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Report to the Chairman, Subcommittee on Telecommunications and Finance, Committee on Energy and Commerce, House of Representatives

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EMPLOYMENT DISCRIMINATION

How Registered Representatives Fare in Discrimination Disputes

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Health, Education, and
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The Honorable Edward J. Markey
Chairman, Subcommittee on
Telecommunications and Finance
Committee on Energy and Commerce
House of Representatives

Dear Mr. Chairman:

The securities industry uses arbitration to resolve disputes between securities firms, between securities firms and investors (customers), and between securities firms and their employees. Arbitration is the submission of a dispute between parties to a neutral third party—an arbitrator—for resolution. The industry uses arbitration because it believes arbitration is faster and less expensive than litigation and that arbitration provides for more informed decisionmaking.

In this report, we focus on the use of arbitration to resolve employment discrimination disputes between securities firms and their registered representatives.[1] Registered representatives are firm employees who accept and execute customers' buy-and-sell orders. To work in the securities industry, they must agree to arbitrate any dispute, claim, or controversy that may arise, including discrimination disputes. Registered representatives constitute approximately 32 percent of securities industry employees in the largest 50 securities firms in the United States.

In response to your request and later discussions with your office we agreed to provide the following data:

- information on employment discrimination cases filed by registered representatives for arbitration at the New York Stock Exchange (NYSE) and the National Association of Securities Dealers (NASD), and on the nature and outcomes of discrimination cases in which NYSE and NASD arbitrators rendered a decision;
- the demographic characteristics of arbitrators serving NYSE and NASD; and
- NYSE and NASD procedures for arbitrating employment disputes and selecting arbitrator pools and panels.

[1]In May 1992, we reported to you on the arbitration of disputes between securities firms and their customers. See Securities Arbitration: How Investors Fare (GAO/GGD-92-74, May 11, 1992).

We also obtained information on the Securities and Exchange Commission's (SEC) oversight responsibilities for the industry's arbitration programs. We did not evaluate the fairness of the decisions reached in the cases we reviewed.

Results in Brief

In recent years, the number of discrimination cases filed by registered representatives for arbitration at NYSE and NASD has remained low and relatively constant. Registered representatives filed 6 discrimination cases for arbitration at NYSE in 1990 and 14 in both 1991 and 1992. NASD did not compile data on the number of discrimination cases filed, but NASD officials said that to their knowledge few discrimination cases were filed during these years with their arbitration department. SEC does not require NYSE and NASD to compile or to track data on discrimination cases.

Between August 1990 and December 1992, NASD's New York office and NYSE decided few—18—discrimination cases. Ten resulted in financial awards to the employees and 8 did not. In 4 of the 10 cases in which awards were granted, the awards were to compensate for discriminatory practices. The other 6 cases involved issues in addition to discrimination disputes, and information in the case files did not directly link the awards to the discrimination disputes. Registered representatives alleged several types of discrimination in these cases; they cited sex and age discrimination most frequently.

NYSE and NASD do not systematically collect demographic data on arbitrators in their pools. We estimate that most of the NYSE New York arbitrators (about 89 percent of 726 at the end of 1992) are white men, averaging 60 years of age. NASD officials said the demographic composition of their arbitrator pools would generally resemble that of the NYSE New York pool.

Some NYSE and NASD procedures for selecting arbitrators for their pools and for serving on arbitration panels need improvement. NASD does not have written criteria for excluding from their pools arbitrators who have a history of disciplinary actions or regulatory infractions while working in the securities industry. NASD, however, has provided informal guidance to its National Arbitration Committee for consideration when deciding whether to exclude arbitrators who have histories of disciplinary actions or regulatory infractions. As a result of our review, NYSE developed written

criteria and, after we completed our work, began using them as a basis for excluding arbitrators from the NYSE arbitrator pool.

In addition, NYSE and NASD have different requirements for their arbitrators to disclose information on criminal convictions. Both require industry-affiliated arbitrators to disclose prior criminal convictions when they register to work in the industry. At the time we completed our work, NYSE did not require nonindustry-affiliated arbitrators to provide information about criminal convictions. In commenting on a draft of this report, SEC told us that NYSE plans to start collecting this information. NASD requires its nonindustry-affiliated arbitrators to disclose criminal convictions.

Further, NYSE and NASD require that arbitrators be "knowledgeable in the areas of controversy," but neither systematically assigns arbitrators to panels on the basis of subject matter expertise.

SEC's oversight of the securities industry's arbitration programs focuses on customer-firm disputes, as opposed to employee-employer disputes, such as discrimination disputes. SEC believes that discrimination cases need not be reviewed separately since they are processed in the same manner as customer-firm cases. However, because SEC does not review discrimination cases during its inspections of securities' arbitration programs, it does not know the extent to which discrimination cases are filed and arbitrated and whether the industry is fairly and impartially resolving these disputes. In addition, SEC has not established a formal inspection cycle—a set time for conducting inspections of securities' arbitration programs—to ensure that all such programs are inspected with reasonable frequency. SEC also does not know whether the securities industry corrects problems identified in its inspections. SEC plans to formalize a schedule for systematically inspecting industry arbitration programs. As part of its monitoring of the arbitration programs, SEC will include, during its inspections, reviews of employment discrimination case files. SEC is also taking steps to improve self-regulatory organizations' (SRO) administration of their arbitration programs.

Background

Arbitration of disputes is a long-standing practice in the securities industry, predating federal nondiscrimination laws. In 1872, NYSE became the first securities exchange to provide arbitration as an alternative to litigation in resolving disputes.

The basic right to equal employment opportunity regardless of race, color, religion, sex, national origin, age, or disability is guaranteed in federal legislation enacted during the past 30 years. The Civil Rights Acts of 1964 and 1991, as well as the Equal Employment Opportunity Act of 1972, protect employees against discrimination on the basis of race, color, religion, sex, or national origin. The Equal Pay Act of 1963 prohibits payment of different wages to men and women doing the same work. The Age Discrimination in Employment Act of 1967 prohibits discrimination against workers aged 40 and over on the basis of age. The Americans With Disabilities Act of 1990 protects the employment rights of workers with physical or mental disabilities.

The Equal Employment Opportunity Commission (EEOC) enforces these laws. EEOC receives and investigates charges of employment discrimination against private sector employers. It also initiates investigations of alleged discrimination on behalf of groups of employees. If it finds reasonable cause to believe that discrimination has occurred, EEOC attempts to persuade the accused employer to voluntarily eliminate and remedy the discrimination. Remedies may include reinstatement in a job that was lost, back pay, or an award of damages to compensate for actual monetary loss. If this fails, EEOC or the employee may initiate court action.

In the securities industry, SROs, which are groups of industry professionals such as NYSE and NASD, operate and regulate their markets. SROs have been delegated primary regulatory responsibility to adopt and enforce standards of conduct for their member securities firms. SROs administer securities arbitration activities.

SEC regulates the securities industry, including arbitration activities, generally through its oversight of SROs. As part of its oversight of securities arbitration, SEC (1) reviews and approves SROs' rule filings and (2) inspects SROs' arbitration programs. SEC's Division of Market Regulation inspects arbitration programs to ensure that SROs have systems in place to comply with securities laws and their own rules.

Securities firms' registered representatives are required to file with the SROs a registration and disclosure document, known as a U-4 agreement. Filing a U-4 agreement is a condition of employment for registered representatives, and the U-4 agreement requires signatories to arbitrate disputes that may arise with their firms.

Federal and state courts have upheld the legality of the U-4 agreements that registered representatives are required to sign. They interpreted the provision for mandatory arbitration as precluding registered representatives from litigating discrimination disputes in court. This does not preclude registered representatives from filing complaints with EEOC alleging employment discrimination and requesting EEOC to investigate their allegations. If EEOC finds reasonable cause to believe that discrimination has occurred, it may initiate court action, but registered representatives may not.

SROs are required to administer arbitration programs in accordance with rules they develop and submit to SEC for approval, pursuant to section 19(b) of the Securities Exchange Act of 1934. SROs administer industry arbitration cases using procedures largely modeled on the Uniform Code of Arbitration, which was developed by the Securities Industry Conference on Arbitration (SICA). SICA was formed in 1977, at SEC's invitation, to review then-existing arbitration procedures.

SROs use the same procedures to resolve discrimination disputes as they use for all other types of arbitrated disputes, such as disputes between customers and securities firms: When a registered representative files a discrimination complaint for arbitration with an SRO, the SRO selects arbitrators from its arbitrator pool to serve on an arbitration panel. Panel members review evidence presented by both parties in the dispute; the panel renders its decision based on the arbitrators' views of the case. With few exceptions, arbitration decisions are final and binding.

Arbitrator and Panel Selection

Any person interested in becoming an arbitrator at NYSE or NASD must submit a disclosure document, known as a profile, to the SROs' arbitration department. The profile includes information on the applicant's educational background, work experience, knowledge of and relation to the securities industry, and professional or other qualifications. NYSE and NASD also require applicants to provide two letters of recommendation. NYSE and NASD decide informally on a case-by-case basis whether an applicant is initially qualified as an arbitrator, using the information in the applicant's profile.

According to SRO rules, individuals selected for the arbitrator pools are classified as "industry" or "public" arbitrators. Industry arbitrators are those currently affiliated with a member firm of the SRO or those affiliated with a member firm within the past 3 years. Industry arbitrators can also

be retirees from the industry or attorneys, accountants, or other professionals who have devoted 20 percent or more of their professional work to securities industry clients within the last 2 years.

Public arbitrators are people who are not from the securities industry. However, if a person who is not from the securities industry has a spouse or other member of his or her household who is associated with the securities industry, that person is not to be classified as a public arbitrator.

The NYSE and NASD arbitration department administrators and their staffs use a number of factors to select three arbitrators from their arbitrator pools to decide discrimination cases. These include the information in arbitrators' profiles, conflict-of-interest considerations, and availability on the date selected to hear the case. SROs provide the arbitrator profile information to both parties in the dispute—the registered representative and the firm. Both sides may request additional information about any of the arbitrators. The information may be used to challenge a particular arbitrator selected for the panel. Both sides may exercise one peremptory challenge—that is, a challenge for which no reason need be given—to the selection of an arbitrator and an unlimited number of challenges for cause—that is, challenges based on a specific cause or reason, for example, a conflict of interest.

Scope and Methodology

To respond to your request, we interviewed NYSE and NASD officials concerning their policies and procedures for arbitrating employment disputes. We obtained information on discrimination cases filed by registered representatives for arbitration at NYSE in calendar year 1992 from NYSE's computerized database and on cases filed between January 1990 and December 1991 from records maintained by NYSE. Since NASD did not compile statistical data on discrimination cases, we looked at the universe of all employment cases decided at NASD's New York office to determine those that involved a discrimination complaint.

To determine the nature and outcomes of arbitrated discrimination cases, we reviewed case files for all such cases arbitrated nationwide at NYSE and arbitrated at NASD's New York office between August 1990 and December 1992. We discussed the cases with NYSE and NASD officials. At NASD, we chose to review cases arbitrated at its New York office because the vast majority of employment cases were arbitrated in this office. We selected the August 1990-December 1992 period because they were the earliest and

latest dates that automated information needed for our review was available at both NYSE and NASD.

We compiled demographic information on the arbitrator pools at NYSE and NASD, to the extent possible. In addition, we obtained information from SEC about its (1) oversight responsibilities of the industry's arbitration activities and (2) monitoring of the arbitration of discrimination cases. As agreed, we did not attempt to determine the number, nature, and outcomes of discrimination disputes settled by the firms and the registered representatives that were not filed for arbitration. We also did not assess the effectiveness of arbitration as a means of resolving discrimination disputes. (See app. I for details on our scope and methodology.)

Registered Representatives Have Filed Few Discrimination Complaints at NYSE and NASD; Few Discrimination Cases Have Been Arbitrated

Registered representatives have filed few discrimination complaints for arbitration at NYSE and NASD during the last several years, and the number of complaints filed each year has remained relatively constant. Specifically, 34 discrimination complaints were filed at NYSE between January 1990 and December 1992: 6 in calendar year 1990, 14 in calendar year 1991, and 14 in calendar year 1992. NASD does not compile data on the numbers of discrimination complaints filed. But NASD officials indicated that very few discrimination complaints have been filed with their arbitration department.

Between August 1990 and December 1992, NASD's New York office and NYSE decided few employment discrimination cases; these cases represent a small fraction of their arbitration caseloads. In total, these SROs arbitrated 18 employment discrimination cases during this period. During all of calendar years 1991 and 1992, NYSE arbitrated a total of 1,110 cases. Of these, 798 (72 percent) were customer-firm cases and 312 (28 percent) were employment cases. Of the 312 employment cases, 16 (5 percent) were discrimination cases.[2]

NASD's New York office arbitrated 1,886 cases between January 1991 and December 1992, of which 1,626 (86 percent) were customer-firm cases and 260 (14 percent) were employment cases. Two of these cases, less than 0.1 percent of all employment cases, were discrimination cases.

[2]Before January 1991, NYSE did not record the number of customer-firm cases and employment cases. Therefore, we are only able to report this information for the period January 1991 through December 1992. This means that the data reported are not totally comparable with that for the period used for our case file review.

Some of the 18 employment discrimination cases decided by NYSE and NASD between August 1990 and December 1992 also involved one or more issues other than discrimination, such as employee compensation. Outcomes of the 18 cases are summarized in table 1.1. As shown, 10 cases resulted in an award to the employee and 8 did not. However, of the 10 cases in which an award was granted, we could link the award directly to the discrimination dispute in 4 cases, but not in 6 cases. Because SROs have no requirement that an arbitration decision explain the disposition of each issue, arbitration awards in cases involving discrimination and other issues did not always indicate whether the award was related to the discrimination dispute. The types of discrimination alleged in these cases included age, race, national origin, sex, pay, and disability. However, the two most frequently cited types of alleged discrimination were sex and age.

Table 1.1: Discrimination Case Outcomes at NYSE and NASD (Aug. 1990 to Dec. 1992)

	Award granted		Award denied
	Link to discrimination dispute		
SRO	Known	Unknown	
NYSE	4	5	7
NASD	0	1	1
Total	**4**	**6**	**8**

Demographic Characteristics of NYSE and NASD Arbitrators

The NYSE and NASD arbitration departments are not required by SEC to maintain data on the demographic characteristics of arbitrators serving in their pools, and neither does. To develop statistical information on the characteristics of the NYSE and NASD arbitrators, we analyzed data provided to us by NYSE and NASD officials. When more reliable data were not available, we relied upon the personal knowledge of NYSE arbitration staff. (See app. I for details.)

We estimate that most arbitrators serving in NYSE's New York arbitrator pool are white males, averaging 60 years of age. As of December 31, 1992, NYSE had 726 arbitrators in its New York pool. Of these, we estimate that 89 percent were men and 11 percent, women. We were able to identify the race of 349 arbitrators (48 percent of the NYSE pool) through discussions with staff attorneys. Of these, 97 percent were white, 0.9 percent were black, 0.6 percent were Asian, and 1 percent were other. The average age for men was 60 and the average age for women was 49. (Age information was available for 85 percent of the NYSE pool.) NYSE officials confirmed that the NYSE arbitrator pool was predominantly white men.

NASD does not collect demographic data on arbitrators' characteristics. However, NASD officials said that in their opinion the characteristics of NASD's arbitrator pool would generally resemble those of the NYSE pool.

Some NYSE and NASD Arbitration Procedures Could Be Strengthened

Perceptions of the fairness of the arbitration process depend on the impartiality and competence of the arbitrators who decide the cases. When considering candidates for their arbitrator pools, NYSE and NASD (1) require applicants to disclose their past educational and professional work experience on arbitrator profiles, (2) conduct computerized checks on industry-affiliated applicants to determine whether they had been subjected to disciplinary actions that should disqualify them from serving as arbitrators, and (3) require potential arbitrators to submit two letters of recommendation. NYSE and NASD select arbitrators from their pools for panels based on factors such as whether they are industry or public arbitrators, their availability on specific dates, and whether a conflict of interest exists.

While we did not address the fairness of the NYSE and NASD arbitration processes or the outcomes of the individual discrimination cases we reviewed, we identified weaknesses and inconsistencies in some NYSE and NASD procedures that could result in inappropriate decisions on which arbitrators they select for their pools and to serve on panels arbitrating discrimination cases. NASD does not have written criteria for excluding arbitrators who have had disciplinary actions taken against them or who have been cited for regulatory infractions; NYSE began using such criteria as a result of our work. In addition, although in 1987, to help assess the qualifications of securities arbitrators, the SROs agreed to require arbitrators to submit information on criminal convictions, NYSE until recently did not require public arbitrators to disclose such information. Finally, neither NYSE nor NASD assigns arbitrators to arbitration panels on the basis of their knowledge of the subject matter in the dispute.

NYSE and NASD Lacked Specific Criteria for Excluding Arbitrators Who Have Records of Disciplinary Actions or Regulatory Infractions

Under the Securities Exchange Act, persons may be precluded from working in the securities industry for reasons such as disciplinary actions taken against them and regulatory infractions. In connection with its oversight inspections, SEC recommended in September 1987 that the SROs determine whether arbitrators have records of disciplinary actions or regulatory infractions and exclude from their arbitrator pools those whose records warrant such action.

SROs have direct access to NASD's Central Registration Depository (CRD), which is a computerized database on current and former securities registered representatives, including those who are securities arbitrators. Information in the CRD comes from a variety of sources, such as registered representatives' U-4 agreements; customer complaints; regulatory violations data submitted by SROs, SEC, or state regulators; and Justice Department criminal arrest and conviction data. Information taken from the U-4 agreements includes information on any securities disciplinary action taken against the registered representative and regulatory infractions committed by the representative.

The NYSE and NASD arbitration departments' staffs use information from the CRD to determine whether an industry arbitrator has a history of disciplinary or regulatory infractions. NYSE's Director of Arbitration told us that he considered the answers to certain questions when deciding whether to exclude people who have histories of disciplinary actions or regulatory infractions from the NYSE arbitrator pool. These questions include (1) Did the person fully disclose the incident on his or her profile? (2) Did any incident involve "moral turpitude"? (3) Was there more than one incident? and (4) Was the incident a technical or regulatory infraction? As a result of our study, NYSE developed and began using written criteria for excluding such persons from its pool.

According to NASD's Deputy Director of Arbitration, its National Arbitration Committee's Qualifications Subcommittee decides who is selected for NASD's arbitrator pool. However, NASD does not have specific criteria for the Subcommittee to use in determining if arbitrators with records of disciplinary actions or regulatory infractions related to their work in the securities industry should be excluded from its arbitrator pool. NASD developed informal guidance in June 1992, which the Subcommittee uses to help decide whether to exclude arbitrators who have such records. The guidance, however, does not set specific criteria or standards on which actions and infractions are significant enough to warrant exclusion from the arbitrator pool.

To determine whether arbitrators with disciplinary actions or regulatory infractions on their records were in the NYSE and NASD arbitrator pools, we randomly sampled 100 industry arbitrator profiles at NYSE and NASD. We found arbitrator profiles in both samples that disclosed disciplinary actions or regulatory infractions. However, without specific criteria, we could not determine whether they were significant or whether the

arbitrators should have been removed from the SROs' arbitrator pools. We did not determine whether any of these arbitrators served on a panel.

The lack of specific criteria hinders the ability of SRO arbitration staff to uniformly apply a selection standard for arbitrators serving in their pools, precludes SEC from assessing whether SROs are using appropriate criteria for selecting arbitrators, and may raise equity issues over differences in the quality of the arbitration process administered by various SROs.

NYSE and NASD Have Different Requirements for Disclosure of Arbitrators' Criminal Convictions

SROs require registered representatives to disclose criminal convictions on their U-4 agreements. Many industry arbitrators are, or have been, registered representatives and would, therefore, have disclosed this information as part of the registration process. SROs can access this information through the CRD when registered representatives apply to be arbitrators. However, public arbitrators are not subject to industry registration requirements and do not file U-4 agreements. SROs, therefore, do not have access to criminal conviction information for public arbitrators through the CRD.

To obtain criminal conviction information for all arbitrators in its pool, NASD has incorporated the criminal disclosure questions asked in the U-4 agreement as part of its arbitrator profile. The U-4 agreement specifically asks registrants if they have ever been convicted of a felony or a misdemeanor. By incorporating these sections of the U-4 agreement as an arbitrator disclosure requirement, NASD obtains information needed to help it determine whether an arbitrator—industry or public—should be excluded from its pool because of critical convictions.

NYSE does not require its arbitrators to disclose prior criminal convictions on their profiles. By failing to do so, NYSE does not have this critical information to help it make informed judgments on whether public arbitrators should serve in its pool. NYSE endorsed a December 14, 1987, SICA letter in which it agreed that its arbitrator profile would elicit information concerning whether an arbitrator has ever been convicted of or, in a regulatory proceeding, found to have engaged in conduct involving any offenses relating to theft, the taking of a false oath, or fraud. NYSE tries to maintain an arbitrator pool, an NYSE official indicated, comprised of people of high moral character. Yet NYSE's ability to make this determination for public arbitrators may be thwarted because this information is not collected. About 58 percent of all arbitrators making up the NYSE pool are public arbitrators.

As a result of our review, NYSE included the topic of arbitrator disclosure of criminal convictions on the agenda for SICA's July 1993 meeting. SICA members discussed this issue but, as of February 1994, they had not reached a final decision on what disclosure questions should be asked of arbitrators regarding criminal convictions. Nevertheless, the NYSE Arbitration Department, in October 1993, revised its arbitrator profile and will begin asking arbitrators to disclose information on criminal convictions. In its comments on a draft of this report, SEC told us that NYSE had provided its staff with an amended arbitrator profile that includes questions on arbitrators' criminal convictions.

NYSE and NASD Arbitrators Are Not Assigned to Panels on the Basis of Expertise

The arbitrator panel selection procedure is largely subjective. Given the industry's practice of classifying arbitrators as industry or public, the procedure for selecting arbitrators for a panel is predicated on an arbitrator's affiliation or lack of affiliation with the securities industry. SRO arbitration staff consider many other factors when selecting an arbitrator to serve on a panel, such as the arbitrator's education and employment background; the arbitrator's availability on a specific date; whether there is any conflict of interest in the case; the frequency with which the arbitrator has served; and, when selecting a chairperson, whether an arbitrator is an attorney.

According to SICA's Arbitration Procedures, which have been adopted by all SROs, arbitrators should be "knowledgeable in the areas of controversy." However, NYSE and NASD do not necessarily consider, as a primary criterion for arbitration panel selections, arbitrators' expertise in the subject matter of the dispute. In fact, NYSE and NASD arbitration staff do not routinely assess the expertise of the members of their arbitrator pools. According to one NYSE official, the determining issue in assigning an arbitrator to a panel is whether the arbitrator can determine the facts of a dispute, not whether he or she has expertise appropriate to the type of dispute being decided.

Since discrimination cases involving registered representatives raise issues that are different from the securities-related disputes administered by SROs, it may be appropriate to consider whether the panels for these cases should be comprised differently, and include at least one arbitrator with expertise in employment or discrimination law. Discrimination disputes are inherently different from the usual types of employment disputes arbitrated by SROs because they involve issues in federal civil rights law that lie beyond the scope of securities statutes and industry practices. In addition, by industry practice, registered representatives are

subject to mandatory and binding arbitration in all employment disputes, including discrimination disputes.

Improvements Needed in SEC Oversight of SRO Arbitration Programs

SEC focuses its SRO arbitration inspections on customer-firm disputes because of its mandate for customer protection. It does not monitor SROs' arbitration of discrimination cases even though employees' civil rights are at issue. Because SEC does not require SROs to report to it on discrimination cases filed and arbitrated, it does not know the nature, types, and outcomes of these cases and whether there are changing trends. Discrimination cases may merit some type of review by SEC.

SEC Does Not Monitor SROs' Arbitration of Discrimination Disputes

SEC does not include employment dispute cases, including discrimination disputes, as part of its inspections of SRO arbitration programs. Rather, SEC's inspections of SRO arbitration activities focus on customer-firm disputes. Therefore, SEC does not know (1) how efficiently and effectively discrimination dispute cases are processed by SRO arbitration departments or (2) the outcomes of these cases.

These cases are not a priority, SEC officials said, since SEC, as it interprets the 1934 Securities Exchange Act, views its primary responsibility to be customer protection. Employment dispute cases, they said, often may involve collections or salary disputes between firms and employees.

Most employment disputes may be disputes about collections, but discrimination disputes are different in nature from collections disputes. In discrimination disputes, employees' civil rights are at issue. For securities registered representatives, arbitration is mandatory and decisions rendered by arbitrators, who may have no understanding of the civil rights laws that protect workers from discriminatory practices in the workplace, are binding. SEC officials acknowledged that SEC does not review securities industry cases involving firms and their employees. However, SEC monitors the procedures that affect all arbitration cases handled by SROs, including discrimination disputes brought by registered representatives.

SEC Lacks Information to Assess Changes in the Numbers of Discrimination Cases Filed for Arbitration

SEC does not require SROs to report the numbers, types, and outcomes of discrimination cases that they arbitrate. We found that NYSE and NASD differ in the extent to which they maintain data on discrimination cases. NYSE has an automated tracking system that identifies the number and type of cases,

including discrimination cases, filed with its arbitration department. The system generates case summaries for active cases. NASD's automated system for tracking arbitration cases does not track discrimination cases, other than sexual harassment cases, as a distinct category of employment dispute cases. This system tracks the status of cases arbitrated at NASD beginning in August 1990.

Because SEC does not require SROs to track discrimination cases, SEC does not receive information to assess trends in the number, types, and outcomes of these cases. Despite the small number of discrimination cases now filed for arbitration, having SROs track these data would enable SEC to select discrimination cases for review. This information would also alert SEC to caseload increases that may warrant further scrutiny.

SEC Needs a Formal Inspection Cycle for SRO Arbitration Programs

SEC conducted its first SRO arbitration inspection at NASD in 1986, but postponed inspections at other SROs to allow them to develop rule changes for their arbitration programs, based upon concerns raised by its 1986 NASD arbitration inspection. In a September 10, 1987, letter to SICA, SEC recommended changes to SICA's Uniform Code of Arbitration. These recommendations included (1) revising standards for eligibility to serve as a public arbitrator, (2) disclosing to the parties the arbitrators' backgrounds and affiliations, (3) instituting programs for arbitrator training and evaluation, and (4) instituting procedures to provide for public disclosure of the results of arbitration cases. Individual SROs responded to SEC's recommendations by drafting proposed rule changes for their arbitration programs. SEC formally approved these changes in 1989.

In 1990, SEC's division of market regulation established an inspection team to review SRO arbitration departments for compliance with its rules. According to SEC officials, their SRO arbitration inspections include all aspects of the departments' administration and processing of customer-firm arbitration, including examining such issues as the timeliness of various aspects of case processing, whether arbitrators are properly classified, and the content of arbitrator profiles. SEC officials stated they do not attempt to reevaluate the outcomes of arbitration disputes.

SEC has completed arbitration program inspections of eight SROs since 1990 and expects to complete a second inspection at NASD in March 1994. SEC intends to establish a cycle for systematically conducting these

inspections after it completes the NASD inspection. SEC officials anticipate that the inspection cycle will include a review of some part of NASD's arbitration program each year, NYSE's every other year, and the other SROs' every third year. By establishing a formal inspection cycle, SROs may be more inclined to respond expeditiously to SEC recommendations made during previous inspections.

SEC Inspections Identified Deficiencies That Still Exist

SEC's inspection reports included recommendations to correct deficiencies in SRO's arbitration programs. Although SEC's inspections focused on customer-firm disputes, the concerns raised also apply to employment disputes, including discrimination disputes, since the arbitration process is fundamentally the same.

For example, in its inspection reports and in a July 16, 1992, letter to the SROs regarding follow-up on issues raised in our May 1992 report, SEC cited concerns about the completeness and meaningfulness of information contained in SROs' arbitrator profiles. The fact that the arbitrator profile is incomplete and fails to contain meaningful information may affect the arbitrator panel selection process. Both NYSE and NASD agreed to implement SEC's recommendations and both initiated efforts to update arbitrator profiles to improve the quality of information contained in them. In November 1992, NYSE revised its arbitrator profile. NASD sent letters to its arbitrators in December 1992 and in April 1993 asking for information from them to update and complete their profiles.

However, we found that NYSE and NASD had not fully implemented all of SEC's recommendations and that the problems still existed. To determine whether NYSE and NASD updated their arbitrator profiles with meaningful and complete information as recommended by SEC, we reviewed a second random sample of 100 arbitrator profiles from both NYSE and NASD. At NYSE, 97 of the 100 profiles we sampled lacked detailed professional background information for the arbitrators. Of these 97, 11 percent also lacked other information despite NYSE's attempts to periodically update records. Of the 100 arbitrator profiles sampled, 15 were for arbitrators who had served on a panel since November 1992, when NYSE revised its arbitrator profile. Of the 15 who served on a panel, 8 had incomplete profiles when they were appointed and they did not update their profiles after they were appointed to the panel, 4 had updated their profiles when appointed to the panel, and 3 had entered information in the wrong place on the profile.

At NASD, of the 100 arbitrator profiles we sampled, 61 lacked background information for the arbitrators. Of those missing this information, 31 percent also lacked other information. We did not determine how many NASD arbitrators in our sample with incomplete profiles served on arbitration panels.

Recommendations to the Chairman, SEC

In our May 1992 report, Securities Arbitration: How Investors Fare, we recommended that SEC require SROs that administer arbitration programs to (1) develop formal standards for selecting arbitrators, (2) verify information submitted by prospective and existing arbitrators, and (3) establish a system to ensure these arbitrators are adequately trained in the arbitration process. SEC agreed to follow up with the SROs on these recommendations.

As SEC continues to work with the SROs to implement these prior recommendations, we recommend that SEC direct SROs to

- use existing information systems to track the numbers, types, and outcomes of discrimination cases that are filed at, and arbitrated by, their arbitration departments;
- establish written criteria and standards for excluding from SRO arbitrator pools industry arbitrators who have histories of disciplinary actions or regulatory infractions;
- require all arbitrators to disclose criminal convictions on their arbitrator profiles; and
- assess and maintain information on arbitrators' expertise and use this information when selecting arbitrators to serve on panels, especially those deciding discrimination disputes.

We also recommend that SEC (1) establish a formal inspection cycle for inspecting SROs' arbitration programs, (2) follow up more vigorously on the implementation of its recommendations, and (3) when selecting arbitration case files to review during inspections, include those involving discrimination complaints.

Agency Comments and Our Evaluation

SEC provided written comments on a draft of this report. (See app. II.) SEC generally agreed with most of our findings and recommendations. It said that changes have been made or would be implemented to respond to our recommendations. We clarified our recommendations on the basis of their comments.

SEC, while agreeing with us that securities SROs should be able to distinguish discrimination cases from other types of cases submitted for arbitration, disagreed with our recommendation that it should require SROs to track the numbers, types, and outcomes of the discrimination cases. SEC believes the small number of discrimination cases filed and arbitrated that we identified at NYSE and NASD does not "warrant any sort of institutional program" for monitoring them. SEC said that "[e]fficient retrieval of discrimination cases [from the SROs' computer databases] is sufficient at this point" and that "[t]his will allow the SROs to monitor effectively any future developments in the volume, types or administration of these cases." We agree. Our intent is not to require the SROs to establish costly monitoring programs. Rather, our intent is that the SROs periodically retrieve the data on discrimination cases that they already have in their information systems so that they can identify emerging trends in the numbers of cases filed and arbitrated as they occur. Having such information will help the SROs and SEC to oversee the securities arbitration process.

Regarding our recommendation on requiring SROs to establish written criteria for excluding from their arbitrator pools arbitrators who have histories of disciplinary actions or regulatory infractions, SEC stated that it agrees that the SROs should exclude arbitrators with significant disciplinary histories. SEC also said that SICA, in response to our findings, established a subcommittee in October 1993 to address the issue of written criteria for excluding arbitrators. SEC said that it will encourage the subcommittee to identify the types of issues that have arisen in the past in order to determine whether useful criteria can be established. To conform to the intent of our recommendation, we believe that SEC, rather than relying on SICA to ascertain whether criteria can be established, should take steps to require the SROs to establish such criteria.

Regarding our recommendation on requiring SROs to assess, maintain, and use arbitrators' expertise when selecting arbitrators to serve on discrimination panels, SEC seemed to agree with us. SEC said that it might be valuable for the SROs to assess arbitrators' training and experience when selecting arbitrators for discrimination panels. SEC further stated that the issues raised in discrimination disputes may be sufficiently different from many arbitrators' experience so as to warrant that the SROs develop additional training in discrimination law issues. In this regard, SEC pointed out that NASD has already expanded its arbitrator training to include sessions on employment law. However, SEC said that it would discuss the issue of arbitrator selection with the SROs in order to determine

whether it is appropriate to have procedures for selecting arbitrators in discrimination disputes that are different from those for other types of disputes. We think SEC needs to do more. We continue to believe that SEC should direct the SROs to consider expertise in discrimination law when selecting arbitrator panels for discrimination disputes.

SEC raised several other concerns relating to our findings, which we address in appendix II. SEC, NYSE, and NASD provided us technical comments. Where appropriate, we used the information to clarify and update our report.

As agreed with your office, unless you publicly disclose its contents earlier, we plan no further distribution of this report until 7 days from the date of this letter. At that time, we will send copies to the Chairman of SEC; NYSE; NASD; the Director, Office of Management and Budget; and other interested congressional committees. We will also make copies available to others upon request.

If you or your staff have any questions about the information in this report, please call me at (202) 512-7014. Other major contributors are listed in appendix III.

Sincerely yours,

Linda G. Morra
Director, Education and
Employment Issues

Contents

Abbreviations

CRD	Central Registration Depository
EEOC	Equal Employment Opportunity Commission
NASD	National Association of Securities Dealers
NYSE	New York Stock Exchange
SEC	Securities and Exchange Commission
SICA	Securities Industry Conference on Arbitration
SRO	self-regulatory organization

Scope and Methodology

Because there are no comprehensive data available on discrimination cases filed by securities firms' registered representatives and arbitrated by securities self-regulatory organizations, we conducted our review at the New York Stock Exchange (NYSE) and the National Association of Securities Dealers (NASD). We choose NYSE and NASD because they both have offices in New York City and, although both hold arbitration hearings in major cities throughout the United States, their New York offices hold more hearings than any other location. We also performed work at the Securities and Exchange Commission (SEC) in Washington, D.C.

To determine trends in the number of discrimination cases filed for arbitration by registered representatives at NYSE, we used NYSE's computerized database to obtain information on the number of discrimination cases filed nationwide at NYSE during the period January through December 1992. In addition, from records maintained at NYSE's New York office, we reviewed case summaries for arbitrated cases from January 1, 1990, through December 31, 1991, to estimate the numbers of filings. NASD's computerized database for arbitration cases does not track discrimination cases as a distinct category; therefore, comparable information was unavailable. NASD officials told us that few discrimination cases involving registered representatives were filed for arbitration at NASD in recent years.

We reviewed records at NYSE and NASD to develop information on the nature and outcomes of discrimination cases that were arbitrated (decided) from August 1990 through December 1992. Because NYSE stores records for all cases arbitrated nationwide in New York City, we reviewed the universe of discrimination cases that were arbitrated at NYSE during this period. To identify any type of discrimination case brought by an employee against his/her firm, we manually reviewed case summary sheets for all cases arbitrated between August 1, 1990, and January 1, 1992. We used NYSE's automated case-tracking system, which was implemented as of January 1, 1992, to identify discrimination cases arbitrated between January 1, 1992, and December 31, 1992.

In contrast, NASD's automated data system for arbitrated cases, which was implemented in August 1990, does not identify discrimination cases, other than sexual harassment cases, as a distinct category of employment dispute cases. It also maintains records for its arbitrated cases at four regional offices located throughout the United States. We chose to review cases arbitrated at its New York office because the vast majority of employment cases were arbitrated in that office. We, therefore, reviewed

all employment dispute cases, a total of 115 cases, that were arbitrated during the August 1990-December 1992 period by NASD's New York office to identify any that involved discrimination issues. The cases arbitrated by its New York office, NASD officials told us, represented the largest number of arbitration cases handled by any NASD regional office.

We used August 1990 as the beginning date for our case selection because that was when NASD implemented its automated data system for arbitrated cases. We used December 1992 as the end date because, when we did our work, that was the most recent date the information was available from both NYSE and NASD.

NYSE and NASD provided us the files for all arbitrated discrimination cases that we identified. We reviewed the details of the discrimination disputes raised; the arbitration case outcomes; and the settlements and awards, if any, made. We discussed the cases with NYSE and NASD officials. We also compiled demographic information (age, race, and sex) from NYSE on arbitrators used to resolve these arbitrated cases. We did not review open cases because information on case outcomes was not available and open cases are not public information.

We interviewed NYSE and NASD officials to learn about the arbitration process for resolving employees' discrimination cases and analyzed arbitration procedures. We also discussed with them procedures for selecting arbitrators to serve in their arbitrator pools and on their arbitrator panels.

Because NYSE and NASD do not maintain data on the demographic characteristics of arbitrators in their arbitrator pools, we compiled these data, to the extent possible. This information was unavailable, NASD officials said, and therefore could not be provided. At NYSE, we relied on the personal knowledge of NYSE arbitration staff when questions arose. Our data on the racial composition of the NYSE arbitrator pool are based primarily on the knowledge of the senior staff attorney in the arbitration department. Age data on NYSE arbitrators are based on profile information, submitted by arbitrators when applying to serve in the arbitrator pool. To determine whether industry-affiliated arbitrators in the NYSE and NASD pools had criminal records or disciplinary histories, we selected a random sample of 100 industry arbitrator profiles at NYSE and NASD.

We interviewed SEC officials to obtain information on (1) their oversight responsibilities concerning arbitration activities at NYSE and NASD in

general and (2) the extent to which they monitor self-regulatory organization arbitration of discrimination complaints. We obtained follow-up information on SEC's actions to implement the recommendations in our May 11, 1992, report, Securities Arbitration: How Investors Fare. We also discussed the results of SEC's inspection reports on arbitration, conducted at NASD in 1986 and at NYSE in 1990. We reviewed relevant findings and recommendations presented in those reports and actions taken by NYSE and NASD to address these concerns. To determine whether NYSE and NASD complied with selected SEC recommendations on meaningful and complete information on the profiles and on arbitrator disclosure contained in recent inspection reports, we selected a separate random sample of 100 arbitrator profiles at both NASD and NYSE.

We did our work in accordance with generally accepted government auditing standards between October 1992 and June 1993.

Comments From the Securities and Exchange Commission

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

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

DIVISION OF
MARKET REGULATION

December 30, 1993

Linda G. Morra
Director, Education
and Employment Issues
United States General
Accounting Office
Washington, D.C. 20548

Dear Ms. Morra:

The Division of Market Regulation appreciates the opportunity to review and comment upon the General Accounting Office's draft report entitled Securities Arbitration: How Registered Representatives Fare in Discrimination Disputes. The Division shares the concerns that influence the draft report -- that securities industry employees are entitled to have any discrimination claims with their employers resolved in a capable and fair arbitration forum.

See pp. 7-8.

The GAO found that there were very few discrimination cases at the self-regulatory organizations ("SROs") to review. Within the eighteen cases that GAO did review, there were neither particular trends of note nor any indication of bias in the administration of the claims. Since the discrimination claims are administered under the same general arbitration rules as are used for the administration of other claims at the SROs, GAO focussed its attention on some aspects of the general operation of the forums, particularly issues related to the composition of the arbitrator pool, and again did not find problems that affected any particular cases. GAO did identify a need for improved internal controls at the SROs and recommended an adjustment of focus in SEC oversight. Some of these observations are very useful adjuncts to the staff's oversight of the arbitration process, and changes either already have been or will soon be implemented to respond to the GAO's findings. 1/

See pp. 8-9.

See pp. 9-16.

1/ This letter addresses only the recommendations for change made by the draft report. As the staff discussed earlier with the GAO team that prepared the draft report, the rationale that supports portions of the report does not match the staff's understanding of the administration and oversight of the SRO arbitration process. For example, the discussion at page four of the Commission's oversight of discrimination dispute cases mischaracterizes the oversight process generally. Likewise, the discussion at pages 21 and 22 of incomplete arbitrator profiles does not clearly identify whether arbitrators with inadequate profiles on file had served

(continued...)

See comment 1.

See comment 2.
Now on pp. 10-11.

A. Recommendations Regarding the Administration of SRO Arbitration Forums.

The adoption of internal controls and the means of oversight should be cost-effective. The general approach that the staff believes should be followed for the maintenance of a capable arbitrator pool was addressed in our response to GAO's earlier report, Securities Arbitration: How Investors Fare (May 1992), and we do not repeat that discussion here. The draft report makes four specific recommendations for the administration of the arbitration forums, some of which the staff agrees will strengthen the administration of the arbitration system.

See p. 16.

1. Tracking of Discrimination Claims. First, the draft recommends that SROs "track the numbers, types and outcomes of discrimination cases that are filed at, and arbitrated by, their arbitration departments." The staff generally agrees with the draft report's underlying point: the SROs should be able to identify discrimination cases. As the draft indicates, the New York Stock Exchange, Inc. ("NYSE") already identifies discrimination cases in its computer system, and is able to retrieve them for collective review. The staff agrees that the National Association of Securities Dealers, Inc. ("NASD") should add discrimination categories to its list of types of cases that can be retrieved automatically, and will pursue this change with

1/(...continued)
since the NASD undertook to expand its arbitrator profiles in 1992. The staff agrees strongly with the need for the SROs to improve arbitrator profiles. That has been discussed in the Commission's inspections, the 1992 GAO report, and the Division's 1992 correspondence with the SROs after the 1992 report. The draft, report, however, indicates only that the arbitrators with inadequate profiles were used between August 1990 and December 1992. Since the report also states that the NASD sent out mailings to arbitrators in December 1992 and April 1993 to obtain updated profiles, it would be useful to know whether GAO found that after the updating process began the SROs continued to appoint to cases arbitrators whose profiles were incomplete. In addition, the staff is unable to respond to references at page 15 of the draft to "infractions" disclosed in arbitrator profiles, since the specific infractions are not identified and there is no indication whether those arbitrators served on cases. We do not pursue these and other issues in our comments since the recommendations themselves are largely consistent with our understanding of effective administration of the SROs' and the staff's own programs.

See comment 3.
Now on pp. 11-12.

NASD staff. 2/ The staff does not believe, however, that the draft report provides any empirical basis for requiring the SROs to establish any ongoing monitoring system for discrimination cases. There are too few cases or criticisms of these cases to warrant any sort of institutional program for them. Efficient retrieval of discrimination cases is sufficient at this point. This will allow the SROs to monitor effectively any future developments in the volume, types or administration of these cases.

See pp. 10-11 and 16.

2. Written Criteria for Excluding Arbitrators. Second, the draft recommends that the SROs "establish written criteria and standards for excluding people from SRO arbitrator pools on the basis of disciplinary action or regulatory infraction histories." The staff agrees that the SROs should exclude people with significant disciplinary history from their arbitrator pools. The SROs all agreed in 1987 that the base line for excluding arbitrators from the arbitrator pool would be whether the arbitrator was subject to a statutory disqualification. The GAO did not find any arbitrators in the SROs' arbitrator pools who are subject to a statutory disqualification.

The Securities Industry Conference on Arbitration established a subcommittee at its October 1993 meeting in San Francisco to address this issue in response to the GAO's concerns, which were raised during the interviews for the draft report. The staff will encourage the subcommittee to identify the types of qualifying issues that have arisen in the past, such as misdemeanor offenses that are not a statutory disqualification, in order to determine whether useful parameters can be established for assessing whether to use arbitrators who have issues in their personal history of possible significance to their performance as arbitrators and the fairness of the arbitration program.

See pp. 11-12 and 16.

3. Required Disclosure of Criminal Convictions. Third, the draft report recommends that the SROs "require for all arbitrators disclosure, on arbitrator profiles, of criminal convictions." The staff agrees. As the draft report correctly states, agreement to elicit relevant conviction disclosures was reached with all of the SROs in 1987. The NYSE has provided the staff with an amended arbitrator profile including questions related to criminal and other relevant disciplinary history, which will be mailed to all of its arbitrators in the near future.

2/ The GAO identified only two discrimination cases that were decided by arbitrators in the more than two-year sample of cases at the NASD. Accordingly, the Commission staff does not believe that the failure to have created an identifier for an almost non-existent category of cases should be considered to be a deficiency.

See pp. 12-13 and 16.

4. Arbitrator Selection. Fourth, the draft report recommends that the SROs "assess, maintain, and use information on arbitrators' expertise when selecting arbitrators to serve on panels, especially those involving discrimination disputes." The staff agrees with the draft report that distinct procedures for appointing arbitrators in discrimination cases and expanded arbitrator training in discrimination law merit serious consideration.

Most cases heard by arbitrators involve issues pertaining to the securities business. The forums rely on their arbitrators to be well educated, versed in the securities business, and capable of analyzing issues presented and explained by the parties or their representatives. Arbitrators are routinely called on to resolve the complicated securities law, RICO and other complex claims presented by the parties. It may be, however that the employment law issues raised in discrimination cases are sufficiently different from the experience of many arbitrators that it would be appropriate for the SROs to develop additional training in discrimination law issues. The NASD already has expanded its training for arbitrators to include sessions on employment law in some of its courses. We agree that it may be valuable to assess arbitrators' training and experience when appointing arbitrators to the panels for discrimination cases. Again, however, simple prescriptions are not likely to be effective. Since professionals such as lawyers who have experience in this area often represent only one side, management or employees, the forum will have to be careful to avoid arbitrator selections based solely on expertise if the selections result in panels that on their face appear to be imbalanced in favor of either of the parties. The staff will take up with the individual SROs the issue of arbitrator selection for discrimination cases to determine whether special procedures are appropriate.

B. SEC Oversight

The draft report also makes three recommendations for adjustment of focus in SEC oversight.

See pp. 14-15 and 16.

1. Inspection Cycle. First, the draft report recommends that the SEC "establish a schedule for inspecting SROs' arbitration programs". As the staff has advised GAO, the staff is on schedule with its arbitration inspections. In 1990, an inspection team was established to inspect the arbitration programs. Since 1990, the staff completed initial inspections at the six exchanges with arbitration forums and the Municipal Securities Rulemaking Board. In addition, the staff has begun a second inspection at one of the exchanges and is completing a second comprehensive inspection of the NASD's forum, which is the largest arbitration forum.

Going forward, the staff advised the GAO that the Division anticipates an inspection cycle that would inspect some portion of the NASD each year, the NYSE (the second largest forum) every other year, and the other SROs every three years. The staff advised GAO that a cycle will be formalized only after the current NASD project is completed in order to assess the best use of staff resources by analyzing the inspections that have been conducted so far.

See pp. 15-16.

2. Arbitration Inspection Follow-up. Second, the GAO recommends that "the SEC follow up on the implementation of its recommendations". It is the staff's practice to follow up on its recommendations. SROs are expected to respond in writing within 30 to 60 days to inspection recommendations, stating the steps that have been or will be taken to address issues raised in an inspection. There are areas for improvement. Specifically, the staff agrees that the missing criminal history questions on the NYSE profile forms should have been identified through the inspection process. The staff also agrees that the quality of arbitrator profiles is a continuing concern. Inspections conducted in 1991 and 1992 identified the need for the SROs to improve the quality of disclosure in arbitrator profiles. 3/ The Division also wrote to all of the SROs about the quality of SRO profiles in the July 1992, and the SROs have begun, as the draft report states, to seek expanded information from their arbitrators. Improving these records is a time consuming process that the staff continues to discuss with the SROs.

See pp. 13-14 and 16.

3. Inclusion of Discrimination Cases in Inspection Sample. Third, the GAO recommends that "when selecting arbitration case files to review during inspection, [the Division should] include those involving discrimination complaints." Given the substantial interest in customer protection issues associated with securities arbitration 4/ and the Commission's investor protection mandate, the Division's oversight of SRO arbitration has been directed at cases involving public customers.

The staff recalls only one inquiry in recent years from an industry employee involved in a discrimination case. That case later settled. Nonetheless, the staff agrees with GAO that public policy concerns inherent in discrimination claims warrant oversight

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3/ See e.g., Securities and Exchange Commission, 1991 Annual Report 42-43 (1992) and Securities and Exchange Commission, 1992 Annual Report 37 (1993).

4/ See generally the GAO's May 1992 report, Securities Arbitration: How Investors Fare and Arbitration Reform: Hearings Before the Subcomm. on Telecommunications and Finance of the House Comm. on Energy and Commerce, Including H.R. 4960, 100th Cong., 2d Sess. (1988).

of the arbitration process as it applies to those claims. The staff's inspections are directed at determining whether the procedures used in arbitration are fair and efficient. In developing case file samples in future inspections, the staff will include industry cases, (including some cases involving discrimination allegations, if there are any such cases that otherwise meet inspection criteria), in order to assess whether the existing rules are adequate for this class of cases.

Thank you for this opportunity to assist the GAO as it prepares its final draft of this report. I respectfully request that this letter be appended to the final report delivered to Congress.

Sincerely yours,

Robert Colby

Robert L.D. Colby
Deputy Director

The following are GAO's comments on the Securities and Exchange Commission letter dated December 30, 1993.

GAO Comments

1. The discussion on page 3 of SEC's oversight of the securities industry's arbitration programs was intended to be general and limited to specific processes and activities related to employment discrimination disputes. Based on discussions with the Division of Market Regulation staff after we received SEC's letter, SEC was concerned that we did not fully describe the Division's mission and activities. The Division staff agreed that we do not mischaracterize those activities.

2. Our finding, discussed on pages 15 and 16, is that the SROs did not fully implement recommendations in SEC's inspection reports to correct deficiencies in their arbitration programs. As an example of this problem, we found that NYSE and NASD did not fully implement SEC's recommendations to update their arbitrator profiles. To demonstrate this situation, we show that NYSE assigned arbitrators to panels after it updated its profiles in November 1992 in response to SEC's recommendation, even though the profiles for these arbitrators were incomplete. In some cases, the profiles were not updated after the arbitrators were assigned.

NASD took a different approach than NYSE to respond to SEC's recommendation. As discussed on pages 15 and 16, to update its arbitrator profiles, NASD sent letters to its arbitrators, initially in December 1992 and in a follow-up mailing in April 1993, requesting them to update and complete their profiles. We found that 61 of the 100 NASD arbitrator profiles that we sampled lacked background information. However, because NASD had not completed its updating of its arbitrator profiles when we completed our work, we did not determine whether any NASD arbitrators in our sample with incomplete profiles had served on an arbitration panel after NASD initiated its mailings. We modified the text on page 16 to clarify why we did not determine how many NASD arbitrators in our sample with incomplete profiles served on arbitration panels.

3. The critical point is that NYSE and NASD do not have specific criteria for determining what disciplinary actions and regulatory infractions are significant enough to warrant exclusion from their arbitrator pools and panels. Without these criteria, NYSE and NASD cannot make decisions about excluding arbitrators who have histories of disciplinary actions and regulatory infractions. Our intention was to show that both SROs have in their pools arbitrators whose profiles indicate prior disciplinary actions or

regulatory infractions. It is the SROs who must determine which actions and infractions should result in exclusion from the pools and panels.

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