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Broker Beware: As Volatile Market Customer Arbitrations Spike, Who is Looking Out for Your BrokerCheck® Reporting Record?

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by Steven J. Stafstrom Jr.

As investors start to receive - and dare to open – recent account statements, the reality of the COVID-19 driven spring market volatility will come into focus. Significant portfolio declines coupled with the financial stress many families are feeling in this economic crisis have the potential to strain even the closest of broker/customer relationships.

Investors, and their attorneys, are likely to scrutinize portfolios with perfect 20/20 hindsight as to whether they were invested in suitable securities prior to the crash. Suitability looks at the investor's age, expected retirement date, net worth, financial goals, risk tolerance and investment experience. Investors will also look at whether their accounts were appropriately diversified or whether there was an over concentration in certain stocks, bonds, mutual funds or annuities. Investors will further question whether their broker took appropriate action as markets began their freefall. While the virus and government-ordered shutdowns might help bolster a defense to a claim of broker negligence, they will not be an outright bar to customers seeking recourse.

As Financial Industry Regulatory Authority (FINRA) mediation requests and arbitration filings increase, individual brokers and advisors named in FINRA filings should consider if there is a need to hire their own counsel to protect their interests. Even if their respective firm offers to provide a joint defense, they should think about their own, possibly separate interests.

Importantly, FINRA settlement terms and arbitrator decisions generally are not confidential and must be reported for purposes of CRD reporting and FINRA BrokerCheck®. Pending claims, all arbitration awards and settlements in an

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amount above \$15,000 must be reported in perpetuity (unless expunged) on a broker's U4. Settlements under \$15,000 need not be reported on a U4 form after 24 months and may be easier to have expunged from the advisor's record.

Reputations matter, and a broker may have an interest in holding out on settling a matter for nuisance value longer than his firm does to try to get under the \$15,000 threshold. Also, given that both a large settlement and an adverse arbitration decision are reportable, a broker who feels she is in the right might be more inclined to fight a matter through arbitration than her firm is. Finally, a broker who has changed firms should be aware that if her former firm is named in the arbitration, the firm may be entitled to seek indemnification from the broker under many standard registered representative agreements.

Securities cases almost invariably involve complicated financial transactions and often focus on who knew what and when. While the FINRA forum is often quicker and less expensive than a traditional court proceeding, it still involves the disclosure of documentation by each party and testimony by witnesses. The careful brokers, and their counsel, will be able to produce and frame account opening documents, client questionnaires, notes of conversations and meetings, procedures and other documentation of their actions in a light most favorable to the broker.

Although FINRA has postponed all in-person arbitration and mediation proceedings scheduled through July 31, 2020, new cases can still be filed electronically, answers remain due, discovery can proceed, and telephonic or video mediations and hearings are available. As pandemic-related investor claims begin to hit the FINRA docket, broker-dealers and advisors will be wise to monitor how FINRA is able to process an increase in filings while also working remotely.

Pullman & Comley's securities litigation team is experienced in handling claims under the federal and state securities laws and common law, including claims of unauthorized trading, suitability, breach of fiduciary duty, fraud and misrepresentation, failure to supervise, churning, and other allegations. We are available to help counsel brokers, investment advisors, broker-dealers, and institutional investors in COVID-related loss issues and to handle FINRA arbitrations and mediations.

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