

Know what you should look for when choosing a broker

By TIMOTHY J. O'CONNOR

It is truly amazing how little thought the average investor puts into the selection of a financial adviser. In many instances, investors entrust their life savings to individuals or corporations whose introduction is made through a telephone cold-call solicitation.

The only other financial investment made by the average investor which compares to the building of a retirement securities portfolio would be the purchase of a house. In the house purchase scenario, you retain counsel who engage in an exhaustive search of the premises and its previous owners in search of any claim of any nature whatsoever that might be made against the house.

Typically, your attorney, in turn, retains a title insurance company to insure the entirety of your investment against the claims of any party which might come forth at a future date to exclaim an interest in your house. Surveys are conducted and exhaustive tax searches are made to assure that your title is pristine.

At a closing, several different attorneys representing different parties pass on the soundness of your title before title passes, and your lending institution has assured itself that mortgage monies being advanced for your house will not be dissipated by some adverse party.

With the selection of a financial adviser, however, no such parallel exists.

Until the bull market of the 1980s, most investors had no direct dealings with financial advisers or investment professionals, other than entrusting their life savings to passbook savings accounts, certificates of deposit and company-sponsored retirement plans. The investment boom of the 1980s saw a proliferation of job titles in the financial services sector, and suddenly, everyone became a "financial consultant." Many investors have fallen prey to investment scams and unscrupulous sales practices that could have been prevented by some diligence on their part.

One of the major databases for broker information is the Central Registration Depository, known as the CRD system. This system was developed by the North American Securities Administrative Association (NASAA) and the National Association of Securities Dealers in 1981, and is operated by the National Association of Securities Dealers (NASD).

The CRD is an online database that contains information relating to brokerage firms and their brokers, and includes information provided by the NASD, the Securities and Exchange Commission (SEC), some self-regulatory securities exchanges, the Commodity Futures Trading Commission, the National Futures Association, States Securities Commission and the Federal Bureau of Investigation.

Information on the CRD database includes about 5,500 brokerage firms and 460,000 registered securities salespeople. In New York, it is the policy of the Investor Protection and Securities Bureau of the state Department of Law to release information relating to particular brokers contained on the CRD system through a simple written Freedom of Information Law request.

This May, the Division of Market Regula-

tions of the SEC issued a report entitled, "The Large Firm Project," which included a number of recommendations regarding investors' access to information regarding brokerage firms and their brokers.

On July 1, 1993, the SEC approved a change of the rules of the NASD, permitting the release of information contained in the CRD system related to disciplinary history of brokerage firms and their brokers through a toll-free telephone number. This information gives investors and the public at large access to the following information:

- Pending formal disciplinary proceedings initiated by federal or state agencies and self-regulatory organizations such as the New York Stock Exchange (NYSE) and the NASD, as well as pending and final disciplinary actions taken by foreign governments or foreign regulatory authorities.

- Criminal indictments or information.
- Civil judgments.
- Arbitration decisions in securities and commodities disputes involving public customers.

All requests for information through the toll-free service also should be followed with a written request addressed to the NASD. This new public disclosure service is still in its infancy and many matters that should be disclosed through a public disclosure request are not being disclosed either through laxity in reporting by firms, failure to report, or simple data-entry type breakdowns.

Beyond inquiry to government and regulatory agencies, a common-sense assessment should be made of your broker. Who is he or she? Who does he or she work for? Where does he or she maintain his or her offices, and to whom will you be entrusting your original investment certificates? Who will stand behind your individual broker, or his or her brokerage firm, in the event of a problem? Are the assets you have entrusted to your broker protected and insured from loss or theft?

Your individual broker may have any number of job titles. But is he licensed to sell the investment products he is presenting to you? The titles of vice president, financial consultant, financial adviser and investment counselor are meaningless in terms of securities industry licensure requirements and are usually titles bestowed by a brokerage firm upon an employee, independent of any requirements or licensure required under the Federal Securities Laws and securities industry regulatory organizations.

What types of investment products does the broker sell? Be careful of single-product brokerage firms that limit sales activities to a narrow range of investments, such as oil drilling products, insurance-only products, penny stocks, limited partnerships or proprietary/in-house products, all of which are generally of a high-risk/high-commission character. The average investor—that is, 99 percent of the investing public—need look no further than a balanced mix of mutual funds, which offer diversification, income, growth and risk minimization.

Can your broker offer professional responsibility? By law, all brokers/dealers affiliated with the NYSE and the NASD, as well as a number of smaller self-regulatory organizations, are required to carry Brokers Blanket

Bonds in the form prescribed by the Surety Association of America with minimum coverage of at least \$25,000 to protect investors from losses occasioned by brokerage theft, loss, misplacement, forgery and fraudulent trading.



Losses caused by gross mismanagement, however, are not covered by Brokers Blanket Bonds, and in most instances, are not covered by professional liability insurance. This leaves an investor with direct recourse only against the broker or the broker's brokerage firm. Reputable and well-capitalized brokerage firms usually settle investor claims when presented with a good case of gross mismanagement. Many small brokerage firms, however, cannot absorb such claims and are not as worried about their reputation being sullied in an adversary proceeding or in the press.

The single most important document that defines your relationship with your broker is your "new account form." Read every question on the form, line by line, and never sign a blank new account form. Also, never sign a new account form that has been completed by your broker, or the broker's secretary.

This harmless-seeming document can come back to haunt you in the event that there is speculation in your retirement account. Be very careful that the investment objectives checked off on your new account form are in line with what you want to do with your money.

Preservation of capital, income with safety and income with growth are objectives more in line with a conservative retirement portfolio, whereas, appreciation with risk, speculation and options trading are more in line with investment objectives of a high net worth individual who can afford to lose significant sums of money in speculative plays.

The net worth and annual income figures indicated in your new account form also should be as close in line with what you are actually worth and what you actually earn. Whether you realize it or not, a broker can put you into highly speculative investments, by including options and private placements, by putting you in a higher income range. If things turn sour here, you surely can expect to be advised that such investments were suited for you because you checked off the higher income level.

Once you have opened your new account with your broker, retain a completed copy of your new account form in your file—it will serve as a roadmap in your dealings with your broker.

It is important to note that virtually all brokerage firms have incorporated certain provisions into their new account agreement requiring you to submit any claims you may have against your broker to arbitration before the arbitration departments of the NASD and/or the NYSE and, in some instances, the arbitration department of the American Arbitration Association.

Customer remedies in arbitration in New York state can be more limited than those that can be pursued in the courts, and include a prohibition against punitive damages. An investor who has sustained losses due to mismanagement or trading improprieties should consult experienced counsel without delay.

O'Connor is a shareholder with the Colonie law firm Ainsworth, Sullivan, Tracy, Knauft, Warner and Rusterlander P.C. □

Capital District

Business Review October 10, 1994

As seen in

© Copyright 1994 by Capital District Business Review, 2 Computer Drive West, Albany NY 12205 • 437-9855.