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GAO

Report to Congressional Requesters

August 2003

EMPLOYMENT DISPUTES

Recommendations to Better Ensure That Securities Arbitrators Are Qualified

GAO-03-790

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Recommendations to Better Ensure That Securities Arbitrators Are Qualified

GAO Accountability • Integrity • Reliability

Highlights

Highlights of GAO-03-790, a report to congressional requesters

Why GAO Did This Study

Employees in the securities industry must submit to binding arbitration in most employment disputes. The Securities and Exchange Commission (SEC) is responsible for overseeing these arbitration programs—the largest being run by NASD and the New York Stock Exchange (NYSE). The Congress asked GAO to examine (1) the circumstances under which NASD and NYSE will arbitrate employment and employment discrimination disputes, and their procedures for selecting and evaluating their arbitrators; (2) the characteristics and outcomes of arbitrated employment and employment discrimination disputes at NASD and NYSE over the last 10 years; and (3) how SEC oversees the arbitration programs at NASD and NYSE and the results of these oversight activities.

What GAO Recommends

To help ensure that only qualified arbitrators hear employment and employment discrimination cases at NASD and NYSE, GAO recommends that SEC direct NASD and NYSE to verify the background information provided by all arbitrator applicants. In addition, GAO recommends that SEC, during its next inspections, continue to review the adequacy of NASD's and NYSE's procedures for evaluating arbitrator performance. SEC, NASD and NYSE all expressed support for the second recommendation, but SEC and NYSE raised concerns about requiring verification at NYSE.

www.gao.gov/cgi-bin/getrpt?GAO-03-790.

To view the full report, including the scope and methodology, click on the link above. For more information, contact Robert Robertson at (202) 512-9889 or robertsonr@gao.gov.

What GAO Found

Arbitration is generally required for most employment disputes, except those dealing with discrimination claims. NYSE will only arbitrate discrimination cases when parties involved agree to arbitrate after the dispute occurs. NASD will arbitrate employment discrimination cases based on agreements entered into between employees and firms before or after a dispute occurs. NASD has instituted additional requirements, however, for these cases, such as requiring that arbitrators not be affiliated with the securities industry. In addition, those chairing hearings for employment discrimination cases must hold a law degree, have 10 years of legal experience, have substantial familiarity with employment laws, and must not have primarily represented employers or employees in the last 5 years.

To qualify to hear cases, NASD and NYSE require that arbitrators have at least 5 years of work experience, supply two letters of recommendation, and complete training in basic arbitration procedures. Arbitrators must also provide information on their complete employment history, including any affiliation with the securities industry, as well as information on whether they have any regulatory or criminal history. Neither organization independently verifies the qualifications for applicants not associated with the securities industry. In addition NASD and NYSE have standard procedures for ensuring that arbitrators selected to hear cases do not have conflicts and for evaluating arbitrator performance. However, evaluations of arbitrators by staff, parties in disputes and other arbitrators on cases are not always completed. Officials at NASD and NYSE noted that if they receive no information about an arbitrator's performance on a case, they assume that the arbitrator's performance was adequate.

Over the last 10 years, 261 (17 percent) of the 1,546 employment disputes arbitrated at NASD or NYSE included a discrimination claim. Discrimination cases differed from cases with disputes that did not involve discrimination in the following ways:

- Discrimination cases required more hearing sessions.
- Employees won discrimination cases less often than cases not involving discrimination claims.
- In cases that employees won, the monetary award in discrimination cases was generally larger than in cases not involving discrimination.

SEC periodically inspects NASD and NYSE arbitration programs. On the basis of its inspections, SEC has recommended improvements. In its most recent inspections of NASD and NYSE, SEC made various recommendations concerning procedures for ensuring that arbitrators are qualified. In addition, SEC recommended that one or both improve procedures for recording information on arbitrator performance in a central database and for disqualifying arbitrators who are poor performers.

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Abbreviations

CRD	Central Registration Depository
EEOC	Equal Employment Opportunity Commission
NYSE	New York Stock Exchange
SAC	Securities Arbitration Commentator
SEC	Securities and Exchange Commission
SRO	self-regulatory organization

GAO
Accountability * Integrity * Reliability

United States General Accounting Office
Washington, DC 20548

August 29, 2003

The Honorable John D. Dingell
Ranking Minority Member
Committee on Energy and Commerce
House of Representatives

The Honorable Edward J. Markey
Ranking Minority Member
Subcommittee on Telecommunications
and the Internet
Committee on Energy and Commerce
House of Representatives

Most employment disputes in the securities industry must be arbitrated—resolved by a neutral third party—because mandatory arbitration of such disputes is often a condition for employment in the securities industry. Arbitrators have the authority to make legally binding decisions that can only be appealed on limited grounds. Their decisions can have serious consequences for an employee's career or livelihood since employee cases can involve such issues as salary, performance evaluations, and alleged discrimination. To resolve disputes filed by employees, the securities firms rely on the arbitration programs run by self-regulatory organizations (SRO)[1], which regulate the firms in the securities industry that are their members. Two SROs, NASD[2] and the New York Stock Exchange (NYSE), run the largest arbitration programs. While NASD and NYSE are responsible for operating arbitration programs, the federal government, through the Securities and Exchange Commission (SEC), oversees NASD and NYSE to help ensure that arbitration procedures are fair and the rights of all parties to the arbitration process are protected.

[1]SROs have an extensive role in regulating the U.S. securities markets, including ensuring that members comply with federal securities laws and SRO rules. SROs include all the registered U.S. securities exchanges and clearing organizations, NASD, and the Municipal Securities Rulemaking Board.

[2]NASD was formerly known as the National Association of Securities Dealers, but now goes solely by the acronym.

Recently you raised concerns about the fairness of the arbitration process and the quality of arbitrators, especially in cases involving alleged employment discrimination.

In response to your concerns about the arbitration of employment cases, this report examines (1) the circumstances under which NYSE and NASD will arbitrate employment and employment discrimination disputes and each SRO's procedures for selecting and evaluating their arbitrators; (2) the characteristics and outcomes of arbitrated employment and employment discrimination disputes at NYSE and NASD over the last 10 years; and (3) how SEC oversees the arbitration programs at NYSE and NASD and the results of these oversight activities.

In response to your request, we conducted interviews with officials from SEC, NYSE, NASD, and other established arbitration forums. In addition, we analyzed existing rules and procedure manuals governing NASD and NYSE. To determine how employees fared in securities arbitration, we analyzed data on 10 years of arbitration cases filed by employees at NASD or NYSE in which arbitrators had issued decisions (referred to as awards). Specifically, we calculated the rates reflecting the extent to which employees won awards, how much employees were compensated in awards, and various factors that could influence arbitration outcomes. Finally, to review SEC's oversight activities, we reviewed a random sample of complaint letters SEC received concerning arbitration and its inspection reports for NYSE and NASD over the last 10 years, concentrating on issues concerning arbitrator qualifications and arbitrator performance. Appendix I contains a detailed description of our scope and methodology and describes the reliability and limitations of our data. We performed our work between August 2002 and June 2003 in accordance with generally accepted government auditing standards.

Results in Brief

Both NASD and NYSE have policies and standard procedures intended to ensure fair arbitration in all disputes, but the circumstances under which they will arbitrate employment and employment discrimination cases differ. Arbitration is required for most employment disputes in the securities industry, except for discrimination cases. NASD will arbitrate employment discrimination cases based on agreements entered into between employees and firms before or after a dispute occurs. NASD has instituted additional requirements, however, for these cases, such as requiring that arbitrators not be affiliated with the securities industry. In addition, those chairing hearings for employment discrimination cases must hold a law degree, have 10 years of legal experience, have substantial

familiarity with employment laws, and must not have primarily presented employers or employees in the last 5 years. NYSE, on the other hand, will only arbitrate if both parties agree after a discrimination claim has been asserted. To qualify to hear cases, NASD and NYSE require that applicants provide information on their employment history, including their affiliation with the securities industry as well as information on whether they have any regulatory or criminal disciplinary history, have at least 5 years of work experience, supply two letters of reference, and complete training in basic arbitration procedures. Neither organization verifies the qualifications submitted by applicants not associated with the securities industry. In addition, NASD and NYSE have standard procedures for ensuring that arbitrators selected to hear cases do not have conflicts, for evaluating arbitrator performance, and for removing poorly performing arbitrators from their rosters. As an indication of how well an arbitrator conducts hearings and makes decisions, NASD and NYSE rely primarily on the evaluations of arbitrators by staff, parties in disputes, and other arbitrators on cases. However, since some of these evaluations are voluntary, not all NASD or NYSE arbitrators are evaluated for every case they hear. Officials at each SRO reported that if they receive no information about an arbitrator's performance on a case, they assume that the arbitrator's performance was adequate.

Over the last 10 years, 261 (17 percent) of the 1,546 employment disputes arbitrated by NYSE and NASD involved one or more discrimination claim(s), most often related to age or sex, and the characteristics and outcomes of discrimination cases were somewhat different from those cases not involving discrimination. Disputes involving discrimination required more hearing sessions and took longer to complete than cases with no discrimination claims. The compensatory damages claimed for the majority of cases, whether or not it included a discrimination claim, was over $100,000. Although the majority of employees were awarded some compensatory damages, employees in discrimination cases were less likely to be awarded any compensatory damages. Most employees in discrimination cases who were awarded compensatory damages, however, received more than their counterparts in cases not involving discrimination.

Based on periodic inspections of NASD and NYSE and reviews of complaint letters, SEC has found problems with procedures that one or both SROs used to oversee arbitrator qualifications and track arbitrator performance. SEC inspections generally include a review of arbitration procedures, interviews with staff, and a review of arbitrator profiles and closed cases, including both employment and employment discrimination

cases. According to SEC officials, complaint letters can affect the focus of an inspection, but we found that SEC receives relatively few letters concerning employment arbitration. In its most recent inspections of NASD and NYSE, SEC made various recommendations concerning procedures for ensuring that arbitrators are qualified. In addition, SEC recommended improving procedures for recording information on arbitrator performance in a central database and for disqualifying arbitrators who are poor performers. For example, SEC recommended that arbitrators' files be updated to reflect changes submitted by arbitrators that affect their qualifications. Both NYSE and NASD have taken steps to implement SEC's recommendations.

To help ensure that all NASD and NYSE arbitrators possess the qualifications required by their SRO, we recommend that SEC direct NASD and NYSE to verify the basic background information provided by all new applicants for their arbitrator rosters. We also recommend that SEC, during its next inspections, continue to review the adequacy of NASD and NYSE procedures for evaluating arbitrator performance. SEC, NASD, and NYSE all expressed support of the second recommendation, but SEC and NYSE raised concerns about requiring verification of information for arbitrator applicants at NYSE. We continue to believe the value of authenticating basic background information of arbitrator applicants outweighs these concerns because it will increase party confidence in arbitration, a process that is required for the majority of disputes. NASD indicated the steps they have taken to begin verifying the background information for all new arbitrator applicants.

Background

The arbitration of disputes first occurred at NYSE in the late nineteenth century but eventually became the practice within the securities industry in general. Arbitration was used to settle disputes over employee contracts, and in 1991 the U.S. Supreme Court ruled that an age discrimination claim brought forth by a securities industry employee could be subject to mandatory arbitration.[3] Subsequent court decisions permitted the use of mandatory arbitration for resolving other employment discrimination disputes, including sexual harassment.[4]

[3]*Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20 (1991).

[4]*Alford v. Dean Witter Reynolds, Inc.*, 939 F. 2d 229 (5th Cir. 1991); *Cremin v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 957 F. Supp. 1460 (N.D. Ill. 1997); and*Circuit City v. Adams*, 532 U.S. 105 (2001).

Proponents of mandatory arbitration believe it is an efficient, cost-effective way to resolve conflicts between employers and their employees. Opponents of mandatory arbitration believe that it puts employees at a disadvantage. They argue that discovery, the process by which parties exchange documents and other information relevant to their case, is limited, hearings take place outside of public scrutiny, and arbitrators favor employers, who are more likely to be "repeat users" than employees.[5]

SROs include NYSE that operates and regulates its market, as well as NASD, a private-sector provider of financial regulatory and dispute resolution services.[6] Their responsibilities include overseeing the arbitration of claims brought in the securities industry by customers, firms,[7] and employees as required by the Securities and Exchange Act of 1934 (the Exchange Act).[8] In 2000, NASD established a separate subsidiary to administer its arbitration program. The subsidiary is headquartered in Washington, D.C., and New York City, but also maintains staff in five regional offices. NYSE administers fewer arbitration cases than NASD and its arbitration program, which is administered by its Department of Arbitration in New York, is much smaller. NASD's subsidiary operates with a staff of about 200 while NYSE maintains a staff of approximately 18. In addition, NASD currently has approximately 7,000 arbitrators on its roster, while NYSE has 1,905.

Arbitrators play a key role in resolving disputes brought forth in the securities industry and their performance has a direct bearing on the fairness of a hearing. Like judges, they oversee the administration of proceedings, including determining the number of hearing sessions a case

[5]According to NYSE, the overwhelming majority of employees in arbitration are represented by attorneys who specialize in employment law.

[6]Although NASD and Nasdaq are in the process of separating, as of this date NASD is the SRO and Nasdaq is a subsidiary of NASD. Nasdaq's application for Exchange Registration status as a registered securities exchange under Section 6 of the Exchange Act is still pending before SEC. NASD delegates to NASD Regulation, its wholly owned subsidiary, SRO responsibilities as its regulatory arm.

[7]Firms must register with an SRO to operate within the securities industry and must abide by its rules.

[8]Customers bring the majority of arbitration cases in the securities industry. For example, in 2002, 78 percent of all decided cases at NASD were customer cases. Similarly, in 2002, only approximately 9 percent of all cases filed with NYSE were filed by employees.

requires and what evidence can be admitted.[9] Unlike judges, arbitrators are not required to base their decisions on legal precedent or to provide any reasoning for their decisions. In addition, their decisions—unlike those rendered in court—can only be appealed on limited grounds.

SEC is responsible for regulating securities market participants, including SROs such as NASD and NYSE. In addition to overseeing SROs through its inspections, SEC approves the rules they use to administer their arbitration programs to ensure they comply with the Exchange Act and other securities laws and rules. When SROs propose new rules or change existing rules, they are required to file them with SEC for approval.[10] SEC then provides interested parties an opportunity to comment on proposed rules or rule changes. In general, SEC is to approve certain new or amended rules within 90 days after they are published or institute proceedings to determine whether they should be disapproved.

[9]At both NASD and NYSE, arbitrators are classified as either public or nonpublic (NYSE uses the term industry). A nonpublic arbitrator is someone from the securities industry, retired from or has spent a substantial part of their career in the securities industry, or is an attorney, accountant, or professional who devoted more than 20 percent of his or her professional work to securities industry clients in the last 2 years. Public arbitrators then are those arbitrators who do not fall into the industry category and in addition do not have a spouse or a household member (referred to as an immediate family member at NASD) who is associated with someone in the securities industry. In June 2003, NASD filed proposed amendments to rules contained in its Code of Arbitration Procedure regarding the classification of public arbitrators. The purpose of proposed rule amendments was to further ensure that individuals with significant ties to the securities industry may not serve as public arbitrators.

[10]Certain rules proposed by SROs that deal with a narrow list of topics, such as rules that establish or change dues, fees, or other charges that can become effective upon filing with SEC without action by SEC. SEC is required to publish notice of the proposed rule changes filed by the SRO and the rule change is subject to a 21-day comment period that begins when the notice of the filing is published. Within 60 days of SRO's filing of a rule that is effective upon filing, SEC can annul the rule change and require that the rule be refiled under the normal notice and comment period.

Both NASD and NYSE Have Policies and Procedures Intended to Promote Fair Arbitration for all Cases

In most employment disputes, arbitration is mandatory, although for discrimination cases NYSE rules strictly limit its use and NASD has instituted additional requirements. For both customer and employment disputes, both SROs require that all arbitrators have certain qualifications in order to be on their rosters of available arbitrators. However, neither SRO verifies the qualifications for all of the arbitrators on their rosters. Both SROs have procedures designed to ensure that the arbitrators selected to hear cases do not have conflicts and have procedures for evaluating arbitrator performance. Yet, arbitrators who hear cases at both SROs may not be receiving evaluations on a routine basis.

Arbitration Is Required for Most Employment Disputes, Although for Discrimination Cases NYSE Has Strictly Limited Its Use and NASD Has Instituted Additional Requirements

Prior to 1999, both NASD and NYSE rules required the mandatory arbitration of all employment-related disputes, including discrimination claims.[11] In the 1990s, as discrimination claims filed at NASD rose,[12] some Members of Congress challenged the use of mandatory arbitration for discrimination disputes. In 1997, the Equal Employment Opportunity Commission (EEOC), which is responsible for enforcing the nation's employment discrimination laws, published a policy statement opposing the use of mandatory arbitration agreements for these disputes. Opposition to mandatory arbitration for these claims stemmed from concerns that arbitration eliminated the role the courts played in deterring discrimination and protecting employees. In addition, others believed that many arbitrators were unfamiliar with antidiscrimination laws and, therefore, could not provide a fair hearing on these claims.

NASD and NYSE took different approaches in changing their rules to address these concerns. NYSE followed EEOC's recommendation and only arbitrates discrimination claims when all parties agree to arbitration after the dispute occurs. NASD, on the other hand, no longer requires that employees arbitrate employment discrimination disputes, but will arbitrate these disputes, based on agreements employees have made before or after the dispute occurs.[13] The net result is that NASD will administer arbitration

[11]Associated persons of broker-dealers accept the rules of SROs by signing the U-4, the application they must complete to become registered with a SRO. Within the U-4, applicants agree to arbitrate any dispute claim or controversy that is required to be arbitrated under the rules, constitutions, or by-laws of the SRO.

[12]Discrimination claims filed rose from 4 in 1991 to 109 in 1996 (see *Federal Register*, 62, 242).

[13]As approved by SEC, effective January 1, 1999, NASD's Code of Arbitration Procedures were amended so that registered persons were no longer required to arbitrate claims of statutory employment.

cases that include discrimination claims if the parties have entered into an agreement to do so. This includes policies employees sign as a condition of employment.

According to NASD, in conjunction with this rule change, they assembled a working group[14] to consider recommendations contained in a document known as "A Due Process Protocol for Mediation and Arbitration of Statutory Disputes Arising out of the Employment Relationship." This Due Process Protocol was developed in 1995 by a committee of representatives from a range of organizations,[15] to provide arbitration procedures for statutory employment claims. Following NASD's review of this protocol NASD introduced additional requirements for these types of claims.[16] Changes ranged from setting qualifications for arbitrators who chair arbitrator panels[17] to specifying how arbitrators documented their decisions.

The arbitrator chairing a discrimination case at NASD must hold a law degree, have 10 years of legal experience, have substantial familiarity with employment law, and must not have primarily[18] represented employers or employees in the last 5 years.[19] In addition to special chair qualifications, all the arbitrators who hear cases with discrimination claims must also be classified as "public"—that is, individuals who are not affiliated with the securities industry either professionally or through their family relationships. For employment discrimination claims of $100,000 or less, a

[14]The working group included attorneys representing employees, general counsels of member firms, and arbitrators with expertise in employment matters.

[15]Organizations represented were involved in labor, employment law, and alternative dispute resolutions.

[16]NASD has also adopted rules to allow claims to be consolidated in one case, meaning if someone chooses to take a discrimination claim to court they will also be allowed to combine nondiscrimination claims in that case.

[17]Arbitration cases are heard by one or three arbitrators, depending on the size of the claim. In discrimination cases where there is only one arbitrator, that arbitrator must also meet these requirements.

[18]Primarily is defined as 50 percent or more of the arbitrator's business or professional activities.

[19]Arbitrators who qualify to serve as chairs on discrimination disputes are asked to provide a summary description of their qualifications for discrimination disputes, which is presented to the parties in the case. This summary is in addition to the narrative summary that all arbitrators must provide regarding their general arbitrator qualifications.

single public arbitrator is appointed, and for claims greater than this amount a panel of three public arbitrators is selected.[20]

In disputes subject to arbitration that arise out of the employment or termination of employment of an associated person, and that relate exclusively to disputes involving employment contracts, promissory notes or receipt of commissions, a single "nonpublic" arbitrator—that is someone who is affiliated with the securities industry—can only hear nondiscrimination claims of $50,000 or less. In similar cases with claims of $50,000 or more, a panel composed of three nonpublic arbitrators is appointed. Currently, arbitrator chairs in cases without discrimination claims need the same qualifications as any arbitrator.[21] At NYSE, all employment disputes, at the option of the employee, are entitled to a panel of three arbitrators, and a majority of the arbitrators cannot be from the industry unless the employee requests it.

NASD rules, adopted in 2000, also made two changes to procedures concerning arbitrator decisions in cases with employment discrimination claims. First, the rules specifically state that arbitrators can award "reasonable" attorney's fees for discrimination claims.[22] This change also creates an incentive for attorneys to take discrimination cases because it provides greater assurance that they will be compensated for their work if they are successful. Second, NASD's rule change requires arbitrators to document the disposition of discrimination claims, something not required for the other claims. While this rule still does not require arbitrators to explain their decisions, it requires arbitrators to specify for the parties how they ruled on any statutory discrimination claim.

[20]Parties may agree to have the case determined by a single arbitrator.

[21]NASD is now considering expanding the qualifications for arbitrator chairs by requiring them to take the chair-training course and to have participated in a certain number of arbitration cases. According to NASD officials, having chairs be more familiar with the legal process would help the arbitration process.

[22]SEC stated in its order approving NASD's rule that it approved "the specific provision governing attorneys fees in cognizance of the special attention to them under the civil rights laws" and that "awards of attorney's fees by arbitrators remain available to all parties in other cases administered under the Code of Arbitration Procedure, if applicable law permits such an award." Self-Regulatory Organizations; Order Approving a Proposed Rule Change by the National Association of Securities Dealers, Inc., Relating to the Arbitration Process for Claims of Employment Discrimination, Release No. 34-42061 (Oct. 27, 1999).

Both SROs Have Similar Qualifications for Arbitrators and Neither Verify the Qualifications of All Applicants

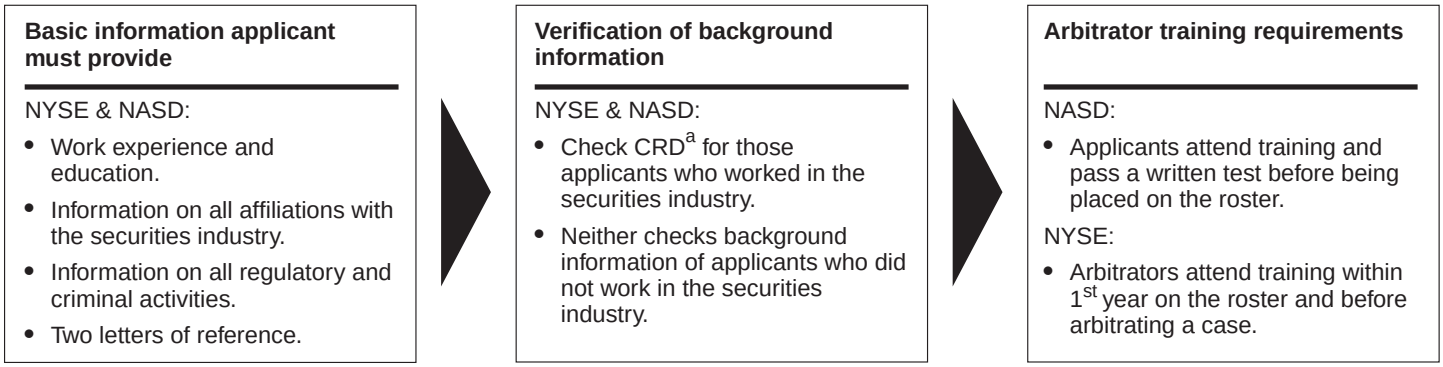
Both SROs require that all applicants for the arbitrator roster provide information on their affiliation with the securities industry, have 5 years of work experience, supply two letters of recommendation, and complete training in basic arbitration procedures.[23] Recommendation letters must include particular information about the person writing the letter, the prospective arbitrator, and an attestation as to the character and fitness of the nominee. NASD also requires that applicants take a multiple choice examination and receive a passing score of at least 80 percent. (See fig.1.) After receiving arbitrator applications from applicants who work or worked in the securities industry, the SROs check the Central Registration Depository (CRD), a computerized database that contains the educational, work, and disciplinary history for current and former securities registered persons.[24] Therefore, the CRD only covers arbitrators classified as nonpublic. Currently, information from arbitrator applicants not employed in the securities industry is not checked by the SROs, but NASD is proposing a rule change that would require the verification of background information on all new arbitrators.[25]

[23]On the application form arbitrators are also asked to answer a series of questions on whether they have engaged in criminal activities and provide information on their affiliation to the securities industry—something arbitrators are required to update on an ongoing basis. For more information on arbitrator disclosure requirements, see U.S. General Accounting Office, *Follow-up Report on Matters Relating to Securities Arbitration*, GAO-03-162R (Washington, D.C.: Apr. 11, 2003) and Michael A. Perino, *Report to the Securities and Exchange Commission Regarding Arbitrator Conflict Disclosure Requirements in NASD and NYSE Securities Arbitrations* (Nov. 4, 2002).

[24]NASD and the North American Securities Administrators Association established the CRD in 1981 and its use allows individual brokers and firms to meet both state and federal reporting requirements. NASD has instituted a statistical quality control process to measure the accuracy of disclosures and has periodic examinations done of the data by data quality professionals.

[25]In August 2003, NASD filed a rule proposal with SEC, which would require that new arbitrator applicants have background information verified for federal and county criminal records, employment information, and professional licenses (SR-NASD-2003-122).

Figure 1: Application Process



Source: NASD and NYSE.

[a]A computerized database that holds the educational, work, and disciplinary history for current and former securities registered persons.

NASD reported that verifying the background information on all new arbitrators would enhance the reputation of its arbitration program. If SEC approves its rule change, NASD will use an independent firm to conduct the background checks and will pass the cost of this process—expected to be between $60 and $85—onto the applicant. NYSE did not report any plans to change its procedures at this time.

At NASD, once arbitrators' applications are approved, they must take a half-day introductory training course, be evaluated by the trainer, and pass a 25-question multiple choice examination on arbitration procedures. Once they pass the examination and evaluation by the trainer, they are included on the NASD arbitrator roster. At NYSE, on the other hand, once an application is reviewed and approved by staff, the applicant is considered able to arbitrate any case once he or she participates in one training course on arbitration procedures and conduct issues.[26]

Ongoing training at both SROs is limited. NYSE requires that arbitrators continue to attend at least one training course every 4 years.[27] NASD does not have such a requirement but does offer chairperson training for those

[26]Arbitrators can fulfill their training requirement by reviewing the arbitrator conduct and procedures with NYSE staff prior to a hearing. In addition, NYSE reported that many of their new applicants have experience and training from other arbitration forums.

[27]NYSE can waive this requirement.

arbitrators wanting to chair cases.[28] One SEC official raised concerns about mandating ongoing training for arbitrators, arguing that it may discourage the most experienced arbitrators from serving.

Both SROs Have Procedures for Selecting Arbitrators for Cases Intended to Ensure That They Are Unbiased

Both SROs, recognizing that arbitrators are one of the key factors to ensuring a fair and efficient process, have developed procedures to help ensure that the selection of arbitrators for a case is unbiased. Prior to 1998, NASD staff selected arbitrators based on the issues in the case and the expertise the arbitrators held. In 1996, a NASD task force, organized to review the securities arbitration process, reported that claimants and their representatives were concerned that staff could be biased in selecting arbitrators. To address this concern, NASD changed how arbitrators were selected. Since 1998, NASD has allowed both parties involved in a dispute to choose the arbitrators, which limited NASD staff involvement in the selection process.[29] NASD provides parties with a computer-generated list of up to 15 arbitrators with profiles for each arbitrator.[30] An arbitrator's profile includes a paragraph on the arbitrator's background, a summary of the arbitrator's education and work history, the arbitrator's experience, the arbitrator's disclosure and conflict information, and a list of all the publicly available award decisions that the arbitrator has rendered. Each party may peremptorily strike any arbitrator from the list, then ranks the arbitrators who remain by order of preference. If the parties do not mutually agree on an acceptable number of arbitrators after striking and ranking, the list is extended by the computer and the parties are assigned the next available arbitrator(s) on the computerized roster. While this process reduces the potential for staff bias, some arbitrators have raised concerns that a computer-generated list may not contain arbitrators with substantial experience.

In 2000, NYSE also began giving parties three options for selecting arbitrators: (1) choosing randomly from a list drawn from all available

[28]In mid-2003, NASD Chairperson training was converted to an online interactive program.

[29]At that time, NASD reviewed all arbitrators on its roster and sent out letters to all arbitrators requesting that they update their profiles; in the process, NASD removed 800 to 1,000 arbitrators on its roster.

[30]The composition of the lists depends on the size of the claim and the nature of the dispute. For example, in employment discrimination cases being heard by three arbitrators (claims of more than $100,000), the list will contain the names of 10 public arbitrators, plus the names of 5 public arbitrators who meet the special additional requirements to chair discrimination cases.

arbitrators; (2) choosing from a list the staff compiles; or (3) having NYSE staff attorneys select, the only procedure used prior to 2000. If all parties cannot agree on one of these options, staff attorneys determine who will arbitrate. According to NYSE, staff selection has remained the most common method for selecting arbitrators, with parties using it for about 85 percent of the cases. Since this method is the default if parties cannot agree, it is not possible to determine how often this method was actually chosen by parties, or used as the default.

At both NASD and NYSE, arbitrators selected to serve on cases are asked to review the case and determine if they have any possible conflicts of interest. In addition, arbitrators must update their profile, which includes information on their employment history and affiliation with the securities industry. Both NYSE and NASD will remove arbitrators from their roster if they misstate or fail to disclose information concerning conflicts of interest.

Both SROs Have Procedures to Track Arbitrator Performance, Although Many Arbitrators May Not Be Evaluated

Each SRO has developed three types of evaluations for arbitrators: (1) party evaluations, completed by either party or their attorneys; (2) peer evaluations, completed by other arbitrators who hear the case; and (3) staff evaluations. Both SROs summarize evaluation results and input them into a centralized arbitrator database. According to NASD officials, staff are required to summarize and input only negative comments on an arbitrator, although SEC staff noted that in practice it also often sees positive comments from NASD staff recorded in the files. NYSE officials, on the other hand, reported recording a complete summary of the evaluations. NASD conducts quarterly audits in which they check to see if staff members are consistently entering information in the centralized database and documenting actions taken concerning any evaluations. In addition, the audits review how complaint letters have been recorded, reviewed, and resolved.

Both SROs reported that it has been difficult for them to get parties to return evaluations.[31] Yet, NYSE reported that response rates have increased since it began requiring that arbitrator chairs encourage parties to complete the evaluations and reiterate that the evaluations are

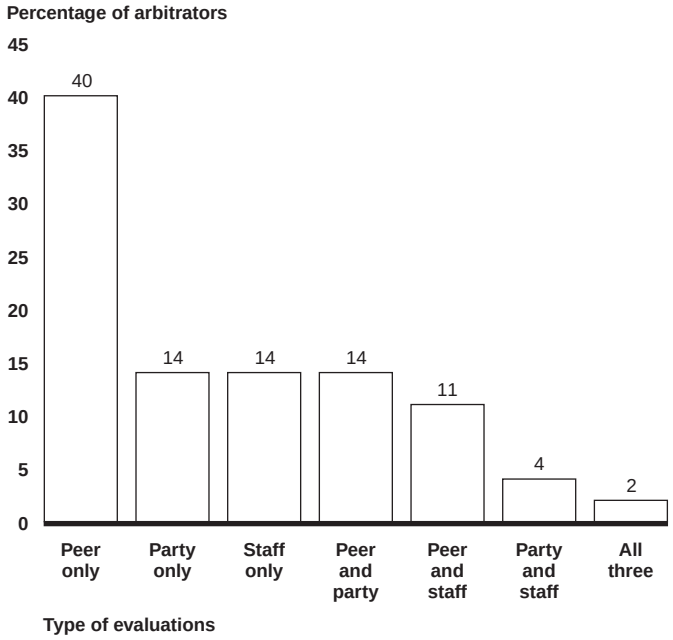
[31]NASD reported that it is currently working to allow parties and arbitrators to complete and return evaluations online and that this feature would increase the number of evaluations completed.

confidential and will not affect the case outcome. NYSE said that peers are very responsive with evaluations. NYSE said it requires that staff observe new arbitrators for their first hearing at NYSE and said it sought to evaluate all arbitrators, who serve on a case that goes to a hearing, at least once a year. Although NYSE said that it had fulfilled this requirement in 2002, NYSE could not provide data on evaluations showing that arbitrators had been observed. NASD could not report how often staff evaluate arbitrators. Officials from both SROs said that if no information is received about an arbitrator on a case, they assume the arbitrator performed adequately.

To gain a better understanding of how often arbitrators were evaluated, we reviewed the records of 124 out of the 494 arbitrators at NASD who had heard discrimination claims and/or other employment claims between January 2001 and June of 2002.[32] On the basis of this sample, we estimate that about 45 percent of arbitrators who heard cases during this time had received some type of evaluation and of those only about 2 percent received all three types of evaluations—peer, party, and staff. (See fig. 2 for a breakdown of the types of evaluations arbitrators received.)

[32]We did not review arbitrator records at NYSE because its current computer system did not allow NYSE to provide us with the data we sought, within the time frame for this report.

Figure 2: Types of Evaluations Arbitrators Received at NASD

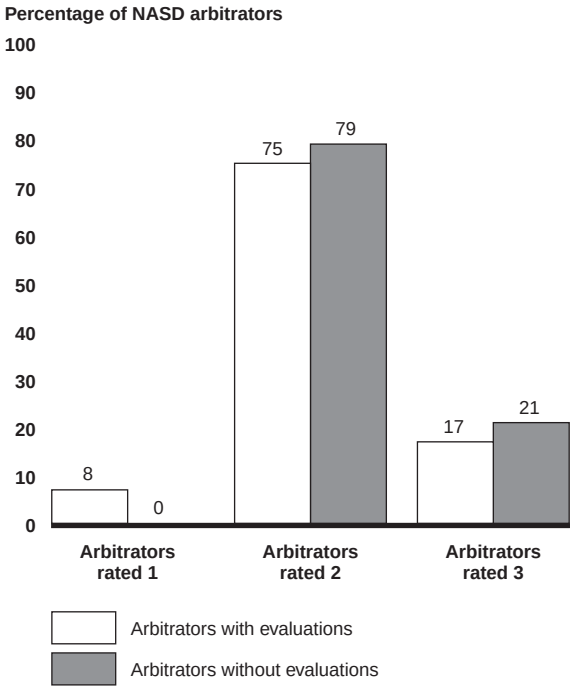


Source: NASD.

Although NASD supplements its evaluations by rating arbitrators on a quarterly basis,[33] our review showed that ratings are often based on little or no information. Every quarter NASD rates those arbitrators who have been active during that time, using a 3-point scale, with 1 being the lowest and 3 being the highest. Staff bases the rating on evaluations and complaints received that quarter and any notes recorded during that time frame in the arbitrator database. In general, NASD reported that any arbitrator who did not have any evaluations during the quarter is likely to be rated adequate ("2"). We estimate that the majority of the arbitrators that were rated received an adequate rating of 2, whether or not they received any evaluations during this time, and 57 percent of arbitrators with a 2 rating had not received any evaluations during this time frame. (See fig. 3.) Some arbitrators without evaluations during this time frame were also rated excellent, which could be a result of the rating from the prior quarter.

[33]NYSE reported that it does not have a numerical rating system and did not think it would add anything to the evaluation process it has in place.

Figure 3: How NASD Arbitrators Were Rated



Source: NASD.

Both NASD and NYSE have mechanisms in place to address poor performance by arbitrators. If NYSE or NASD receives either a poor arbitrator evaluation or complaints about an arbitrator on a case, staff will take steps to respond. For example, the staff member assigned to the case may be asked to corroborate the complaint or be asked to consult other arbitrators assigned to the case to see if they support the allegation. A staff member who confirms the complaint may then speak to the arbitrator and suggest how he or she could improve his or her behavior. If the complaint suggests no corrective action is possible, both SROs reported that the arbitrator would be removed from the active roster immediately. All complaints are recorded in the arbitrator database, and both SROs reported that staff input how the complaint will be resolved.

In reviewing the records of NASD arbitrators, we found that staff did not always document how they responded to poor evaluations and complaints. We estimate that 10 percent of all 494 NASD arbitrators that heard cases between January 2001 and June of 2002, received some kind of complaint, either from a staff member, a party member, or another arbitrator. In our sample, 6 of the 16 arbitrators that received negative complaints were

permanently dropped from NASD's arbitrator list and 1 was temporarily made unavailable pending further review. One arbitrator, who had been permanently dropped in 2001, appeared to have complaints going back to 1993, yet the notes showed that no changes had been made to the adequate rating of 2. For another permanently dropped arbitrator, staff noted they were concerned that no negative comments were recorded on the computer file since other staff and arbitrators had complained about this arbitrator's conduct. Of the 9 remaining arbitrators, information provided by NASD indicated that staff had followed-up on the complaints raised for 5 arbitrators.

Over the Last 10 Years, Relatively Few Employment Disputes Involved Discrimination, and Some Variations Existed between These Cases and Other Employment Disputes

Of the 1,546 employment cases[34] decided by arbitrators at NASD and NYSE over the last 10 years,[35] 261 (17 percent) included at least 1 discrimination claim. Cases with discrimination claims required more hearing sessions and took longer to complete than those with no discrimination claims. At the same time, the compensatory damages claimed in all cases was generally over $100,000, with claimed amounts generally higher at NYSE than at NASD. In over half of all employment cases, employees won some level of monetary compensation, although in cases with discrimination claims employees were generally less likely to win. In most cases, when employees won they received less than half of the compensatory damages they claimed, with over 50 percent of the awards over the last 10 years being $50,000 or less. When compensatory damages were awarded in cases involving discrimination, it tended to be higher than compensatory damages awarded in other employment cases, with just over 60 percent of discrimination cases receiving more than $50,000. Appendix 1 describes the reliability and limitations of these data.

[34]Our analysis was conducted on cases decided by arbitrators and does not include cases that were settled or withdrawn. According to NASD, in recent years, parties agreed on a resolution in nearly 60 percent of all cases.

[35]The data analyzed spanned from January 1993 through June 2002—the most current data available.

Age and Sex Discrimination Were Most Prevalent in the Relatively Few Employment Cases That Included Discrimination Claims

Employment cases arbitrated at NASD and NYSE can contain 1 or more claims, some of which might involve discrimination. Of all 1,546 employment cases heard (1,289 at NASD and 257 at NYSE) at NASD and NYSE over the last 10 years, 261 (17 percent) included at least 1 type of discrimination claim. NASD arbitrated 202 of the cases that involved discrimination allegations. NYSE arbitrated the remaining 59. Given that some cases involved more than 1 type of discrimination claim, in 261 cases a total of 324 discrimination claims were made. As shown in table 1, the majority of these 324 discrimination claims was either age (33 percent) or sex-based (32 percent).[36]

Table 1: Types of Discrimination Claims in Employment Cases at NASD and NYSE, 1993 through 2002

	Age		Sex discrimination/ harassment		Race/national origin		Disability		Religion		Unspecified		Total
Year	NASD	NYSE	NASD	NYSE	NASD	NYSE	NASD	NYSE	NASD	NYSE	NASD	NYSE	
1993	1	7	2	6	2	1	0	1	0	0	0	0	**20**
1994	6	8	11	6	3	2	1	0	2	1	1	0	**41**
1995	15	4	9	2	4	0	2	0	1	0	0	2	**39**
1996	9	2	10	2	2	1	3	2	0	0	0	1	**32**
1997	8	2	15	5	6	0	6	2	3	1	3	1	**52**
1998	18	2	13	2	5	0	7	3	1	2	2	0	**55**
1999	3	2	9	0	5	0	2	1	2	0	0	1	**25**
2000	8	0	5	0	5	0	4	0	2	0	5	0	**29**
2001	7	1	6	0	2	0	1	1	1	0	3	0	**22**
2002	4	1	1	0	1	0	0	0	0	0	2	0	**9**
Total	**79**	**29**	**81**	**23**	**35**	**4**	**26**	**10**	**12**	**4**	**16**	**5**	**324**

Source: Securities Arbitration Commentator.

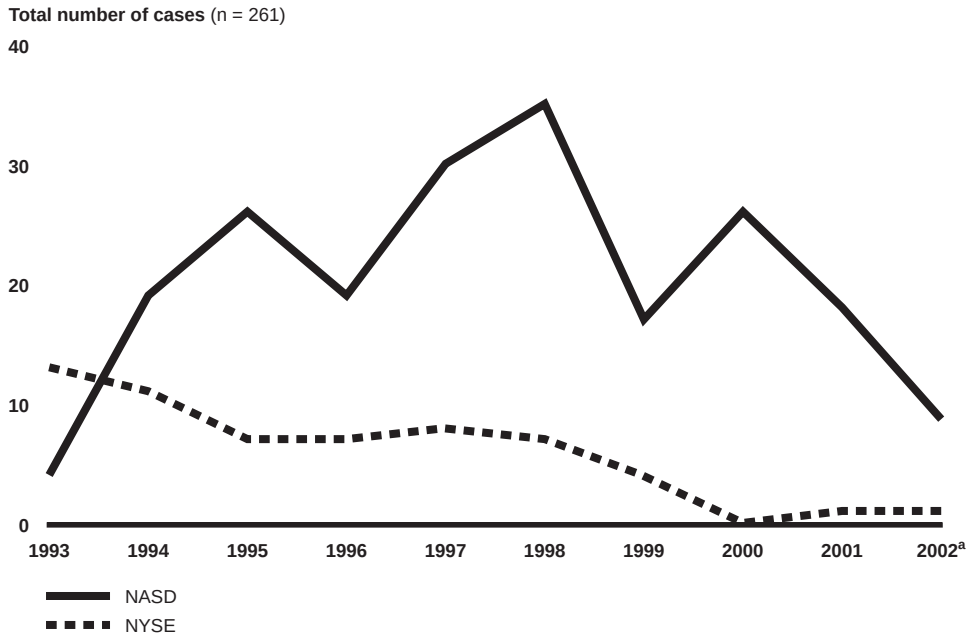
Note: Year 2002 includes cases decided in January through June.

Over the last 10 years, the number of cases with discrimination claims has generally decreased at NYSE. In more recent years, this has also occurred at NASD, although prior to 2000 the number of cases at NASD involving discrimination fluctuated. (See fig. 4.) NASD and NYSE officials reported that the rule changes in 1999, which altered if and how discrimination

[36]Sex discrimination includes sexual harassment claims.

cases are arbitrated, might have reduced the arbitration of these types of cases.[37]

Figure 4: Number of Cases Involving Discrimination at NASD and NYSE, 1993 through 2002



Source: Securities Arbitration Commentator.

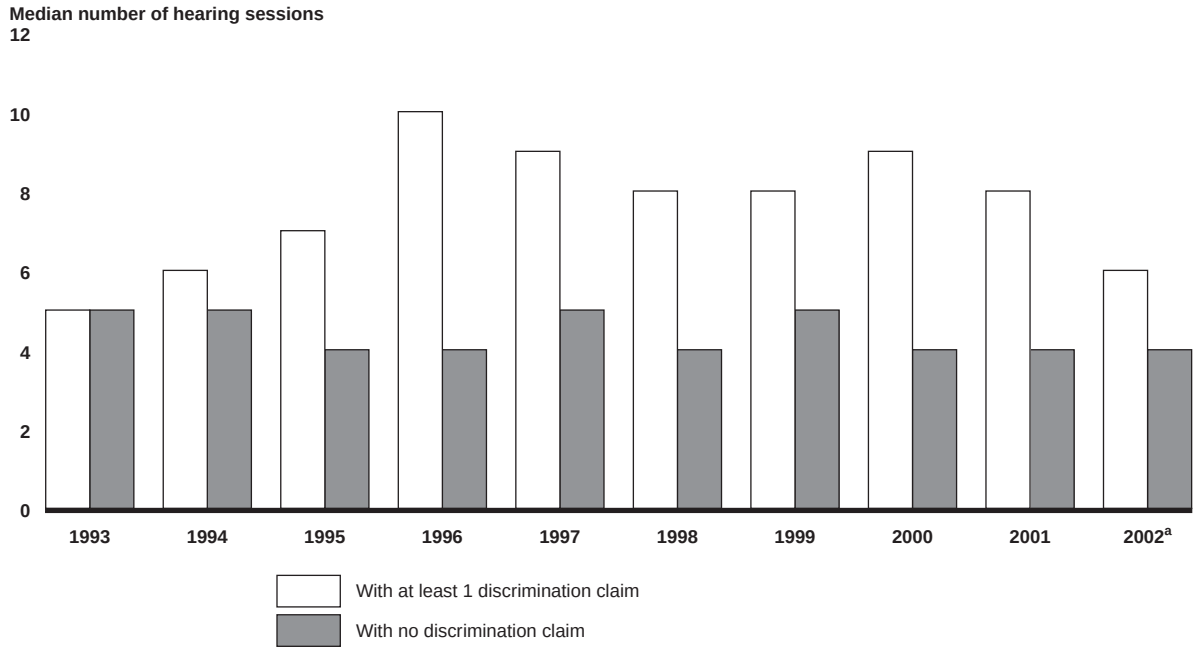
[a]Includes only those cases decided in January through June 2002.

Cases That Included Discrimination Claims Required More Hearing Sessions and Took Longer to Complete

Over the last 10 years, the median number of hearing sessions in discrimination cases ranged from 5 to 10 at NASD (see fig. 5) and from 8 to 15 at NYSE (see fig. 6). The median number of hearing sessions in cases that did not involve discrimination ranged from 4 to 5 at NASD and 5 to 11 at NYSE.

[37]We were unable to determine what factors caused this decrease.

Figure 5: Median Number of Hearing Sessions for Discrimination and Nondiscrimination Cases at NASD, 1993 through 2002

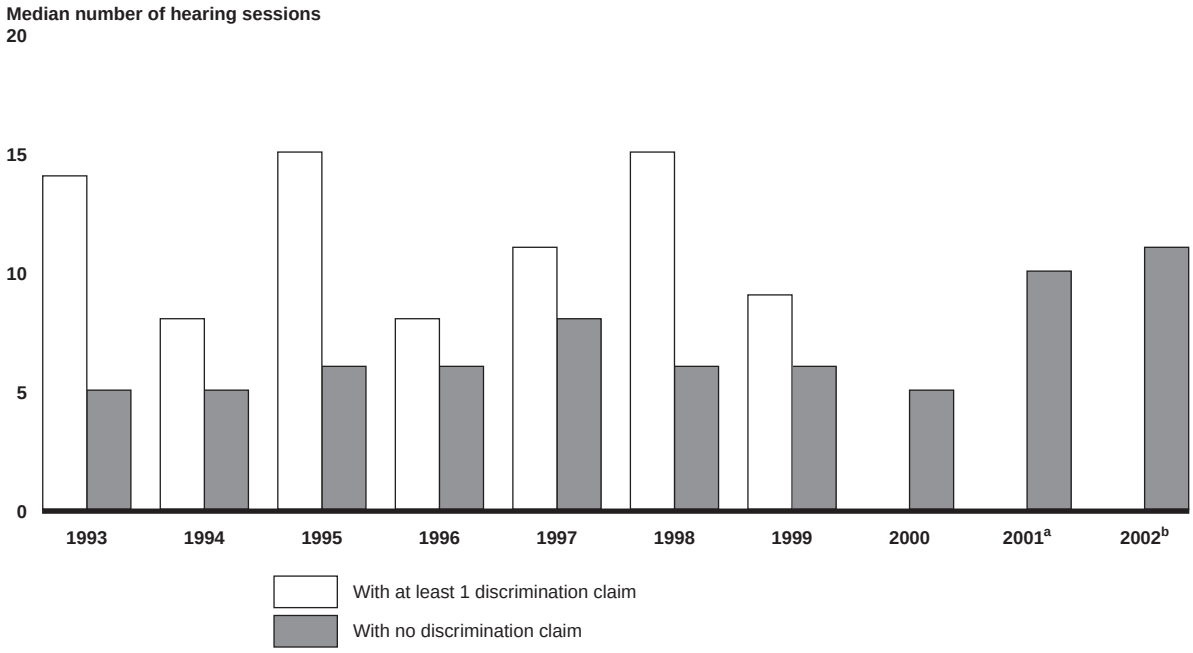


Total number of cases (n = 1,236)										
With at least 1 discrimination claim	4	19	26	19	28	35	16	26	18	8
With no discrimination claim	31	68	92	138	153	145	110	105	133	62

Source: Securities Arbitration Commentator.

[a]Median number of hearing sessions based only on cases decided in January through June.

Figure 6: Median Number of Hearing Sessions for Discrimination and Nondiscrimination Cases at NYSE, 1993 through 2002



Total number of cases (n = 252)										
With at least 1 discrimination claim	12	11	7	7	8	7	4	0	1	1
With no discrimination claim	29	26	24	34	14	24	14	8	12	9

Source: Securities Arbitration Commentator.

[a]Too few cases with at least 1 discrimination claim were decided in 2001 to calculate the median number of sessions per case for that year.

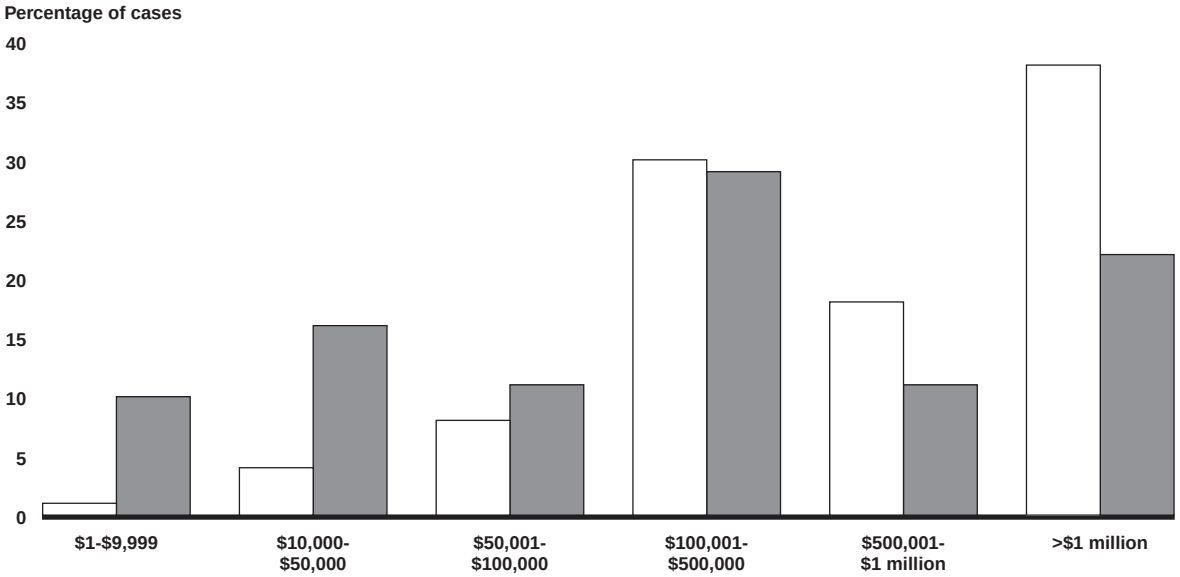
[b]For 2002, only cases decided in January through June were included in this analysis; however, not enough cases with at least 1 discrimination claim were decided during that time to calculate the median number of sessions per case for cases with at least 1 discrimination claim.

Not surprisingly, cases requiring more hearing sessions also took longer to complete. For example, cases requiring 1 to 2 hearing sessions took 438 days on average to complete, while those requiring 5 to 8 hearing sessions took 490 days on average. According to NASD, discrimination cases could require more hearing sessions and take longer to complete because they are more complex.

Amounts Claimed in the Majority of Employment Cases Were over $100,000

In most cases arbitrated at NASD and NYSE over the last 10 years, employees sought more than $100,000 in compensatory damages, whether or not the case included a discrimination claim. (See fig. 7.)

Figure 7: Percentage of Discrimination and Nondiscrimination Cases at NASD and NYSE from 1993 through 2002, by Amount Claimed



Total number of cases (n = 1,295)						
With at least 1 discrimination claim	3	9	17	64	39	80
With no discrimination claim	111	169	124	317	122	240

Source: Securities Arbitration Commentator.

Note: For 2002, analysis based only on cases decided in January through June.

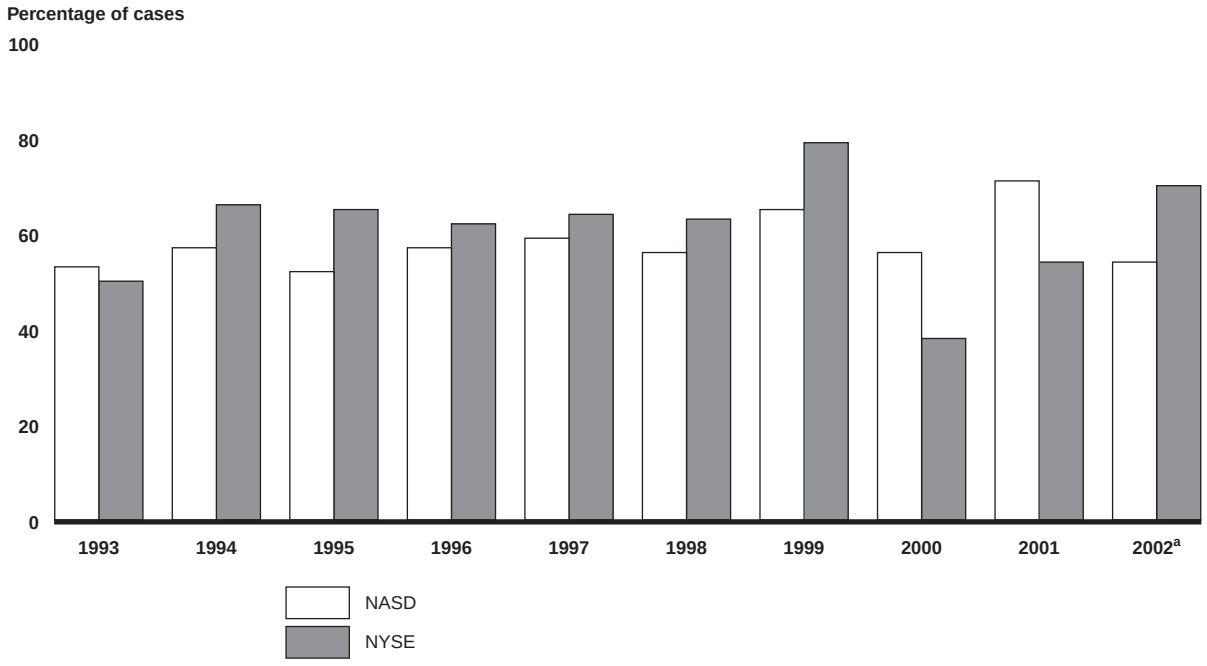
Overall, employees in NYSE cases sought higher compensatory damages than employees in NASD cases with the average compensatory damage claimed at NYSE over $2 million and the average compensatory damage claimed at NASD was under $1 million. These differences might reflect differences in the membership of the two SROs. For example, members of

NYSE tend to include mostly the larger, more established broker-dealers, whose employees may seek higher compensatory damages in arbitration cases.

Cases Involving Discrimination Were Less Likely to Win Some Level of Compensatory Damages Than Cases with No Discrimination Claims

In general, in more than 50 percent of cases at NASD and NYSE, employees were awarded some level of compensatory damages. (See fig. 8.)

Figure 8: Percentage of Cases at NASD and NYSE in Which Employees Were Awarded Compensatory Damages, 1993 through 2002



Total number of cases (n = 1,546)										
NASD	36	97	124	159	188	189	138	135	153	70
NYSE	42	38	31	42	22	32	19	8	13	10

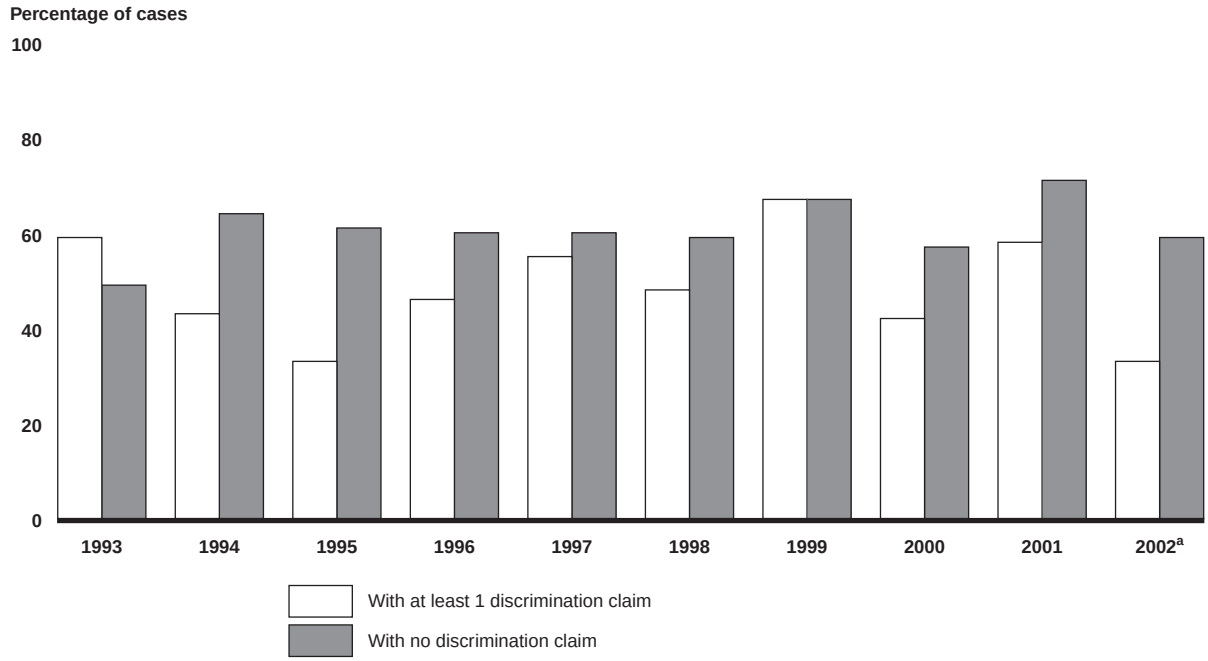
Source: Securities Arbitration Commentator.

[a]For 2002, analysis based only on cases decided in January through June.

Employees in cases involving discrimination, however, were less likely to win some compensatory damages than employees in cases with no discrimination claims. (See fig. 9.) Forty-eight percent of all NASD and NYSE cases over the last 10 years that included a discrimination claim won some level of compensatory damages compared with 61 percent of cases with no discrimination claims.[38]

[38]Because of data limitations, in cases with both discrimination and other employment claims, we could not determine what proportion of the award, if any, was awarded for a discrimination claim.

Figure 9: Percentage of Discrimination and Nondiscrimination Cases at NASD and NYSE in Which Employees Were Awarded Compensatory Damages, 1993 through 2002



Total number of cases (n = 1,546)										
With at least 1 discrimination claim	17	30	33	26	38	42	21	26	19	9
With no discrimination claim	61	105	122	175	172	179	136	117	147	71

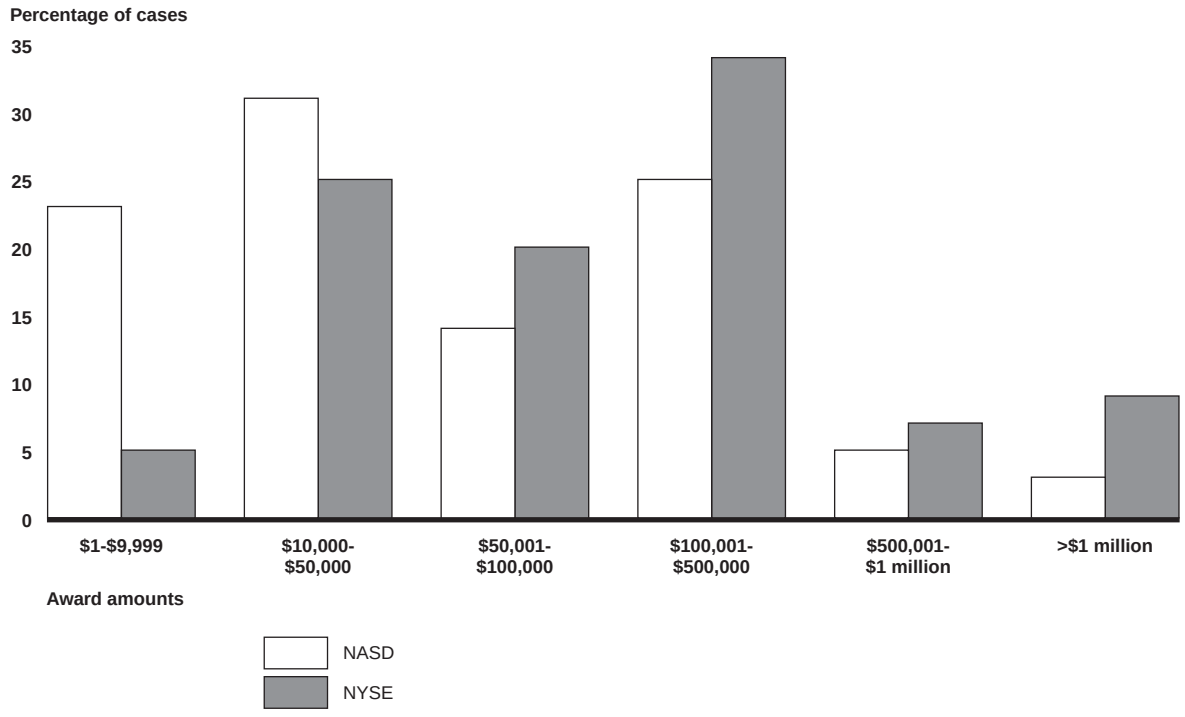
Source: Securities Arbitration Commentator.

[a]For 2002, analysis based only on cases decided in January through June.

While Most Employees Received Less Than Half of the Compensatory Damages They Claimed, Cases That Included Discrimination Claims Received Higher Awards

In cases where employees received a monetary award, over 60 percent of employees received less than half of the compensatory damages they claimed. In terms of the amount of compensatory damages awarded, awards in cases at NYSE tended to be higher. (See fig. 10.) At NASD, just over half of the cases won had awards of $50,000 or less, while at NYSE 70 percent of awards were over $50,000.

Figure 10: Percentage of Cases Won at NASD and NYSE from 1993 through 2002 by Amount Awarded



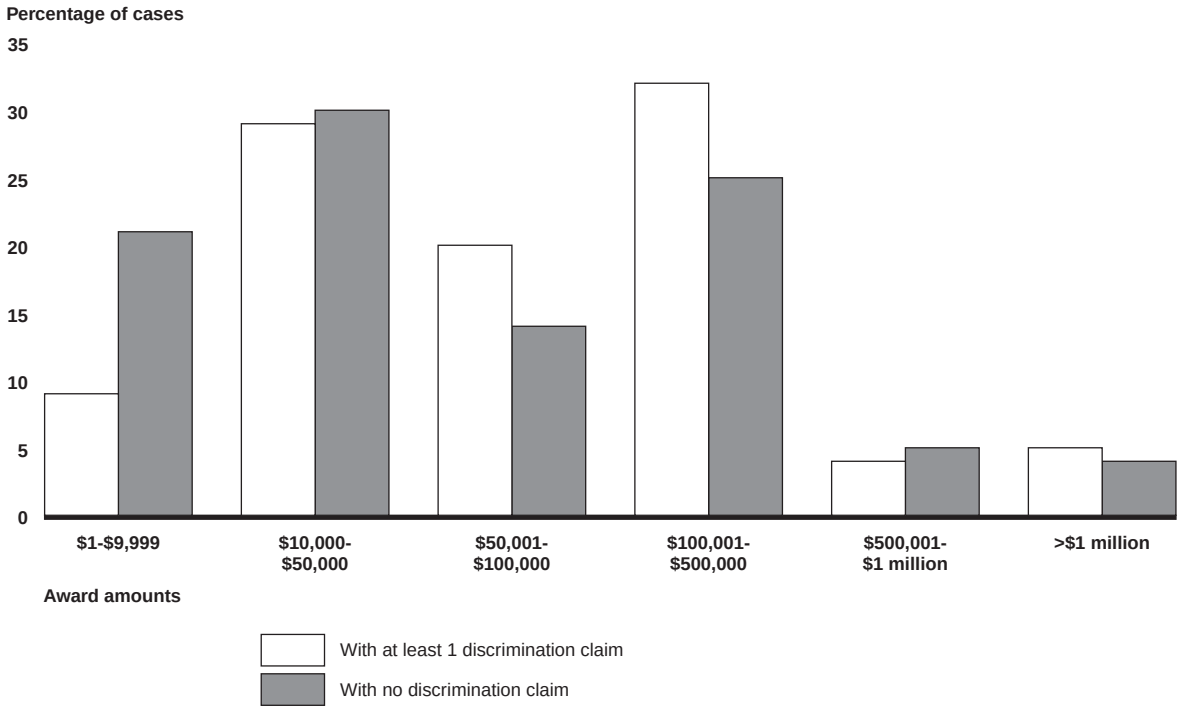
Total number of cases with monetary awards (n = 784)						
NASD	147	199	89	158	29	18
NYSE	7	36	29	49	10	13

Source: Securities Arbitration Commentator.

Note: For 2002, analysis based only on cases decided in January through June.

Compared with cases with no discrimination claims, employees in cases involving discrimination were more likely to receive larger awards.[39] (See fig. 11.) Sixty-two percent of cases with discrimination claims that received monetary awards had an award amount over $50,000, compared with 48 percent of cases without discrimination claims.

Figure 11: Percentage of Discrimination and Nondiscrimination Cases at NASD and NYSE from 1993 through 2002, by Amount Awarded



Total number of cases with monetary awards (n = 784)						
With at least 1 discrimination claim	11	34	23	38	5	6
With no discrimination claim	143	201	95	169	34	25

Source: Securities Arbitration Commentator.

Note: For 2002, analysis based only on cases decided in January through June.

[39]On average, the amount claimed in discrimination cases was also higher.

In addition to receiving monetary compensation, employees sometimes seek and receive nonmonetary awards. For example, an employee may want defamatory language removed from his or her record. In the employment cases that we analyzed, approximately 13 percent of employees won some type of nonmonetary award without any monetary award.

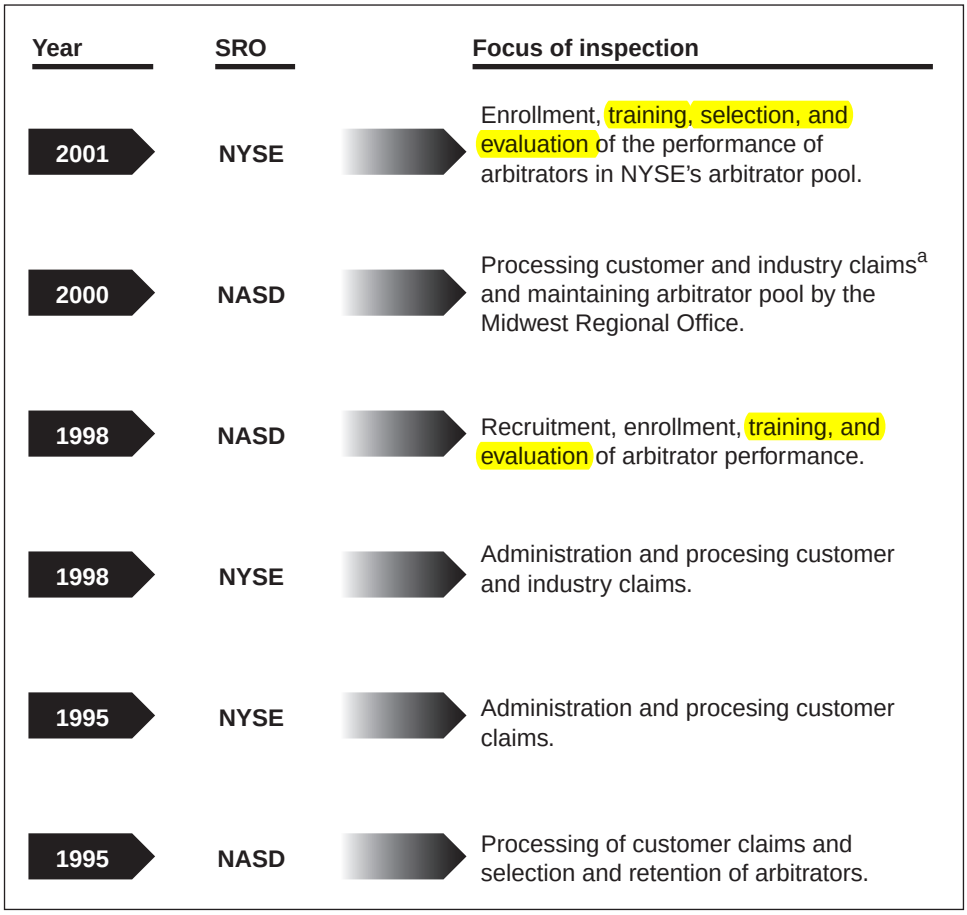
SEC Oversight Found SROs Could Improve Procedures to Ensure Arbitrators Are Qualified and Perform Well

To assess arbitration programs at NASD and NYSE, SEC conducts periodic inspections and reviews complaint letters it receives. It has cited problems at one or both SROs in the procedures used to (1) ensure arbitrators are qualified and (2) track arbitrator performance. SEC generally reviews arbitration procedures, arbitrator profiles, disclosure reports, and closed cases and interviews staff during its inspections. Although SEC officials indicated that complaint letters could affect the focus of an inspection, we found that few of the letters SEC receives focus on employment arbitration. In its most recent inspections, in addition to problems with procedures both SROs used to ensure arbitrators are qualified, SEC found that one or both SROs did not record information on arbitrator performance in a central database or disqualify all arbitrators who were poor performers from hearing cases. Both SROs have taken some steps to address the problems.

SEC Conducts Systematic Inspections and Reviews Complaint Letters to Assess SRO-Administered Arbitration Programs

Since 1995, SEC has examined NASD's and NYSE's arbitration programs three times each and has routinely responded to complaint letters about the process. Most inspections have focused on either case processing or recruiting and maintaining arbitrators. In general, inspections also included reviewing problems raised in previous inspections to determine whether they had been resolved. (See fig. 12.)

Figure 12: Focus of SEC Inspections of NASD and NYSE, 1995-2002



Source: SEC inspection reports.

[a]Customers' claims are claims made by investors while industry claims are made by members of the securities industry.

In conducting inspections, SEC reviews a variety of documents, summarizes findings, develops recommendations, and provides SRO with the opportunity to comment on both its findings and recommendations. The documents SEC reviews generally include case files[40] and arbitrator

[40]Prior to 1998, SEC limited its review to customer cases. In its 1998 inspections, SEC began to also review employment cases. An SEC official reported that because relatively few employment discrimination cases are arbitrated, typically all cases alleging employment discrimination closed during the inspection review period are selected for review.

profiles and disclosure reports. Some of the case files are chosen randomly while others are selected based on risk factors that suggest problems may exist, such as the length of time it took to complete a case. In addition to reviewing documents, SEC interviews SRO staff to better understand its operations. In its 2000 inspection of NASD, SEC reviewed 110 arbitrator profiles and disclosure reports and 89 arbitration case files. In its 2001 inspection of NYSE, SEC reviewed 200 arbitrator profiles and disclosure reports and 40 customer and employment cases in addition to other documents.[41] An SEC official noted that under the Exchange Act,[42] SEC has a broad range of authority to address deficiencies found in an inspection. As a practical matter, SEC staff and SROs discuss deficiencies and document that necessary steps have been taken.[43]

In addition to carrying out inspections to oversee SRO arbitration programs, SEC reviews complaint letters from individuals employed in the securities industry and other interested parties regarding SRO-administered arbitration programs. Of all the complaint letters SEC receives, however, only a small percentage raise concerns about the arbitration and an even smaller percentage deal with employment cases. According to SEC's complaint letter log, of the over 12,000 complaint letters SEC received from January 1992 through October 2002, approximately 500 contained a specific reference to arbitration. We reviewed a random sample of 100 of the letters that referred to arbitration and found 16 that discussed the arbitration of employment clams.[44] Of the 16, 6 raised concerns about the use of mandatory arbitration to address employment or employment discrimination claims. The other 10 letters dealt with a variety of issues, including the amount of time allocated to address a claim, the scheduling of hearings, and a proposal to limit damages that can be claimed.

[41]SEC was unable to provide the total number of closed cases their sample was drawn from.

[42]Securities Exchange Act of 1934 Section 19(h), 15 U.S.C. § 78s(h).

[43]In the event deficiencies were not adequately addressed, SEC has authority under Section 19(h) of the Exchange Act to institute administrative proceedings to remove SRO officials, limit or suspend SRO activities, or revoke SRO registration.

[44]Twenty-five of the 100 letters in our sample were missing from SEC files. The issues raised in the remaining 59 letters were either unclear or dealt with issues unrelated to employment cases.

An SEC official with the division that approves SRO rules said the division responds to all complaint letters it receives, which are tracked using the database letter log.[45] The official indicated that when letters register general discontent with the arbitration process but do not contain a specific allegation, parties are provided general information about arbitration, including information on the narrow procedural mechanism for challenging awards. When letters contain specific allegations, SEC attorneys contact the SRO or use other means to investigate the allegation before providing a response. SEC attorneys may also forward a copy of the letter to the office that oversees periodic inspections, so it can assess the allegation in its inspection activities. For example, an SEC official reported that SEC had placed special emphasis in a recent inspection on reviewing updates SRO staff made to arbitrator profiles and disclosure reports in response to concerns raised in a complaint letter.

SEC Has Made a Variety of Recommendations to Improve SRO Procedures

In recent inspections, SEC staff identified a number of ways NASD and NYSE could improve their procedures for ensuring that arbitrators are qualified and for tracking arbitrator performance. For example, to ensure that arbitrators are qualified, SEC staff recommended that one or both SROs

- ensure that they consistently conduct CRD checks of all industry arbitrators and document those reviews in arbitrator profiles;
- ensure that all arbitrator profiles are complete and reflect new or updated information arbitrators submit about themselves;
- lengthen training courses for new arbitrators;
- include in arbitrator training manuals guidance on certain arbitration procedures and certain problems arbitrators are likely to encounter; and
- develop policy on how often arbitrators must attend ongoing training, the circumstances under which it can be waived, and documentation of reasons waivers are granted.

[45]The official reported that although other SEC divisions receive complaint letters, the division that approves SRO rules receives the most letters dealing with employment issues.

On the basis of our review of SRO documents containing policies and standard procedures and interviews with SRO officials, we found that each SRO had taken steps to address SEC's recommendations. One or both SROs now require that CRD checks be recorded in arbitrator profiles; have an online reporting form arbitrators can use to submit updated information about themselves;[46] and have a basic training course for new arbitrators, more comprehensive training manuals, and a written policy regarding ongoing arbitrator training.

In addition, in recent inspections, SEC staff found that the procedures in place to track arbitrator performance could be improved. For example, SEC staff recommended that one or both SROs

- ensure that all pertinent information on arbitrator performance, whether negative or positive, is recorded in a central database and
- do more to address complaints of poor arbitrator performance, including, if appropriate, removing arbitrators from the active pool and better documenting actions taken in response to complaints of poor performance.

SEC staff reported that it appears from recent ongoing and completed inspections that the SROs have taken steps to address these recommendations.[47]

In general, to determine if any issues raised in past inspections remain unresolved, SEC, at the beginning of each new inspection, reviews recommendations from prior inspections. SEC is currently inspecting NASD and will report on the results, including unresolved issues, if any, within the next year. NYSE will be reexamined beginning in 2003, at which time SEC will assess what additional steps, if any, NYSE has taken to address the issues reported here.

Conclusions

SEC oversees NYSE and NASD, which regulate their member firms in the securities industry. All three are responsible for ensuring that the procedures for arbitrating discrimination and other employment disputes

[46]GAO-03-162R (Washington, D.C.: Apr. 11, 2003).

[47]In GAO-03-162R, we report that one SRO has implemented procedures making it easier to remove arbitrators from ongoing cases.

are fair and the requirements of the Exchange Act are met. Although SEC's approval of rules governing arbitration programs and its periodic inspections of these programs has resulted in improvements, there are aspects of these programs that deserve closer scrutiny.

Currently, NASD and NYSE verify the qualifications for those arbitrators who have worked in the securities industry and neither SRO verifies the information provided by nonindustry arbitrators. While we did not find instances where arbitrators provided false statements of qualifications, verifying the qualifications of all arbitrator applicants is an important step in ensuring that employees and employers receive accurate information on the arbitrators they select to hear their cases. Additionally, while SEC has reviewed both SROs procedures for evaluating arbitrator performance, we found evidence that arbitrators are not evaluated on a routine basis. Although NASD has procedures for peer, party, and staff to evaluate arbitrators and identify poor performers, these evaluations are not always completed. While NYSE officials indicated that NYSE has similar procedures and reported staff generally evaluate active arbitrators at least once a year, we were unable to confirm this information. Securities industry employees must use NASD and NYSE arbitration programs to resolve most employment disputes. Therefore, more effort should be made to verify that arbitrators meet the qualifications SROs require and to encourage parties, other arbitrators, and staff to submit evaluations more regularly, so that only arbitrators who perform adequately are maintained on SRO rosters.

Recommendations

To help ensure that all NASD and NYSE arbitrators possess the qualifications required by their SRO, we recommend that the Chairman of SEC direct NASD and NYSE to verify basic background information of all new applicants for their arbitrator rosters. We also recommend that SEC continue to review the adequacy of procedures for evaluating arbitrator performance in their next inspections at NASD and NYSE.

Agency and SRO Comments

We provided a draft of this report to SEC, NASD, and NYSE for their review. A copy of their written comments is in appendixes II, III, and IV, respectively. SEC, NASD, and NYSE also provided technical comments on the draft report, which were incorporated as appropriate.

SEC agreed with the focus of our recommendation concerning the verification of background information. However, SEC believed that in the absence of any indication that the falsification of information is a problem,

it might not be necessary for NYSE, as a smaller arbitration forum than NASD, to add this cost to the arbitration process. As a result, SEC indicated that it should be up to NYSE to decide whether the independent verification of basic background information of arbitrator applicants is needed. NASD noted that although it has had no evidence that arbitrators ever falsified information, it is planning to verify the background information on all new applicants to increase party confidence in the accuracy of arbitrator records. NASD reported that a one-time fee for arbitrator applicants would cover the cost of this procedure. NYSE reported that since it has found no proof of anyone providing false information, there is insufficient justification for independently verifying application information and adding costs to the process. In addition, NYSE believes that it has already taken steps to ensure that its application procedures are adequate, such as having applicants affirm that the information they provide is correct and requiring two recommendation letters. NYSE also indicated that counsel for employees can and do take further actions to review the background of arbitrators.

Despite concerns raised by SEC and NYSE, we continue to believe that verifying background information for all new arbitrators is an important part of ensuring the integrity of arbitration, a process required for most disputes. While adding costs to the process is a legitimate concern, NASD's approach of instituting a one-time application fee of $80 would not increase the expense of arbitration for the parties involved. Additionally, the fact that lawyers representing parties are already sometimes verifying information suggests that verification is valued and further supports the need for it to be done independently and systematically for all new arbitrators. Moreover, although our report has focused on the arbitration of employment cases, a small percentage of all the cases arbitrated in the securities industry, our recommendation will benefit all parties, since NASD and NYSE arbitrators are available for both employment and customer cases.

Concerning our recommendation that SEC continue to review evaluation procedures at SROs, SEC, NASD, and NYSE, all indicated that they understand the importance of evaluating arbitrators. Specifically, SEC agreed that evaluating arbitrator performance is a fundamental element of the arbitration process and reported that it will continue to review the adequacy of procedures for evaluating arbitrator performance during its inspections of SRO arbitration programs. NASD noted that it would strive to provide better documentation of the actions it takes in response to complaints or evaluations. NYSE reported it has a new computer system that creates a centralized, easily accessible record of all feedback and

comments from arbitrator evaluations, which will allow staff to have a more comprehensive view of an arbitrator's performance.

As arranged with your offices, unless you announce its contents earlier, we plan no further distribution of this report until 30 days after the date of this report. At that time, we will provide copies of this report to the Chairman of SEC, the President of NASD, and the Director of Arbitration for NYSE, appropriate congressional committees, and other interested parties. We will also make copies available to other interested parties, upon request. This report will be available at no charge on GAO's Web site at http://www.gao.gov.

If you have any questions about this report, please contact me on (202) 512-9889. Other contacts and staff acknowledgments are listed in appendix V.

Robert E. Robertson
Director, Education, Workforce, and
Income Security Issues

Appendix I: Scope and Methodology

This appendix provides a detailed description of the scope and methodology we used to determine (1) the characteristics and outcomes of arbitrated employment and employment discrimination disputes in the securities industry; (2) who evaluates arbitrators and what performance ratings they receive; and (3) how the Securities and Exchange Commission (SEC) responds to complaint letters it receives concerning arbitration of employment and employment discrimination cases.

Determining the Characteristics and Outcomes of Arbitrated Employment Disputes

To determine the nature and outcomes of employment and employment discrimination disputes in the securities industry, we analyzed a database containing employment disputes in which arbitration decisions had been made by NASD[1] or the New York Stock Exchange (NYSE) from January 1993 through June 2002. We obtained this database from Securities Arbitration Commentator, Inc. (SAC), Maplewood, New Jersey. SAC is a commercial research firm that maintains a database of information from publicly available records on decided cases from all self-regulatory organizations (SRO) arbitration forums, as well as the American Arbitration Association.

The SAC database contained information on arbitration awards that resulted from employee claims for damages against SRO member firms. By definition, this database did not include cases that were settled or withdrawn before an arbitration decision was reached. The 1,564 cases in the database included fields describing a range of variables, such as the name of the forum, the parties involved in the case, types of claims in the case, amounts of compensatory damages claimed, and amounts of compensatory damages awarded. Data on every variable we analyzed were not available for all 1,546 employment cases arbitrated at NASD and NYSE over the last 10 years. Our analyses of the median number of hearing sessions were based on 96 percent of the total 1,546 cases. The amounts claimed in discrimination and nondiscrimination cases, overall, were based on 84 percent of the 1,546 cases. All other analyses presented in this report were based on the total 1,546 employment cases arbitrated over the last 10 years, unless otherwise noted.

To assess the reliability of the data we received from SAC, we reviewed 100 randomly sampled cases in the database, 50 with discrimination claims

[1]NASD was formerly known as the National Association of Securities Dealers, but now goes solely by the acronym.

and 50 without discrimination claims. To verify the accuracy of the information for cases in the database, we compared this information with information in copies of the original awards for the same cases as issued by the forums or as reprinted by Lexis/Nexis. For most variables, data reliability was adequate for the analysis we conducted. We did not use any variables in the SAC database with high error rates. However, we were unable to verify that the SAC database included all cases decided by NASD or NYSE from January 1993 through June 2002.

Determining Arbitrator Performance

To determine who evaluates arbitrators and what performance ratings they receive, we first generated a list from the SAC data file of all NASD arbitrators who had decided at least 1 employment case that did not include a discrimination claim. We stratified this list of 494 arbitrators into two groups—those that had also decided at least 1 case involving discrimination during this time and those that had not decided any cases involving discrimination. We selected all 60 arbitrators from the group that had heard at least 1 discrimination case and selected a random sample of 64 of those that had not heard any and obtained NASD's files containing evaluation and rating information for each of these 124 arbitrators.[2] From the files associated with the sampled arbitrators, we extracted data on the number of evaluations, if any, these arbitrators received from the parties and/or other arbitrators in the cases they had decided and on performance ratings these arbitrators received.

Each arbitrator in our study population of 494 had a nonzero probability of being selected for our sample. In analyzing data about the arbitrators in our sample, we weighted each sampled arbitrator to account statistically for all arbitrators in the study population, including those who were not selected.

Because we followed a probability procedure based on random selections, our sample is only one of a large number of samples that we might have drawn. Since each sample could have provided different estimates, we express our confidence in the precision of our particular sample's results as 95 percent confidence intervals. These are intervals that would contain the actual population value for 95 percent of the samples we could have

[2]Our initial list contained 496 arbitrators, but we later learned that 2 of the 62 arbitrators we believed had decided a discrimination case had not, in fact, decided any cases during this time. We removed the arbitrators from the population and from the sample. Therefore, the actual study population was 494 arbitrators, from which 124 arbitrators were sampled.

drawn. As a result, we are 95 percent confident that each of the confidence intervals in this report will include the true value in the study population. The width of a confidence interval is also referred to as the sampling error associated with the estimate. Sampling errors associated with estimates from our file review do not exceed plus or minus 15 percentage points.

Determining the Content of SEC Complaint Letters

SEC tracks complaint letters in a computerized database and has logged over 12,000 from 1992 through October 2002. To determine how SEC responds to complaint letters it receives concerning arbitration of employment and employment discrimination cases, first we asked SEC staff to search its database and identify those letters that mention arbitration. SEC found that approximately 500 of the logged letters mentioned arbitration. We reviewed the content of a random sample of 100 of these letters to determine how many dealt specifically with arbitration of employment or employment discrimination claims. Out of the 100 letters, we found 16 that dealt with the arbitration of employment or employment discrimination claims. Twenty-five of the 100 letters in our sample were missing from SEC files, and the issues raised in the remaining 59 letters were either unclear or unrelated to employment cases.

Appendix II: Comments from the Securities and Exchange Commission

DIVISION OF
MARKET REGULATION

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

August 5, 2003

Mr. Robert E. Robertson
Director
General Accounting Office
Education, Workforce, and
Income Security Issues
441 G Street, N.W. - 5T57
Washington DC 20548

Re: Draft Report GAO-03-790

Dear Mr. Robertson:

Thank you for the opportunity to comment on the General Accounting Office's draft report GAO-03-790, which addresses the arbitration of employment disputes at NASD and New York Stock Exchange arbitration forums. The draft report provides helpful discussion of issues surrounding the administration of employment disputes.

In the draft report, GAO addresses the varieties of employment disputes that parties bring to NASD and NYSE arbitration forums, actions the two self-regulatory organizations have taken to provide fair procedures for the parties, as well as the Commission's oversight of the process.

GAO has concluded correctly, we believe, that ultimately the success and fairness of the arbitration process comes from the strength of the arbitrator pool. Accordingly, we agree with the focus in the draft recommendations on arbitrator qualifications and evaluation. The draft calls for the SROs to take additional steps to verify basic background information provided by applicants for their arbitration rosters, and for the Commission to continue to include in its oversight work attention to arbitrator evaluation.

We note that NASD – which administers the largest securities arbitration forum – has filed with the Commission the proposed rule change, which it discussed with GAO, to address verification of arbitrator qualifications. NASD's proposal reflects a judgment made by its Board that routine verification of basic arbitrator application data would improve its parties' confidence in their arbitrators. The proposal, if approved by the Commission, would impose the cost of verification on arbitrator applicants. At the same time, in the absence of examples of false statements of qualification, it is reasonable to permit smaller arbitration forums to assess independently benefits and costs of verifying the application data. We have found that it is beneficial to the parties to have a choice among a variety of arbitration forums. Given competing demands on their budgets, it may not be necessary for all of the smaller forums to

formalize verification. Nevertheless, we intend to share your recommendation with all of the smaller arbitration forums, and to ask NASD to advise them of its experience under the new procedure.

As GAO recognizes in its draft report, Commission staff inspections of SRO arbitration programs already focus on SRO procedures for evaluating arbitrator performance. The staff closely reviews party, peer and staff evaluations, along with the SROs' procedures for tracking and following-up on evaluations of arbitrator performance. We agree with GAO that evaluating arbitrator performance is a fundamental element of the arbitration process, and will continue to review the adequacy of procedures for evaluating arbitrator performance during future inspections of SRO arbitration programs.

Thank you again for the opportunity to comment on the draft report. We request that GAO include a copy of this letter in the final report.

Sincerely,

Annette L. Nazareth
Director

Appendix III: Comments from NASD

Linda D. Fienberg
President, Dispute Resolution
Executive Vice President and Chief Hearing Officer, Regulatory Policy and Oversight

August 6, 2003

Mr. Robert E. Robertson
Director, Education, Workforce, and Income Security Issues
U.S. General Accounting Office
441 G Street, N.W.
Washington, D.C. 20548

Re: *EMPLOYMENT DISPUTES Recommendations to Further Ensure that Securities Arbitrators are Qualified*

Dear Mr. Robertson:

Thank you for the opportunity to comment on the GAO Report (GAO Report or Report) to Representatives Dingell and Markey regarding the review of securities industry employment disputes. NASD considers the resolution of employment disputes to be an important part of the services we provide, and we appreciate the acknowledgement in the Report of NASD's policies and procedures intended to ensure fair arbitration for all cases.

The GAO Report covered two primary areas:

1. Expanded steps to verify arbitrator qualifications; and
2. Measures to enhance procedures to evaluate arbitrator performance.

We respond below to the GAO's findings in each area and describe numerous initiatives NASD has implemented to improve our arbitration forum. We highlight the actions already taken to implement the GAO recommendation regarding background verification and discuss NASD actions to improve collection of arbitrator evaluations from parties, peer arbitrators, and staff.

Executive Summary

NASD is committed to providing a fair and efficient forum for the resolution of discrimination claims and other employment disputes. Although the GAO Report covered a period of 10 years, the most significant changes in the arbitration of securities industry employment disputes have occurred more recently. NASD requires arbitration of regular employment disputes such as compensation claims and will arbitrate statutory employment discrimination claims when employees and firms agree to arbitrate such disputes before or after a dispute occurs. We have implemented numerous measures in the past several years to improve our process for resolving employment disputes and to enhance due process procedures for employment discrimination matters. In addition, we have adopted special qualification requirements for arbitrators serving on discrimination cases and adopted other enhancements.

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We have already filed with the Securities and Exchange Commission (SEC) a rule proposal (NASD-SR-2003-122 on August 5, 2003) to begin background verification for arbitrator candidates. We also have plans to supplement our current efforts to encourage arbitrator evaluations by parties and peer arbitrators by offering new tools to facilitate submission of those evaluations.

Previous Employment Rule Changes

In August 1997, the Boards of NASD Regulation and NASD ("NASD Boards") submitted a proposal that removed from the NASD Code of Arbitration Procedure provisions requiring registered persons to arbitrate claims of statutory employment discrimination. That rule change was approved by the SEC, and became effective for claims filed on or after January 1, 1999. The amended rule provided that associated persons no longer would be required, solely by virtue of their association or their registration with NASD, to arbitrate claims of statutory employment discrimination. Associated persons were still required to arbitrate other employment-related claims, as well as any business-related claims involving investors or other persons.

In conjunction with this rule change, the NASD Boards recommended certain enhancements to the voluntary arbitration process for employment discrimination claims. To carry out the Boards' mandate, NASD staff assembled a working group, including attorneys representing employees, general counsels of member firms, and arbitrators with expertise in employment matters, to advise on issues relating to the arbitration of employment discrimination claims. In addition to several issues presented to them by NASD staff, the working group considered recommendations contained in a document known as "A Due Process Protocol for Mediation and Arbitration of Statutory Disputes Arising Out of the Employment Relationship" ("the Protocol"). The NASD Boards recommended that the working group consider due process procedures similar to those in the Protocol. As a result of these initiatives, NASD, in 2000, further amended its Rules to enhance the dispute resolution process for the handling of employment discrimination disputes, and to expand disclosure to employees concerning the arbitration of all disputes.

These rules, as approved by the SEC, deal with the qualifications of arbitrators hearing claims of employment discrimination; the number of arbitrators to hear such claims; special rules for discovery, awards, and attorneys' fees; coordination of claims filed in court and arbitration; and disclosure to associated persons of the effects of the arbitration clause found in the Form U-4[1].

This series of rule changes has resulted in a reduction of employment cases in NASD's forum, particularly matters involving employment discrimination claims. Since 2000, the number of cases involving employment discrimination claims has averaged fewer than 50 per year. Although there are relatively few of these claims filed in the NASD forum, we believe that arbitration and mediation are extremely effective means to resolve employment disputes. Indeed, the majority of all matters in NASD's forum are resolved between the parties through direct negotiation or through mediation.[2] In addition to the decided matters in which employees

[1] Individuals must sign and submit Form U-4 to become registered with a Self Regulatory Organization (SRO) such as NASD. The U-4 Form contains a requirement that the applicant agree to arbitrate any dispute, claim, or controversy that is required to be arbitrated under the rules, constitution, or by-laws of the SRO.

[2] In 2002, parties settled 56 percent of all cases closed either through direct negotiation or through mediation. Employment cases follow a similar pattern.

recovered damages, numerous other matters were settled between the parties through direct negotiation or mediation.

The GAO Recommendations

I. Verification of Arbitrator Qualifications

Since at least 1990, Dispute Resolution has used the Central Registration Depository[3] (CRD) system to verify background information of all arbitrator candidates affiliated with the securities industry. In addition, NASD has taken numerous measures to assure the completeness and accuracy of arbitrator background information provided to parties. The GAO noted many of these on page three of its November 9, 2000 GAO Report entitled: *Procedures for Updating Arbitrator Disclosure Information:*

> *"NASD-DR* has taken actions to help ensure that arbitrators submit updated background information. After arbitrators become enrolled in the program, NASD-DR officials told us NASD-DR repeatedly reminds arbitrators of the obligation to update background information. For example, NASD-DR's arbitrator training materials note that each time arbitrators are appointed to a case, they are to review their disclosure reports for accuracy and update them as necessary. Other NASD-DR materials provided to arbitrators-the Arbitrator's Reference Guide, the Code of Arbitration Procedure, and the Arbitrator's Manual-also contain discussions of required disclosures and the obligation to update background information. In addition, NASD-DR officials stated that in the NASD-DR newsletter-called The Neutral Corner, which it sends to all arbitrators free of charge-NASD-DR regularly places reminders about their duty to provide updated disclosure information.
>
> NASD-DR has also used other measures to further ensure that arbitrator background information is up to date. In 1992, and again at the end of 1998, NASD-DR surveyed its pool of arbitrators to review and verify the accuracy of information on their backgrounds."

In 1999, the staff updated the records of over 6,500 arbitrators based on the arbitrators' responses to a November 1998 questionnaire. Arbitrators who failed to respond to the questionnaire were subsequently dropped from the roster. NASD Dispute Resolution also has implemented regular audits to ensure that the staff inputs important updates provided by arbitrators in a timely manner.

Additional NASD Initiatives
As indicated above, NASD Dispute Resolution has long recognized the importance of updating its arbitrator records in a timely and accurate manner. We believe that when parties consider an arbitrator for possible service, they have a fundamental right to arbitrator information that is up-to-date, correct, and relevant. To address this issue further, NASD Dispute Resolution took the following actions to supplement its existing efforts:

1. *Centralization of the Roster Maintenance Function.* Beginning in Fall 2000, the Department of Neutral Management (DNM), located in New York City, became

[3] The CRD system, which is operated by NASD's Regulatory Services and Operations Division, is the registration and licensing system for the United States securities industry and its federal and state securities regulators and SROs. NASD and the North American Securities Administrators Association (NASAA) jointly administer the CRD system.

solely responsible for updating and revising arbitrator records. We believe this change made the process easier to control and reduced the possibility of errors.

2. *On-line Update Form*: Since November 1, 2000, arbitrators have been able to update their records on-line via NASD Dispute Resolution's Web Site. An easy, step-by-step form allows arbitrators to update their information and to submit it electronically[4] to the DNM.
3. *Arbitrator Disclosure Reports*: Since November 1, 2000, NASD has been giving arbitrators serving on three-person panels a copy of the disclosure reports of their fellow arbitrators. This helps arbitrators have a better understanding of the expertise and background of the people with whom they are serving, and also encourages panel members to consider the disclosures made by other arbitrators and to make similar disclosures themselves.

NASD Dispute Resolution has undertaken an ambitious project to redesign completely its legacy computer system. We will implement this new system in phases over the next few years, and will create a web-based gateway for parties, counsel, arbitrators, mediators, and staff. The new system will provide for on-line filing of claims, pleadings, and correspondence, as well as on-line scheduling of hearings and selection of arbitrators and mediators. It will enable neutrals to access the data we maintain for them on our system and to update their own records.

Last year, even though there was no evidence that individuals were falsifying information in order to become approved as arbitrators, NASD felt that additional efforts to verify arbitrators' background information would increase the confidence of parties and counsel in the accuracy of arbitrator records. Accordingly, Dispute Resolution resolved in the Fall of 2002 to implement by January 2, 2003 procedures to verify the following information provided by new applicants to the Dispute Resolution roster of arbitrators:

- Federal and County criminal records,
- Employment information, and
- Professional licenses.

Because of our intent to pass on the cost of verification to applicants, the SEC advised us that we would need to make a rule filing to seek approval of this new procedure. Therefore, Dispute Resolution obtained the approval of the NASD National Arbitration and Mediation Committee at its meeting on February 13, 2003, and the approval of the Dispute Resolution Board of Directors at its meeting of April 23, 2003. NASD filed with the SEC (NASD-SR-2003-122) the verification rule proposal on August 5, 2003.

II. Initiatives Related to Arbitrator Evaluations

NASD recognizes the critical importance of evaluating the performance of arbitrators. We seek to maintain the quality of our roster by continuously reviewing the performance of our neutrals. On a quarterly basis, NASD staff members gather all evaluations from parties and from peers and consider whether to remove certain arbitrators from the roster. Staff observations of the arbitrator's performance and any complaints received about a particular arbitrator are also

[4] Arbitrators may also print the form, complete it by hand, and fax or mail it to the Department of Neutral Management.

considered. NASD has removed arbitrators from the roster due to poor evaluations, lack of training, failure to provide complete and accurate disclosures, and other reasons.

In order to make appropriate determinations to maintain the quality of the arbitrator roster, we need the input of our customers. NASD has tried many methods to encourage parties and peers to complete evaluations. For example, in 1997, NASD implemented new party evaluation forms. The initial party and representative response to the new forms was favorable in terms of both the number filed and the valuable feedback received. This early success was due in large part to the procedure of asking presiding chairpersons to distribute the new questionnaires at the conclusion of the last evidentiary hearing and to encourage the parties or their representatives to participate voluntarily. At that time, NASD also revised the Hearing Procedure Script to remind the chairperson to make this important request of the parties. These efforts resulted in a temporary increase in the number of evaluations returned but parties and counsel are not always willing to take the time to submit evaluations. NASD staff members take every opportunity, during focus groups, in regular meetings of the Securities Industry Conference on Arbitration, the Public Investors Arbitration Bar Association, and the Securities Industry Association, and in individual meetings with attorneys, to remind regular participants in our forum to complete evaluation forms. In addition, NASD regularly reminds arbitrators of the importance of completing the peer evaluations through correspondence, in numerous articles in *The Neutral Corner*, and in individual conversations.

As of July 28, 2003, the party and peer evaluation forms are available to download from the NASD Web Site as part of the case-related materials provided for parties and arbitrators. In addition, during the first half of 2004, we are planning to implement evaluation forms that parties and arbitrators can fill out on-line. This should provide greater access to the forms, and facilitate collection and recording of party and peer evaluations.

NASD also is committed to continue to improve record keeping of evaluations and of follow up actions. NASD takes every complaint or evaluation seriously and we promptly investigate any claim of improper conduct. As suggested by the GAO, we will strive to provide better documentation of the actions we take in response to complaints or evaluations.

Conclusion

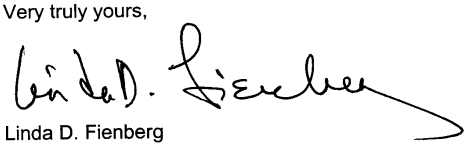
NASD believes that arbitration and mediation are fair and effective means of resolving employment disputes. We are keenly aware of the importance of the parties' perception of fairness and of their confidence in the process. Thus, we have taken significant steps to ensure that arbitrator background information is complete and accurate and have implemented measures to enhance the parties' confidence in our forum through the verification of arbitrator background information.

NASD also understands the importance of evaluating arbitrator performance. Staff provides part of this monitoring through participating in initial prehearing conferences, attending hearings when matters are brought to their attention, and conducting conversations with arbitrators. However, we also rely heavily on parties and peer arbitrators to provide signals about arbitrator performance. In addition, we monitor complaint letters, conduct focus groups, and elicit comments during informal meetings and at Dispute Resolution public presentations. We have great confidence in the qualifications and skills of our arbitrator roster. Nevertheless, when

there are problems, we want to identify them early and address them through education, counseling of individual arbitrators, or, when necessary, removal from the roster.

We are pleased that the many steps we have taken to improve our procedures have been effective; we will continue our efforts to maintain a fair and efficient process for resolving employment disputes. Thank you for the opportunity to respond to the GAO Report and to work with your staff to help fashion responsive initiatives. If you have any questions or require further information, please contact me at (202) 728-8407.

Very truly yours,



Linda D. Fienberg
President

cc: Clarita Mrena - GAO
Margaret A. Holmes - GAO
Robert Love - SEC

Appendix IV: Comments from the New York Stock Exchange

Robert S. Clemente
Director
Arbitration

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August 11, 2003

Robert E. Robertson
Director
Education, Workforce and Income Security Issues
U.S. General Accounting Office
441 G Street, NW -- Room 5928
Washington, DC 20548

Re: Draft GAO Report 03-790 -- *Employment Disputes: Recommendations to Further Ensure that Securities Arbitrators are Qualified*

Dear Mr. Robertson:

The New York Stock Exchange, Inc. ("NYSE") appreciates the opportunity to provide comments on the above-referenced draft GAO report, a copy of which you emailed to me on July 15, 2003 ("the draft report"). We also discussed some of the general points in this letter with your colleagues Margaret Holmes and Clarita Mrena during a conference call last week, and we are mindful of the time and effort that GAO staff have devoted to seeking information from NYSE relating to its arbitration program.[1]

The draft report recommends that NYSE and NASD be directed by the SEC to verify the qualifications of all applicants for arbitrator positions. For the reasons detailed below, NYSE believes that, for NYSE, the costs of additional verification of the arbitrator pool significantly exceed the benefits that would be gained. Accordingly, we respectfully request that GAO consider and implement the comments in this letter and in the enclosed marked pages of the draft report (a copy of the marked pages also was emailed to Ms. Holmes on August 5, 2003). Doing so, we believe, will enable GAO to provide a fuller and more accurate account of the current requirements and procedures relating to the qualification and evaluation of Exchange arbitrators.

* * *

Because the draft report's title and overall focus relates to arbitrated employment disputes, NYSE initially notes the important fact that employment disputes constitute a very small percentage of its arbitrations, and *discrimination* arbitrations initiated by employees are a particularly small subset of those filings. In 2000, only 18% of the arbitration filings at NYSE were initiated by employees; in 2001, that number dropped to 13%; and in 2002, the figure

[1] In response to specific requests from GAO staff, NYSE provided information and/or documents – including the materials referenced in this letter – on or about August 27, 2002; November 21, 2002; January 17, 2003; February 7, 2003; February 26, 2003; and March 7, 2003.

dropped further to 8.7%. Discrimination claims are a tiny subset of this subset: they constitute less than 1% of all arbitration filings since 2000, and during 2003 only one employment discrimination claim has been filed. The draft report correctly notes the diminished filing of employment discrimination claims at NYSE since it amended its Rule 600 (in late 1998) to provide for arbitration of statutory discrimination claims only upon agreement of the parties after the dispute arises. Since that amendment, the majority of employment dispute NYSE arbitrations have been claims filed by NYSE member firms against their employees or former employees. These claims are generally contractual disputes based upon an employee's failure to repay a promissory note or training costs. Accordingly, they generally do not require arbitrators to have expertise in and apply state or federal employment laws.

Regardless of the subject matter of the dispute, NYSE is committed to providing a fair and efficient dispute resolution forum. However, verifying the qualifications of all applicants for arbitrator positions seems to be directed at solving a problem that does not exist. NYSE is not aware of any complaints by parties or counsels that arbitrators misrepresented their qualifications or that a particular proceeding or award was compromised on that basis. Additionally, the Exchange itself is aware of no instances where an applicant has submitted false information.

The absence of such complaints may reflect the fact that considerable background information must be disclosed before an individual is even appointed to NYSE's list of eligible arbitrators, or selected for a specific case. To become eligible to serve as an NYSE arbitrator, an applicant must first submit a biographical and disclosure form, known as an "NYSE Arbitrator/Mediator Profile."[2] The profile requires detailed information regarding the applicant's educational background, employment history, disciplinary or regulatory background, and any affiliations with the securities industry. The form also inquires as to additional qualifications that make the person competent to serve as an arbitrator, including experience in alternative dispute resolution or the completion of an arbitrator training program. Applicants swear or affirm that the information provided is "true and complete" to the best of their knowledge.[3]

The overwhelming majority of employee-parties in NYSE arbitrations are represented by counsel, typically highly experienced practitioners, who can and do "make further inquiry of the Director of Arbitration concerning an arbitrator's background." (Exchange Rule 608.)[4] In addition, counsel often conduct their own independent due diligence and verification of qualifications, although arbitrators generally are from the same community as, and their qualifications already may be known to, the parties and/or counsel. Thus, in addition to the current mechanism for assuring the quality of the arbitrator pool itself, the process embodies a "last chance" qualification check by those most interested in quality assurance, the very parties to an arbitration.

Turning to the question of costs, note that verification of all qualification-related information would entail a more detailed background check, involving records possessed by employers,

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[2] This form is available at www.nyse.com/pdfs/profile2.pdf.
[3] Additionally, as the draft report notes, an applicant must submit two letters of recommendation. The letters – from two members of the applicant's community, field, or profession – must contain the length of time the writer has known the applicant and under what circumstances; a description of the experience the applicant possesses that qualifies him or her to serve; and an attestation as to the character and fitness of the applicant. In many instances, recommendations come from current NYSE arbitrators or other persons known to NYSE.
[4] Potential arbitrators who refuse to respond to further inquiries are subject to disqualification for cause.

educational institutions, and/or licensing authorities across the country. Regardless of who bears those costs – the parties through higher fees, NYSE's constituents by increasing NYSE's subsidy to its arbitration program, or the arbitrator applicants – NYSE believes they ought not to be borne in the absence of a more compelling case for greater verification of pool quality.

With respect to evaluation of arbitrator performance, we are pleased that the draft report acknowledges some of the steps NYSE has taken to improve its policies, in part in response to prior SEC recommendations. Specific recent enhancements to NYSE's evaluation of arbitrators include its implementation in 2003 of new software which allows for a centralized, easily accessible record of all feedback and comments from arbitrator evaluations, listing the type of evaluation based on its author (party, peer or staff). Prior enhancements enabled NYSE to note the need (if any) for remedial action, as well as the steps taken to improve the particular arbitrator's performance. In addition, NYSE revised its arbitrator evaluation forms to include specific questions regarding arbitrator performance. Also, NYSE has directed chairmen of arbitration panels to specifically include in their opening and closing statements comments encouraging the parties and counsel to submit evaluations.

NYSE continuously monitors and upgrades arbitrator qualification, evaluation and training. In addition to formal evaluations, NYSE Arbitration staff receive informal feedback from arbitrators, parties and counsel, and regularly attend or conduct dispute resolution and arbitrator training seminars. Additionally, the Director of Arbitration attends conferences of the Securities Industry Conference on Arbitration, which is a cooperative effort on the part of the securities industry, the SROs, and the public – working with the SEC – to implement a uniform system of arbitration, to monitor that system, and to change it as appropriate or required.

With respect to compliance with prior SEC recommendations and general improvements to its arbitration program, NYSE is monitored not only by periodic SEC and other government inspections and inquiries, but also by NYSE's own Regulatory Quality Review Department ("RQR"), which is part of NYSE's Division of Corporate Audit and Regulatory Quality Review. RQR functions independently with its own audit staff and regularly reports to NYSE's Board of Directors. RQR currently is engaged in a review of arbitrator qualification, selection, evaluation and training, in part to review compliance with a prior RQR examination and prior SEC recommendations on these subjects. The conduct of follow-up reviews on matters raised by GAO and the SEC are part of the NYSE Board's charge to RQR, and RQR has indicated, for its current review and for its ongoing arbitration review program, that it will focus on these issues.

* * *

NYSE will continue to work with the SEC, arbitrators, parties, counsel, and other industry participants to improve NYSE's arbitration program, including implementing rational and cost-effective enhancements to arbitrator qualification and evaluation.

Again, we appreciate your consideration of NYSE's comments. If you have any questions, please do not hesitate to contact me.

Sincerely yours,

Robert S. Clemente

Enclosures

Appendix V: GAO Contacts and Staff Acknowledgments

GAO Contacts

Clarita A. Mrena (202) 512-3022
Margaret A. Holmes (202) 512-3283

Staff Acknowledgments

In addition to those named above, Susan S. Pachikara, Joan K. Vogel, and Sidney H. Schwartz made significant contributions to this report.

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