The ChicagoBoard
Options
Exchange

Alger B. Chapman
Chairman and
Chief Executive Officer

LaSalle at Van Buren
Chicago, Illinois 60605 312 786-7001

October 14, 1988

FEDERAL EXPRESS

David S. Ruder, Chairman
Office of the Chairman
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Re: Mandatory Predispute Arbitration Agreements

Dear Chairman Ruder:

The Chicago Board Options Exchange, Inc. ("CBOE" or "Exchange") is pleased to respond to your July 8, 1988 request for comments regarding mandatory predispute arbitration agreements.

Over the past year, there have been many initiatives with respect to arbitration. Richard Ketchum in a letter dated September 10, 1987 to the self-regulatory organizations ("SRO") reported the findings of the Commission Staff Study ("Study") of the arbitration process. In that letter approximately fifteen modifications to the arbitration process were recommended to enhance the fairness and efficiency of the arbitration process. The CBOE, as you are aware, has taken an active role in implementing such modifications through its participation in the Securities Industry Conference on Arbitration ("SICA") deliberations. During the past year, SICA has addressed the concerns raised by the Commission and is recommending implementation of many of the modifications outlined by the Commission in its Study. The CBOE intends to implement such recommendations in conjunction with the other participating SROs.

On June 21, 1988, the CBOE in a letter to Jonathan Katz, expressed its views regarding mandatory predispute arbitration agreements and disclosure. The CBOE has not altered its position as stated in the attached June 21, 1988 letter.

After our response, you raised three additional concepts regarding predispute arbitration agreements in your July 12, 1988 Statement to the Subcommittee on Telecommunications and Finance of the House Committee on Energy and Commerce. The three concepts and our comments follow:

1. Notice to the investors as to the importance and significance of their election to sign an opening account agreement containing a predispute arbitration clause;

2. Breadth of the arbitration clause;

3. Procedures that would permit investors or arbitrators to "opt" out of the arbitration process.

Regarding the first concept, the CBOE fully supports sufficient notice to investors as to the importance of their election to arbitrate any future dispute. The Exchange continues to believe, as stated in the attached letter, that it is appropriate to require greater disclosure of the arbitration clause in the opening account agreement. Such disclosure might include an informational pamphlet in addition to the account agreement form. We do not believe, however, that a customer should be required to acknowledge that he has read the pamphlet.

The second concept follows the first. The CBOE is in favor of an industry-wide standardized arbitration clause. The clause should grant the customer the full spectrum of remedies provided by Federal and state arbitration rules. We would be pleased to work with SICA participants in developing such a uniform arbitration clause so investors will be familiar with their rights and obligations, even if they choose to move their account or open additional accounts at other brokerage firms.

Finally, you suggested that investors be permitted access to the courts in appropriate cases. The CBOE utilizes sophisticated arbitrators that are well-versed in various areas of securities law. We are confident that we can continue to administer the arbitration of large and complex cases. However, we do appreciate the concept of a mechanism for referral of certain extraordinary cases to the courts. The Exchange will work with SICA in attempt to develop a standard to guide arbitrators to recognize extraordinary circumstances. Care must be taken in crafting such guidelines so that appropriate cases do not circumvent arbitration.

The Exchange will continue to examine its arbitration rules while taking an active role in SICA. To that end, we would be pleased to respond to any further suggestions which you or the Staff may have.

Sincerely,

Alger Chapman

The ChicagoBoard Options Exchange

Alger B. Chapman
Chairman and
Chief Executive Officer

LaSalle at Van Buren
Chicago, Illinois 60605 312 786-7001

June 21, 1988

Mr. Jonathan G. Katz
Office of the Secretary
(File No. S7-7-88)
Mail Stop 6-9
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Re: File No. S7-7-88

Dear Mr. Katz:

We are in receipt of the letter to Frederic Krieger, Associate General Counsel and Director of Arbitration of the Chicago Board Options Exchange, Inc. ("CBOE" or "Exchange") from Richard Ketchum, Director of the Commission's Division of Market Regulation, dated June 3, 1988. The CBOE is pleased to respond to Mr. Ketchum's request for comments on the captioned proposed legislation concerning arbitration ("Commission proposed legislation"). These comments are also applicable to a legislative proposal concerning arbitration, which is under consideration before the Subcommittee on Energy & Commerce, Committee Print of June 8, 1988 ("Committee Print").

Before providing the Exchange's comments on the proposed legislation, I wish to make several observations about arbitration, based on my experience over the past thirty years, as a regulator, securities firm principal, and investor. The securities arbitration process has worked and has adapted to change well. Small customers are particularly well served by availing themselves of a process that offers less formalities as well as speedy, inexpensive and fair resolution of their disputes than would be the case in our back logged court system. The majority of customer disputes are either settled or are decided in favor of the customer.

The legislation proposed by the Commission addresses one aspect of arbitration, providing that a broker-dealer would be required to accept a customer to do business with the firm even if the customer refuses to agree to the arbitration provision which may be proposed in the customer account agreement by the broker-dealer. The Committee Print makes that same proposal, and in addition, would require highlighted and separate documentation on binding arbitration, and mandates standards concerning the rules governing arbitrations at Self

Regulatory Organizations. The Committee Print's mandatory standards, to be implemented by the Commission, would include new discovery provisions, written decisions by arbitrators, alteration to the awarding of costs and attorneys' fees, and modification to the provisions concerning relationships of arbitrators to the industry. For the reasons set forth in this letter, the Exchange does not believe that any legislation is necessary at this time.

The Exchange, as the Commission is aware, has participated through the Securities Industry Conference on Arbitration ("SICA") in the development of modifications to the arbitration process over the past year which address many of the concerns which have been expressed concerning arbitration. The Exchange notes, for example, that SICA has virtually completed work on modification to the standards for selecting arbitrators, a new discovery rule, providing greater authority to arbitrators to resolve discovery matters, a rule concerning pre-hearing conferences, a more detailed form of award to be rendered, and increased biographical information on arbitrators. SICA is also developing new arbitration manuals and increased arbitrator training. The Exchange is supportive of these efforts and has participated in the development of these rules. The Exchange sees no reason for Congressional legislation in these areas and believes that the Commission, in any event, has appropriate authority under the Exchange Act to insure that the arbitration process continue to be a fair and expeditious forum for the resolution of disputes, including disputes between customers and member firms.

The Exchange believes that it would be appropriate to require more disclosure concerning the effects of any arbitration provision in a member firm's contract with the customer. Such disclosure might include an informational document to be transmitted to the customer at the time that a customer account agreement is entered into. The Exchange does not believe that legislation is necessary to effectuate this disclosure and believes that the rule making process would be more appropriate.

The Exchange also believes that, by rule making, it should be provided that the customer would, in all disputes with a member firm, have the ability to select the forum for the arbitration dispute. The Exchange notes that some firms currently allow customers to select the forum within specified periods of time after notice of a dispute. The Exchange believes that this selection provision should allow the customer to select an appropriate registered securities exchange or association and also should provide a non-self-regulatory forum which forum may be specified by the member firm. The rule would supercede any provision to the contrary in a customer account agreement.

The Exchange believes that the foregoing modifications will serve the arbitration process well and that no further legislative effort is needed. Indeed, requiring a member firm to accept a customer account when the customer wishes to opt out of the arbitration provision would dramatically alter the way in which business is done and would be an inappropriate intrusion into the agreement between a customer and a customer's firm. Currently, there is not industry uniformity on the subject. While there are some firms which do not require exclusive arbitration in their agreements, there are other firms that do. There are other firms that make exceptions to their policy. Further, in the Exchange's experience as a regulator of the options markets, most options accounts are margin accounts. It seems entirely appropriate for a member firm when it is extending its credit to a borrower, to be able to enforce its rights expeditiously in a pre-

determined forum that offers expertise and fairness. We also note that we have not observed a groundswell of public interest in imposing this limit on the ability of member firms to develop their own contractual relationships. The Exchange therefore believes that the securities industry in its diversity should be allowed to continue to handle this matter in differing ways.

We would be pleased to answer any further questions that the Commission may have on the subject.

Yours sincerely,

Alger B. Chapman

cc: Richard G. Ketchum