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2013 AWARD SURVEY: A CYCLE IN PERSPECTIVE

A SAC Award Survey Comparing Results in 2013 to 2007-2012

INTRODUCTION

The last several years have seen the securities markets riding a rollercoaster, courtesy of the 2007 credit crunch, financial adventurism that seems foolhardy in retrospect, a 2008 crash and the deepest economic recession since the Great Depression. Indeed, if the news events of the recent past are any indication, stomach-churning market volatility is not yet entirely a thing of the past. Still, we are finally enjoying some hopeful signs of economic recovery.

If the stock market's journey up and down from day to day is often unsteady and unpredictable, securities arbitration has followed a necessarily related, but more predictable and shallower, arc. The truth is that investors are more likely to notice – or at least, complain about -- unsuitable strategies and insufficient warnings of risk when they lose money on their investments. Seven years ago, arbitration filings were on the decline, as cases fueled by the 2000 "tech-wreck" crash dissipated.

They reached their nadir in 2007 and, then, as angry investors inexorably responded to the effect of the financial debacle on their pocketbooks, the rate of filings quickly picked up. New case submissions more than doubled in the space of two years. However, even in 2009, the numbers never matched the previous twenty-first century highs of 2002-04.

Then, the number of new arbitrations gradually slid downward after 2009. Indeed, 2012 was the second most anemic year in the last 15 and the new case totals in 2013 drew even closer to 2007 levels.

Almost all of those cases for the last several years have been filed in the Financial Industry Regulatory Authority (FINRA), which has had a near monopoly in handling securities arbitration dispute resolution, since the forum emerged from a merger of the regulatory functions of the National Association of Securities Dealers (NASD) and the New York Stock Exchange (NYSE). Those two regulatory giants were previously the two leading securities arbitration forums in the country, when the two became one on July 29, 2007. According to FINRA's own statistics, the number of filings bottomed out in 2007 (3,238 cases), then quickly spiked in 2009 (7,137), before sliding down again.

Interestingly, this drop actually resembled the parabola of a roller coaster: at first, the decline was almost as sharp as the rise (5,680 in 2010 vs. 4,982 in 2008), but the angle of descent became shallower in succeeding years, falling by fewer than 1,000 filings in 2011 (4,729) and by even fewer in the next two years (to 4,299 in 2012 and 3,714 in 2013). It is too soon to know whether the sequence has, indeed, reached the bottom again, but comparison figures for the first four months of FINRA-DR filings in 2014 reveal an 11% increase.

In short, the last seven years has seen an entire cycle of arbitration filings. It seems an appropriate time to take stock of securities arbitration generally, something we have not done in five years. While each case must follow its own course before a panel of arbitrators resolves it by issuing an Award, we review the Awards overall to identify statistical trends and make generalized

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observations about the trends and and anomalies that we encounter.

In doing so, we must keep in mind that it takes more than a year for the average arbitration to wend its way to an Award, so the cycle of Awards in this survey will lag behind the filing cycle, even as it matches its step. Moreover, many of those cases will never become Awards, as they will settle or be withdrawn along the way. Because data about those matters, which constitute about 75-80% of the whole, are not collectively known, we must be cautious in assuming that our observations about the Awards bear relevance to the nature of the whole.

Methodology & Caveats

This year's review follows mostly the normal presentation path we followed in our Award Surveys in 2006 (2007 SAC 2(1)) and in 2008 (2009 SAC 1(1)), but with some notable changes. We generally exclude Stipulated Awards from our Survey numbers. Stipulated Awards are not the product of arbitration decisions on the merits of a dispute, but of negotiations between the parties that are memorialized in an Award, in order to secure one or another aspect of the settlement agreement (e.g., expungement relief or installment payments).

In determining "win" rates, readers should understand that we count as a "win" any monetary award assessed by the arbitrators (other than fees and costs). Those upset with the inflationary effect that may have on the "win" results may find company with those of another camp who object to the deflationary features of our "recovery" rate analyses. Ultimately, we must base our calculations on figures disclosed in the Awards. Thus, if an employee makes an outrageous claim for "compensatory" damages stretching from the date of his/her termination through the rest of his/her working years, we honor that assessment and include it as the denominator over which we place the numerator of dollars awarded.

Dollars awarded, we should disclose, include all amounts assessed by the arbitrators, other than fees, costs and sanctions. That may seem like a comparison of apples to oranges to the purist, but it is the most practical approach, given the information available in the Awards, and it "compensates" somewhat – only by a fraction – for the excesses in the claims figures. To adjust for these imperfections, to the extent we can, we present both average recovery rates and median recovery rates. The latter has a mitigating impact on the outliers for the total statistical results, especially with smaller samples. In very large samples, we find the average recovery rate to be the more representative of true expectations.

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In calculating the recovery rate, we include only those Awards in which the claimant recovers some monetary damages. Since the purpose of the recovery rate is to measure how generous arbitrators are when they do award damages, including losses in the calculation would subvert that purpose and depress the recovery rate. Furthermore, it would make the recovery rate partially dependent on the win rate, instead of serving as an independent yardstick.

In past surveys, we produced separate charts for Customer-Member recovery rates and for Employee-Member recovery rates (the latter of which also included a repetition of the calculations of Employee-Member win rates, taken from another table). This treatment was partially justified by the fact that we excluded claims of more than $1 million from our sample of Customer-Member Awards, but had no such limitation in the table on Employee-Member Awards. Another reason for the separation, however, was that we measured median recovery rates for Customer-Member Awards issued in the three states that traditionally included the largest number of Awards – California, Florida and New York.

In 2013, because of the decline in Award totals, the number of Awards issued in these top states numbered only a dozen each, not enough to offer meaningful statistics (in fact, the median recovery rate for Florida Awards exceeded 100% in that year, thanks to three punitive damage awards, and the median recovery rate for California Awards exceeded 90%). In this survey, therefore, we are excluding individual states and combining Customer-Member and Employee-Member recovery rates in a single chart. The top states are now covered in a separate chart.

The Charts that follow number five. Charts 1-4 – of which all but Chart 3 appear as did analogous Charts in SAC's prior surveys – seek to compare Award results on a yearly basis from 2007 to 2013. Chart 5 covers the entire period in aggregate from the perspective of selected states. Our commentary covers the same territory as the Chart on which it is commenting, although it takes a broader perspective in time. More specifically, the Charts approach the Awards in the following manner:

Chart 1 -- Award Volume, Distribution & Win Rates: Four categories of Awards form the Chart's columns (Customer/ Member, Small Claims, Member/ Employee and Employee/Member). The Chart shows the reader the "win" rates for each category, plus the changing Award volume over the years and the distribution of Awards among these major categories.

Chart 2 – Small Claims Awards, Win Rates: Customer-initiated cases involving $25,000 or less will proceed "on the papers," unless the customer opts for a merits hearing. We look at how frequently Small Claims investors are represented by counsel and how often customers opt for a hearing. Do these variables have an impact on "win" rates? This Chart addresses such possibilities.

Chart 3 – Recovery Rates: CustomerMember (<$1M) and Employee-Member Awards: By limiting the range of Customer-Member compensatory claims to cases involving more than $25,000, but not more than $1 million, this Chart seeks to define the usual (calculated by both the median and average) recovery an investor can expect in securities arbitration. This focus also permits a more reliable look at yearly comparisons over the seven-year period, because that has been our approach in past Award Surveys. We concede, at the same time, that claims are inflating and a larger segment of the Awards are being excluded by the dollar limitation. In 2013, for instance, Awards exceeding $1 million in compensatory claims accounted for one-quarter of all Customer-Member Awards.

Employee disputes with former employers over compensation, hiring and firing decisions, and account transfers form an array of disputes within this one category. However, because there are fewer Awards in this category, and unlike our practice with Customer/ Member Awards, we calculate only the median recovery rate and include all Employee/Member "win" Awards in doing so.

Chart 4 – Total Amounts Awarded: This Chart returns to the four categories in Chart 1 and provides data about the aggregate amounts awarded in each category and how much of the total was comprised of punitive damages awards and attorney fee assessments.

Chart 5 – Customer-Member Awards in the Top Ten States: This Chart differs from the others by breaking down the results of Charts 1 and 3 for Customer-Member Awards, not by year, but by state -- more specifically, the ten states with the largest number of Customer-Member Awards (other than stipulated Awards) in the survey period. The Chart provides an opportunity to compare Award totals and win rates for all Customer-Member Awards and median recovery rates of Customer-Member claims in the $25,000-$1 million range between the identified states and with the national total.

CHART 1 – TOTALS, TYPES & TALLIES

Customer-Initiated Awards

Customer claims have, not surprisingly, been the driving force in most of the changes in Award frequency. When investments go down, customer complaints go up and the securities arbitration mill gets grinding. However, the effect is not instantaneous; even if a customer files the day he suffers as loss, he or she must wait while the case goes through pre-hearing proceedings and a set of evidentiary hearings before a panel issues an Award on the merits.

In 2007-08, even as the waters of financial turmoil raged through the securities markets, the number of contested Customer/Member Awards – those resolving claims of more than $25,000 by customer against broker-dealers – continued to plummet, as it had since its 21st Century high of 1,600 in 2004, falling from 582 in 2007 to 370 in 2008. At that point, however, the numbers bottomed out and then sharply rose, from 396 in 2009 to a new peak of 616 in 2010, before

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AWARD VOLUME, DISTRIBUTION & WIN RATES
BY TYPE OF DISPUTE & YEAR (2007-2013)

YEAR	CustomerMember Win/All (#) Win Rate (%)		SmallClaims Win/All (#) Win Rate (%)		All Cust. Wins	MemberEmployee Win/All (#) Win Rate (%)		EmployeeMember Win/All (#) Win Rate (%)	
2007	217/582	37%	36/124	29%	36%	161/200	81%	74/166	45%
2008	158/370	43%	45/111	37%	42%	135/162	83%	72/171	42%
2009	201/396	51%	97/244	40%	47%	185/204	91%	59/145	41%
2010	323/616	52%	83/202	41%	50%	264/286	92%	75/153	49%
2011	228/486	47%	47/130	36%	45%	346/377	92%	74/167	44%
2012	206/437	47%	42/121	35%	44%	266/291	91%	52/136	38%
2013	153/350	44%	49/142	35%	41%	282/315	90%	55/160	34%
All years Combined	1486/3237	46%	399/1074	37%	44%	1639/1835	89%	461/1098	42%

Notes to Chart 1:
!. Stipulated Awards are excluded from the numbers.
2."CustomerMember" Awards describe disputes by complaining customers against broker-dealers that involve $25,001 or more, while "SmallClaims" Awards identify disputes by complaining customers that involve $25,000 or less.
3. The term "Wins" signifies a "win" for the Claimant. Any monetary award in favor of the Claimant is counted as a "win."
4. The "win rate" is determined by dividing the number of Awards that are "wins" into the total number of Awards that issued in that category of dispute and year.
5.The four types of dispute reflected in this Chart represent the great majority, but not all, of the Awards that issued during each of the given years. Other dispute categories include CustomerEmployee, MemberMember and NonMemberMember.
6.The "All Cust. Wins" column combines the results in the "CustomerMember" and "SmallClaims" columns to arrive at a "win rate" for all customer Claimants. The "win rates" for all years, 2007-2013, combined are calculated by adding together all of the "wins" and dividing the sum into the sum of all Awards in that category.

sliding down again, reaching a new low of 350 in 2013.

Small Claims cases – customer claims of $25,000 or less – react to the same market phenomena as Customer/Member cases, but, because so many of them rely on simplified procedures, and the parties have less incentive to invest a lot of time and effort, they tend to take less time to reach a conclusion on the merits. Although the schedule and vector were not the same, contested Awards in Small Claims had a similar trajectory, falling from a high of 622 in 2004 to a low of 111 in 2008, then suddenly doubling to 244 the following year, before sliding downward, especially between 2010 (202) and 2011 (130). It is worth noting that their numbers seem not only to have bottomed out but to have risen above 2011 levels in 2013.

"Win" rates for customers shrank throughout most of the first decade of this millenium, reaching a low of 37% in Customer/Member cases and 29% in Small Claims in 2007. The next few years saw the win rates for both types of disputes move in tandem, rising again to top off in 2010 – at 52% in Customer/Member disputes and 41% in Small Claims – before falling again over the next few years, reaching 44% in Customer/Member cases and 35% in Small Claims in 2013. Interestingly, this trajectory mimics – at least since 2009 – the rise and fall in the yearly tally of Awards. Respondents are wont to explain away investor losses attributable to the 2007-08 crash as the result of market forces beyond their control; these figures suggest that many arbitrators are not buying that argument.

Small Claims disputes have, throughout the seven-year period covered by this survey, consistently suffered a "win rate" gap of 6-12% per year, when compared to their bigger brother, "Customer/Member" Awards. We will return to this phenomenon, and suggest a reason for this gap, in our discussion of Chart 2 below.

INDUSTRY-INITIATED AWARDS

The fact that customer-initiated Award statistics are particularly sensitive to market turbulence does not necessarily mean that industry-initiated Award statistics are necessarily immune to its effects. The crash of 2007-08 caused a shakeup in the securities industry, most clearly evinced in the collapse of Lehman Brothers and some notable mergers, but no doubt forcing many other firms, large and small, to face closings, downsizing, and broker migrations. This, in turn, we presume, spawned more proceedings to recover the unpaid balances of forgivable, but not yet forgiven, loans previously paid to the now-terminated brokers when they were first hired.

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SMALL CLAIMS AWARDS (SCA) "WIN" RATES

BY PRESENTATION & REPRESENTATION (2007-2013)

YEAR	Merit Hearing(MH) Win/All (#) Win Rate (%)		On The Papers Win/All (#) Win Rate (%)		MH v. All SCA	Cs Pro Se Win/All (#) Win Rate (%)		Cs w/Counsel Win/All (#) Win Rate (%)		ProSe v. All SCA
2007	9/36	25%	27/88	31%	29%	26/90	29%	10/34	29%	73%
2008	10/31	32%	35/80	44%	28%	28/87	32%	17/24	71%	78%
2009	18/48	38%	79/196	40%	20%	56/167	34%	41/77	53%	64%
2010	9/29	31%	74/173	43%	14%	58/146	40%	25/56	45%	72%
2011	8/23	35%	39/107	36%	18%	21/73	29%	26/57	46%	56%
2012	6/21	29%	36/100	36%	17%	16/74	22%	26/47	55%	61%
2013	9/23	39%	40/119	34%	16%	18/86	21%	31/56	55%	61%
All Years Combined	69/211	33%	330/863	38%	20%	223/723	31%	176/351	50%	67%

Notes to Chart 2:
1. Stipulated Awards are excluded from the numbers.
2. The term "Wins" signifies a "win" for the Claimant. Any monetary award in favor of the Claimant is counted as a "win."
3. The "win rate" is determined by dividing the number of Awards that are "wins" into the total number of Awards that issued in that category of dispute and year.
4. The "MH v. All SCA" column presents percentages for each year that represent the ratio between those Small Claims Awards (SCA) in which an oral hearing on the merits was conducted and the total number of SCAs.
5. The "Pro Se v. All SCA" column presents percentages for each year that represent the ratio between those Small Claims Awards (SCA) that are handled by customers without counsel (pro se) and the total number of SCAs.

The rise in promissory note cases accounts for a substantial majority of Member/Employee cases and therefore has a substantial impact on them. Thus, mimicking customer-initiated Awards, contested Member/Employee Awards fell to a low of 200 in 2008, the smallest number since 2001, before rising again, reaching 377 – a record for this millennium so far – in 2011. Nor is the connection between these numbers and loan default cases idle speculation – the proportion of Member/Employee Awards that involved promissory notes rose from 75% (122/162) in 2008 to 95% (353/377) in 2011; in fact, the number of non-promissory note cases in 2011 was only half those in 2008. Since then, the total numbers of Member/Employee Awards have slipped without displaying such a clean pattern, though more than 90% each year still involve promissory notes.

This increase in promissory note disputes has also affected the "win" rates for employers in Member/Employee Awards. Loan default claims rarely fail; the sums are fixed, promissory notes clearly document the debt and few brokers have much in the way of an effective defense. In the first nine years of this millennium, ending in 2008, inclusive, the win rate remained stable, in the 81-89% range. In 2009, it jumped to 91% and thereafter ranged from 89% to 92% each year.

Employee/Member disputes are more diverse in nature and the damage figures are especially prone to subjective adjustments (as Chart 4 reflects). The disputes are oftentimes straightforward compensation disputes, but more usually they involve tortious conduct, such as defamation, discrimination, retaliatory discharge, and wrongful conduct leading to termination or constructive discharge.

The number of Employee/Member Awards in contested cases is less affected by the ups and downs of the markets and more likely to reflect seemingly random fluctuations. If anything, the average number per year declined after 2008, for no apparent reason. In the five-year period immediately preceding the period covered by this survey (2002-06), the annual numbers fluctuated from a low of 172 to a high of 206. In the seven full calendar years since (2007-13), however, they fluctuated from a low of 136 (in 2012) to a high of only 171 (in 2008) and two of the three highest numbers were in the first two years of that period.

For some, perhaps related, reason that we have not identified, the win rates for employee claimants showed a similar decline. In the first seven years of the millennium (2000-06), they ranged from a low of 52% (in 2004 and 2005) to a high of 65% (in 2001). Since then, however, they ranged from a high in 49% (in 2010) and a low of 34% (in 2013). Indeed, the rate has declined in each of the last three full calendar years.

CHART 2 – SMALL CLAIMS: CHOICES AND CONSEQUENCES

As we determined in reviewing Chart 1, Small Claims customers do not fare as well as investors with larger claims (by 6-12% each year), even as their

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