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Could Arbitration Help You Recover Investment Losses?

By Rob Silverblatt

As Horace Grant found out the hard way, it's not always easy being a Bull in a bear market. But even though the former basketball star saw his investments take a dive during the credit crisis, he managed to net a victory recently. Grant, best known for his career with the Chicago Bulls, won \$1.46 million from mutual fund provider Morgan Keegan & Co. after charging that the company underplayed the amount of risk that some of its bond holdings carried.

All told, Grant's case, which fits nicely into the familiar story of the big man (in this case a 6-foot, 10-inch basketball player) taking on big business, is certainly one of the more high-profile instances of mutual fund arbitration. And his award is the largest arbitration recovery to date against Morgan Keegan, whose RMK bond funds reportedly lost \$2 billion in the year starting March 31, 2007. But Grant's win is hardly the only one, and recent results have shown that you don't need to be a celebrity to collect.

In a pattern typical of downturns, the Financial Industry Regulatory Authority (FINRA), the body that handles virtually all securities arbitration, has seen a significant uptick this year in the number of dispute-resolution cases filed. "When people open up their statements and they see a decline in value from the previous statement, it gives them pause to think about the conduct of their registered rep

or their firm," says FINRA spokesperson Brendan Intindola.

As a result, investors who got burned are looking to collect based on what they consider to be irresponsible behavior by fund managers and investment advisers. The bursting of the housing bubble has been a particularly popular trigger for arbitration. At the same time, mutual funds have begun replacing common stocks as the most popular security type named in filings.

According to Jacob Zamansky, the founder of the New York-based financials and securities law firm Zamansky & Associates, these cases are increasingly falling on friendly ears. "[Arbiters], I think, are becoming more sympathetic to people claiming that their investment brokers gave them bad advice during the market turmoil" and, for example, led them into the mortgage maze without proper warning. Brian Smiley agrees. He is an Atlanta lawyer and the president of the Public Investors Arbitration Bar Association, a group whose member attorneys represent investors in arbitration cases. "I think they're beginning to see that there are a lot more meritorious claims," he says, using as an example investors who lost out in the bond market in 2007 and 2008 after managers took on additional risk. "Folks don't go into a bond fund expecting to lose 50, 60, or 70 percent of their money," he says.

"And they shouldn't lose that kind of money in bond funds."

S. Lawrence Polk, a partner in the Litigation Practice Group of the firm Sutherland Asbill & Brennan, says the number of unsubstantiated filings is also on the rise. "I find that the majority of people that file claims just think it's a money-back guarantee," says Polk, who primarily represents banks, broker-dealers, and accountants. "They're just being told, 'File a claim, and you can get some money back.' "

To get an idea of the changing landscape, consider the following statistics, all from FINRA:

Through August, FINRA had received 4,991 new dispute-resolution cases this year. That's up 65 percent from the same period in 2008.

FINRA's website breaks down the complaints by category for each year since 2005. Last year was the first time in that period that mutual funds rather than common stocks were the most common category, and that pattern is continuing. Through August, 1,173 of this year's cases involved mutual funds, compared with 935 that pertained to common stocks. Each case can involve up to four types of securities; other examples include corporate bonds, options, derivative securities, and annuities. Notably, in 2008, derivative securities, which FINRA began tracking that year, also came in ahead of common stocks.

The three most common charges in FINRA arbitration cases are breach of fiduciary duty, misrepresentation, and negligence. Each case can contain up to four charges.

In 2008, investors received compensation in 42 percent of cases that went to arbitration. But when prearbitration settlements are included, investors won in 74 percent of total cases.

For most investors, filing an arbitration claim is the only practical way to collect from investment brokers. That's because virtually all contracts between investors and brokers contain provisions requiring that disputes be settled that way rather than through lawsuits.

Looking to change this pattern, a number of federal politicians have been pushing the Arbitration Fairness Act, which would nullify mandatory-arbitration clauses in certain contracts between companies and individuals. Affected industries would include mutual funds, cellphone service providers, and credit card companies.

Even under current regulations, investors can still join class action lawsuits. But since doing so restricts their ability to participate in arbitration, Smiley said he wouldn't recommend the strategy. "You're going to want to bring that claim in arbitration if you want an individualized recovery," he says. "Class actions tend to be pennies on the dollar, and they don't look at the merits of individual claims."