

HOW WALL STREET PROTECTS BAD BROKERS

The National Association of Securities Dealers makes it easy for stockbrokers to hide their past from investors.

By Susan Antilla

◀ In 1992, Albert and Margarete Weyer of Mason, Michigan, took their life savings of \$215,000 out of bank accounts and annuities and entrusted them to George Ledden, a stockbroker employed by Mariner Financial Services Corp., a retail brokerage firm in Southfield, Michigan. Ledden invested the Weyers' nest egg in mortgage-backed securities and unsecured bonds, a strategy he continued when he moved in January 1998 to an Ann Arbor, Michigan, brokerage firm called Sigma Financial Corp. A year later, the investments soured and the Weyers received a letter saying their monthly income payments had been suspended.

The Weyers filed a complaint in arbitration, accusing Ledden and his companies of misrepresentation, deceptive practices and breach of duty. They asked the National Association of Securities Dealers (NASD), the self-regulating body that oversees the securities industry, to get their money back.

The Weyers won their case. On Jan. 17 of this year, NASD arbitrators awarded them \$120,000, to be paid by Sigma. In a separate arrangement, they recouped additional funds from Mariner; those terms were confidential. The result was a happy one for Albert, 71, and Margarete, 63, who say they were relieved to come back from the big losses. Immigrants from Germany with eighth-grade educations, the Weyers



The NASD tried to block **Edward Siedle's** directory of firms' data.

have recouped enough to resume their lifestyle. They had been struggling to survive on Albert's \$900 a month in Social Security benefits.

The outcome wasn't so great for investors who might

be interested in knowing about the Weyers' complaints against Ledden and the companies he worked for. Ledden filed for Chapter 7 bankruptcy on Dec. 10, 2001, the day before the arbitration began. His bankruptcy meant they could not recover money in a claim against him. As a result, there would be no arbitration result to go on his NASD record.

Ledden, who is still a registered broker at Sigma in East Lansing, Michigan, says he filed for bankruptcy because his firm told him he might be personally liable for the Weyers' losses. He points out that his bankruptcy is on his NASD record, and he says he would not have put the Weyers into any investments that put their savings at risk. In addition, the couple consented to the deletion from NASD records of their complaint against six Mariner officers. State regulators and other critics of such sanitizing of records—known as expungement—say it is common for brokers to demand it in exchange for settlements in cases like the Weyers'. Lawyers for the Weyers and for Mariner would not comment on the question of expungement in this case.

Expungement is just one of the ways the securities industry protects the reputation of brokers and other financial professionals. The NASD's system of public disclosure of broker and broker/dealer violations looks like a monument to transparency: customer complaints, securities law violations and criminal histories are stored in its system amid the records of hundreds of thousands of investment professionals. "Our membership is our membership, but we serve the public interest," says Elisse Walter, the NASD's chief operating officer and executive vice president of legal and regulatory policy. On June 7, the NASD's board said it was merging the NASD with its regulatory arm, NASD Regulation Inc. (NASDR), and launching a new slogan: "Investor Protection. Market Integrity." The NASD is preparing a proposal for the U.S. Securities and Exchange Commission that will address some issues of expungement.

Yet investors who request a broker dossier by calling an NASD hot line or by going on the Internet usually get an incomplete response. Even if disclosure hasn't been avoided because of a bankruptcy or a deal with complainants, the system routinely deletes the records of brokers

who've been out of the business for two years and erases potentially defamatory language—which could include the reasons a firm gave for firing a broker. "The system is a scandal and a disgrace," says Vincent DeCarlo, a former SEC enforcement lawyer who now represents investors against brokers. "NASD says you can research your broker by checking the records. But it relies on self-reporting that isn't always enforced, and even when brokers make the required filings, they can wind up getting them expunged."

The NASD has acted recently on other fronts to curtail disclosure of information on brokers. In two recent cases, the agency has rebuffed former regulators who want to publish directories that would draw on broker data and make it more available to the general public. On May 9, one of them, Edward Siedle—a former lawyer for the SEC who now investigates money managers and pension funds from his Lighthouse Point, Florida, firm Benchmark Financial Services Inc.—sued the NASD. He's asking the circuit court of Hillsborough County, Florida, whether the NASD had grounds when it threatened in writing in February to sue him if he published his *Siedle Directory of Securities Dealers*. William McDonald, former securities enforcement chief of the California Department of Corporations, says the NASD turned him away also when he sought cooperation to publish a database of customer complaints in all of the financial industries: real estate, insurance and securities.

Members of the plaintiffs' bars, state regulators and other critics say such cases underscore the fact that the NASD focuses on promoting the interests of its members while often ignoring the other half of its charter: protecting the public. Joseph Borg, Alabama's securities commissioner and president of the North American Securities Administrators Association (NASAA), the organization of state regulators, says

WHAT'S TO HIDE?

Customers are having more problems than ever with brokers, as measured by requests for arbitration hearings. NASDR projects 2002 will be a record.



*Projection based on first-quarter filings. Source: The NASD



The NASD wouldn't back **William McDonald's** idea to publish customer complaints.



Joseph Borg, president of a state regulators' group, says this is a bad time to erode investors' trust.

this is no time to risk eroding investors' trust. "Given Enron and the research analyst scandal, the American people have more and more concerns about their retirement money and their ability to trust what they hear from Wall Street," he says.

NASD officials reject such criticism. They maintain that they offer ample information to investors who access their Web site or call their hot line. The fact that members all come from the securities industry is not an issue, says NASD COO Walter. Nancy Condon, a spokeswoman for the NASD, says Siedle's directory was not in the best interest of investors because it would have been outdated as fast as it was published. The NASD, she says, is concerned that investors have the most up-to-date information possible.

Some industry executives argue that expungement can be necessary because sometimes brokers are accused unfairly. "It's pretty serious when you lead a life where you never want a blemish on your record and somebody sues you when there are no grounds," says James Brinkley, president of Legg Mason Inc., a Baltimore-based investment bank. "Someone named me in some frivolous thing. You settle for a little bit to get rid of it." Brinkley declined to provide details of the incident. Charles Schwab Corp.'s Chief Corporate Counsel Gregory Scanlon suggested to the NASD in written comments on Dec. 17, 2001, that customers who file frivolous claims—for example, naming multiple respondents when only one is relevant to the case—be subject to sanctions similar to those invoked for the punishment of lawyers or other parties who submit such actions in federal court.

Consumer advocates and state securities regulators say it's no wonder the NASD has become the center of

firms. The arbitration data is difficult to access because it can be searched only one month at a time.

Regulators in several states have leveled their harshest criticism over the issue of expungement. The conflict has its roots in a set of 1995 NASD guidelines that permitted arbitrators to order deletion of material from brokers' records if a customer dropped a broker's name and charged only the broker's firm in a claim before a settlement took place—or if a customer dropped the complaint altogether. State regulators, who jointly operate the database the NASD uses for its Public Disclosure Program, say they knew nothing about the new internal rules, which the NASD didn't inform the states about until January 1996. That's when John Deden, a securities investigator working for the state of Colorado, went to double-check on the records of broker Michael Abramowitz and saw that a customer complaint from December 1994 had vanished. At the time, the understanding between the NASD and the states was that records could be deleted only if the broker got a judge to certify an expungement in court, according to a memo published on Feb. 23, 1996, by Renee Erdmann, a Montana regulator.

Deden, who'd printed out a copy of the records with the complaint still showing, called Erdmann, who was chair of a committee of state regulators working with the NASD to revise the disciplinary data. Erdmann found out that Abramowitz, a broker at the firm then known as Dean Witter & Co., had settled a complaint and had his record deleted—along with the records of hundreds of other brokers who'd had complaints expunged. Abramowitz, now a broker at Morgan Stanley Dean Witter & Co. in Houston, referred calls to a company spokesman, who declined to comment.

controversy. The association maintains the data that the public, regulators and plaintiffs attorneys would most like access to—and that many of its members would least like it to release. Its Public Disclosure Program, accessible through an 800 number or an Internet address, provides disciplinary data on stockbrokers and all licensed professionals—all the way up to the chief executive officers of securities firms. The NASD also holds a database of the results of arbitration hearings in which investors levied charges against brokers and their

The NASD expunged the complaint after the customer dropped the claim against Abramowitz in the settlement.

In January 1999, the NASD and the NASAA agreed to a moratorium on expungement unless arbitrators recommended that a record be deleted and a judge certified the decision. Over time, says the NASAA's Borg, state regulators began to get feedback that the involvement of the courts was not enough. Borg says brokers were getting investors to take settlements in exchange for their agreement to wipe a record clean. "The judges said: 'The parties agree? Well, bring me an order and don't waste my time,'" says Borg. "There is no merit review in most cases."

Under the current system, even when customers win a case against a broker, arbitrators can clean up brokers' records with no obligation to explain to anyone why they granted the expungement. On Feb. 4, for example, a panel of three New York Stock Exchange arbitrators awarded \$47,233.26 to Lillian Boyd, a widow living in Baldwin, New York. Along with the decision to award her the money, the panel also recommended that references to the arbitration on the records of Boyd's broker, Michael Ledva of Janney Montgomery Scott Inc., be expunged. The one-page decision does not explain the reason. "I received a copy of the final decision, and I was shocked," says Boyd. "I won, so how did he get off the hook?"

Boyd says she wasn't thinking clearly when she lost her spouse unexpectedly and didn't have the background in the financial markets to understand that she didn't belong in the stock market. "I hadn't worked," she says. "I was a homemaker." Ledva began writing covered call options, which she says she didn't understand. She says she told Ledva that she was nervous about being in the stock market. "But he said, 'If you don't watch your account, you won't worry,'" she says.

Ledva says he didn't ask that his record be sanitized. "I did not ask for them to do that," he says. "That was the decision they had come to." Not so, according to the arbitration record. Janney's lawyers, in the formal answer they filed to Boyd's request for an arbitration, asked the panel to expunge from his record all references to the complaint.

Many investors, interested solely in making themselves whole after losing money with a broker, raise little or no protest when the issue of expungement comes up. "I represent people like doctors, and they don't give a rat's ass about

hiding their claim from future generations," says Chuck Austin, a plaintiffs lawyer in Richmond, Virginia. "They want their money back."

The expungement issue often doesn't come up in arbitration cases because some brokers don't report to the NASD what they're required to. Arbitrators, who come from a pool of lawyers and financial professionals from on and off Wall Street and whose names are compiled by the NASD, are not

'The system is a scandal and a disgrace,' says Vincent DeCarlo, a former SEC enforcement lawyer.

required to file reports that would ensure that the people named in complaints get into the system. Paid and trained by the NASD, arbitrators operate independently of the enforcement and licensing divisions of the NASD. Derek Linden, the NASD's senior vice president of public disclosure, says members with a license are supposed to report to

the NASD when investors file arbitration complaints in which they're named as a respondent—though that doesn't always happen. In March, for example, UBS PaineWebber Inc. and the city of Nashville, Tennessee, announced a \$10.3 million settlement that arose out of the findings of several reports on the handling of the city's pension account.

On March 31, 2000, KPMG LLP, the auditor, released a first and the only public report: a 75-page publication in which it said that broker Keith Phillips, who'd handled the account, had been providing Nashville's pension board with "misleading

information" that resulted in decisions that "generated higher commissions." Though the NASD requires that customer complaints be listed on a broker's record, there was no mention of any problem with a customer until two years after the KPMG audit was released. On May 2, 2002—after the *New York Times* had written about the UBS PaineWebber settlement—a reference was added to Phillips's public record: "Customer alleged various sales practice violations in connection with pension consulting relationship." Phillips's lawyer, Aubrey Harwell, said he didn't consider the issue of reporting KPMG'S results when they were released in 2000.

BROKERS' REPORT CARD

Congress told the NASD to make brokers' disciplinary history available via a toll-free number in 1990. The NASD provides an edited version of brokers' records, and its members have resisted suggestions to expand disclosure.

DETAILS THE NASD OFFERS

- States where a broker is registered to do business
- Ten years of employment history
- Job terminations
- Regulatory actions, civil judicial actions, some consumer complaints
- Bankruptcies, unsatisfied judgments and/or liens

FACTS THE NASD LEAVES OUT

- Exam records
- Identification of customers who complain
- Reasons why a broker was fired
- Records of brokers who haven't been in business for two years or more
- Written customer complaints settled for under \$10,000*
- Misdemeanors, including gambling charges*
- Summary courts-martial*
- Dishonorable discharges*

*Brokers aren't required to report this information, but if it should appear on their records, the NASD will delete it before releasing the records. Sources: The NASD, state regulators

Asked why UBS PaineWebber did not report the audit on Phillips's record from two years before, spokesman Paul Marrore declined comment. Phillips is now a broker at Morgan Stanley Dean Witter in Brentwood, Tennessee.

Even when files are complete, the public may not get access to all of the data. Though state regulators and the NASD share the brokers' record system, the states tend to disclose more to the public. For example, Marco Dominic Carnevale, who left his most recent job in July 2000—with Prudential Securities Inc. in Boston—has an NASD record that shows only one customer complaint. Massachusetts state records, meanwhile, show that complaint as well as two occasions when Carnevale was "permitted to resign" by his employers; seven customer complaints spread across the months of April, July, November and December of 2001; and two customer complaints in June 1996. The allegations behind the complaints ranged from unauthorized trading to churning. Carnevale, who is no longer in the securities business, did not reply to phone messages seeking comment.

Or take Cliff R. Sharfman, a broker in Glastonbury, Connecticut, affiliated with Source Capital Group Inc. Sharfman was barred from the securities business for one year and

slapped with a penalty by the SEC, according to NASD records. Those records say that, related to the SEC action, New Jersey wouldn't permit Sharfman to do business there. Sharfman paid a \$17,290.50 civil penalty and refunded \$34,581 in an SEC lawsuit. Managers at a former employer, Investors Associates Inc., charged that he had attempted to hire professional hit men "to strong-arm firm's management."

Sharfman says all of this is "completely false." He points out further that "there isn't a single consumer complaint against me."

True enough: Sharfman's NASD record doesn't show any customer complaints, yet his Massachusetts state records tell a different story. They show five customer complaints charging—among other things—fraud, misrepresentation and breach of fiduciary duty. Sharfman says that in four of the five cases, the customers were harmed by other brokers who'd taken over accounts from him. The fifth case, he says, was settled for just \$6,000. And indeed, the Massachusetts record says it was settled "to avoid the cost and expense of litigation." Still, like many of his fellow brokers, Sharfman benefits from a system that masks his full record from investors. ▶

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BLOOMBERG TOOLS

The NASD's Public Disclosure Program

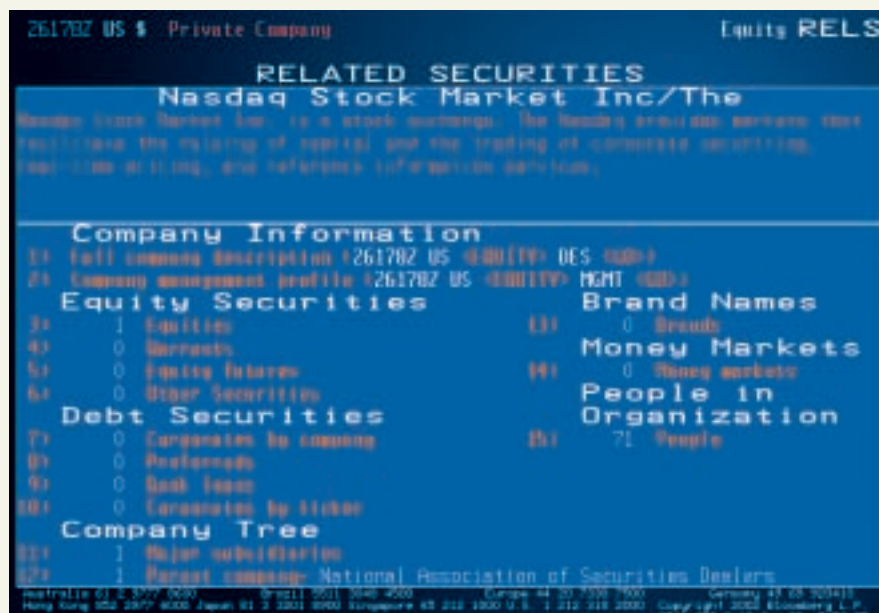
The NASD Public Disclosure Program, which maintains disciplinary data on all licensed professionals, including stockbrokers, is accessible via the NASD's Web site; type NASD <Go>. From here, you can get more information

about the program as well as perform an online search. Available data include current and 10 years of previous employment information on brokers, addresses, legal status and approved registrations. You can also request

a public disclosure report if one is available.

To find out who's who at the NASD, type NASD <Help> 10 <Go> 6 <Go> for the Nasdaq Stock Market, as shown at left, and then 12 <Go> for the NASD. Type 12 <Go> from the Related Securities screen for a list of those associated with the NASD, and then click on any listed name for more information, including job title and news. Telephone and fax numbers are also sometimes provided.

JONATHAN HELLER



For news on the NASD, type NI NASD.