

Read fine print before signing brokerage forms

By TIMOTHY J. O'CONNOR

When the average investor opens an account with a stockbroker, certified financial planner or money manager, he or she is asked to complete and sign any number of forms that serve to establish the accounts and provide vital information as to the kind of investments most suited to the client's investment needs.

Such documentation may include a client application agreement, a new account form, an options disclosure statement, a trading discretion form, a margin trading authorization form and required tax-reporting forms, in addition to other forms. This documentation often is presented to the investor in a blizzard of paperwork with the directive to "sign here, here and here."

Many investment firms maintain a separate new account form or customer profile document that often is never provided to the customer. This document consists of the broker's representations to his superiors and his firm as to a client's net worth, previous investment experience, investment objectives, education, profession, and vital information such as the extent to which the customer is willing to expose his or her financial account to market risk.

The misrepresentation of one or all of these elements may afford a broker the opportunity to engage in a more aggressive (and higher commission-yielding) investment strategy exposing the customer to speculative, illiquid and unsuitable investments, as well as the potential for staggering losses. Whether or not a firm's policy includes the routine provision of a new account form or customer account profile, the customer always should insist on being provided with a copy of this form to make sure that the information that the broker has related to his superiors is, in fact, in line with the customer's true profile.

Cash management-type brokerage accounts that offer customers the availability of debit money-card purchasing power, as well as leveraged securities purchases, usually have a built-in **margin agreement** whereby the customer agrees to pay a determinable percentage rate of interest on monies borrowed in the account for either consumer purchase or securities purchase transactions.

The prudent investor should know his or her exact responsibility to pay interest charges to the brokerage firm in such instances and also should inquire as to whether the percentage rate charged is competitive with rates offered by other brokerage firms.



Timothy J. O'Connor

Brokerage firms that offer non-cash management-type securities accounts have been known to offer margin agreements to customers, usually for the sole purpose of leveraging trading activity in the customer's accounts. While this might mean more securities purchasing power in the account, it also provides the broker with the opportunity for greatly increased commission charges and exposes the account to a greater likelihood of account losses in the event of a market downturn.

Such a trading strategy usually is reserved for speculative, well-heeled investors with money to lose. The small investor has no business signing a brokerage margin agreement for the sole purpose of leveraging securities purchasing power.

Likewise the margin agreement is a first step an aggressive broker might take to introduce an unsuspecting customer to speculative trading activity in equity and index options that can expose the small investor to staggering losses.

Other than isolated conservative options trading strategies that might see a small investor protecting a large position in a specific stock from a drastic downturn in market conditions, the small investor should not invest in index or equity options and never should sign an **options account form**.

The majority of brokerage firms that are members of the National Association of Securities Dealers Inc. execute trades made in customer accounts through a clearing broker. In such an arrangement, the customer will have to sign forms permitting the broker to trade through a clearing broker, authorizing the clearing broker to act as the custodian for investments by keeping them in "street name" (securities held by the brokerage firm).

The distinction between the "introducing" or "trading broker" and "clearing broker" is important. Brokers affiliated with thinly capitalized, one-office and/or unheard-of firms that clear all of their trading activity through a clearing broker often will try to leave the customer with the impression that they are, in fact, closely affiliated with the more reputable and established clearing broker to lull the investor into a false sense of security.

The exact relationship between the introducing broker and a clearing broker should be explained to the customer by the broker and the documentation establishing this account relationship should be fully understood before you sign.

Investors also should note that some brokerage firms will seek the execution of **account agreements that may designate the judicial or arbitral forum** of any customer dispute proceedings in another state, with the further proviso that any such disputes must be resolved in accordance with the laws of that state. Is this what you really want?

Chances are, if a firm has to be so heavy-handed

as to compel you to submit any disputes to a forum with a venue somewhere in Dallas or Denver, it has something to hide. This should be a warning sign to the investor that he or she is being presented with an investment opportunity of a highly suspect and dubious nature. Stay away.

One of the most dangerous documents that might be presented to the investor for signature is the **"trading discretion form."** This document effectively can afford the broker full authority to buy and sell investments in your account without prior authorization. Granting an investment broker such blanket authority is a recipe for disaster and provides the broker with an opportunity to buy and sell investments repeatedly for the purpose of generating commissions. While many reputable firms no longer permit brokers to present such trading discretion forms to customers, they still are in use.

The **"activity letter"** is yet another document that your broker might convince you to sign without fully describing its legal effect. Activity letters are letters that branch managers of brokerage firms send to customers whose accounts have seen an inordinate volume of trading, speculative trading, and/or significant losses.

Typically, the branch manager will send the customer an innocuously worded one-page letter seeking to have the customer return a signed copy of the letter acknowledging the fact that he has been apprised of the branch manager's concerns about the activity in the account.

These letters afford protection only to the brokerage firm and are designed to be used against

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investors in the event they bring a claim against the brokerage firm. The receipt of an activity letter probably is a good tip-off that it is time to change brokerage firms and to have your account analyzed for possible trading improprieties.

When investing money with any type of investment brokerage firm, the age-old maxim of reading the fine print before signing on the dotted line should be followed by all investors. The simple cautionary step of taking the time to get a second opinion from a reputable professional may protect you from a financial catastrophe.

Mr. O'Connor maintains a law practice in Albany, New York., and represents investors in securities brokerage claims.

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