram down industry arbitrator. A thorough investigation was initiated on the industry arbitrator. The investigation revealed something far more sinister than the innocuous disclosure provided by FINRA. The cram down industry arbitrator had actually been sued in a case with "eerily similar" facts and circumstances. In addition, the arbitrator had recently been fired by his brokerage house employer for conduct which was non-compliance related. The broker's CRD had not been properly updated and none of this information was provided to the Claimant's attorney prior to the arbitration. If these facts had been known to the Claimant when the cram down appeared on the scene, there would have been a successful "challenge for cause." The cram down arbitrator appeared biased, not neutral, and potentially conflicted in relation to the facts of the case.

Due to FINRA's failure to disclose pertinent and important information to the parties, the victim's case was being heard by an arbitrator who had been sued for the same facts and products for which the Claimant was suing the Respondents. Unless the cram down arbitrator could equal the ethics of an ancient philosopher, capable of setting aside personal bias in favor of another party, the former teacher was in trouble with this cram down hearing her case.

Here is a dirty little secret about securities arbitration. FINRA's failure to provide complete or meaningful information about proposed or cram down arbitrators to public customers is, at worst deceitful, and, at least negligent. Whether deceitful or negligent, the harm done to the investor is the same. Remember, the Claimant had no choice. She was required, by virtue of the account opening documents she signed, to pursue her claims before a FINRA arbitration panel. She cannot pursue a remedy in court and is dependent on the FINRA process to assume that a case is being heard by neutral and unbiased arbitrators.

In FINRA arbitrations, full disclosures about arbitrators, are often not provided. The problem becomes worse with "cram down" arbitrators who are "not chosen" by the parties as all other arbitrators, but are simply appointed.

The belated challenge, to the "cram down" arbitrator, resulted in the brokerage house agreeing to a settlement of the case for a substantial sum of money. This story has a happy ending but far too many similar stories do not.