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SIFMA: Ending Mandatory Arbitration Will Hurt Individual Investors.

The Investor Choice Act of 2013 is the latest in a series of attacks on securities arbitration at the state and federal level. Introduced last month, the bill would ban broker-dealers and investment advisers from specifying in their agreements with clients how future disputes between them should be resolved, whether by arbitration or in court.

Unlike prior bills, however, this one would destroy the existing fair, well-functioning dispute resolution process by turning it into a lawyers' free-for-all, driven by strategic gamesmanship rather than common sense. The bill would give investors the unilateral right after a dispute arises to force firms into either court or arbitration, or perhaps even both at the same time, depending on where the client's lawyer thought he or she could extract the biggest payday.

Individual investors with modest-size claims in search of prompt, low-cost dispute resolutions could well be sacrificed on the altar of greed if false promises of mind-boggling jury awards led them astray.

Investor choice, much like investment risk, has both upside and downside potential.

One downside is that one person's choice may adversely affect others in a manner that imposes greater burdens and costs on everyone. Another downside is that people may choose incorrectly, leaving them worse off than they would have been if they had followed the time-honored path.

Choice for its own sake isn't always a benefit. The bill is ill-conceived because it assumes that it is.

Perhaps the bill's saving grace is that it is so brazen in its overreach that it actually highlights certain bigger-picture issues and clarifies what "choices" really are at stake.

First, the securities arbitration system works.

There is no longer any serious debate that securities arbitration is faster and less expensive than court and that investors fare well in it, recovering through settlements or awards in the vast majority of cases. The statistics on the Financial Industry Regulatory Authority Inc.'s website bear this out.

The bill's proponents don't seriously contest these points. Arbitrator selection and rulings are consistently fair and transparent.

Multiple regulators oversee the system and maintain its focus on investor protection and fairness. Problems are promptly addressed, and rule changes are approved by a committee of practitioners from all constituencies.

Second, the system is premised on "mandatory" arbitration.

Finra rules grant clients the right to require broker-dealers to arbitrate disputes with them if the clients elect to do so. Firms secure the same right for themselves by including arbitration clauses in client contracts.

Thus most broker-dealer client contracts include arbitration clauses so that all parties know in advance that any dispute that does arise will be dealt with on a level playing field.

If mandatory arbitration is banned, then the Finra rule that compels broker-dealers to arbitrate will have to be re-examined and probably repealed. The Catch-22 is that without the Finra rule and without an arbitration clause in the client contract, both the firm and the client would need to agree — post-dispute — to arbitrate.

That is highly unlikely to happen, because after a dispute arises, tactical considerations for one party or the other will lead to refusals to arbitrate, leaving court-based litigation as the default.

If the bill were to pass, and the Finra rule remained, the Catch-22 for investment adviser clients would become even worse. They would have virtually no access to arbitration, as there is no comparable Finra rule that compels investment advisers to arbitrate at the client's election.

This would create an even more uneven playing field for clients, brokers and financial advisers at a time when harmonization is the stated goal.

Third, the issue is legal parity and fairness, not "investor protection." The bill seeks to strip firms of the contractual freedom to name a commercially reasonable dispute resolution forum at the outset of the client relationship.

Firms rely on dispute resolution clauses to provide certainty to all parties and to control dispute costs. Without such clauses, dispute resolution would be much more costly and time-consuming for all parties.

Financial services clients don't have a "right" to their choice of dispute resolution forum. When a dispute arises, both parties have legal rights that are entitled to equal protection.

Clients are entitled to adjudicate their claims in a fair forum that provides due process. Both securities arbitration and court afford these same protections.

Finally, unilateral post-dispute client choice generally would be a disservice to investors. If the bill passed, securities arbitration as a fair and effective dispute resolution process would die a gradual but sure death.

Post-dispute choice of forum would be governed by tactical advantage. Court would be the default and the norm, to the particular detriment of investors with small claims or a need for expeditious resolution.

Moreover, parties would be left with a confusing, bifurcated regime where some cases, and perhaps even some claims, went to court and others went to arbitration. The resulting smaller caseload in arbitration would downsize the forum, perhaps drastically, resulting in higher costs and delays for investors.

Investors by their own choice, or on the advice of their lawyers, would inevitably and perhaps frequently choose unwisely by opting to litigate cases and claims that were better suited to arbitration. How many court systems can demonstrate, as Finra can, a track record of concluding cases within an average of 15 months, with most claimants receiving payments in resolution of their claims?

For customers who choose court, their ability to collect a judgment promptly could be compromised. Finra arbitration rules, on the other hand, require brokers to pay awards within 30 days or face sanctions.

The prospective benefit offered by the bill — granting investors a license to try to game the dispute resolution system to exact their highest return — is grossly outweighed by the costs and inefficiencies that all parties would bear, but none more so than individual investors.

If the arbitration process needs to be changed, as it has been routinely over the years, then reasonable people familiar with the process should sit down and work together to improve it. Such people meet on a regular basis every few months to do just that.

Recklessly destroying the process in the name of "choice" isn't the answer for investors or anyone else.

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