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Broker-client handshake not enough, FINRA wants paperwork

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By Suzanne Barlyn
Thu Apr 11, 2013 1:19pm EDT

(Reuters) - [Morgan Stanley](#) broker Douglas Greenberg recently suffered a fate that is increasingly befalling advisers.

Greenberg was fined \$10,000 after he traded securities in a client account in 2010 without written instructions from the client or the firm to do so, according to a Financial Industry Regulatory Authority settlement dated March 27.

"The client and broker spoke and agreed on the strategy," said Abe Lampart, Greenberg's San Francisco-based lawyer. Lampart said it was not a case where the trades were not authorized.

Greenberg, who neither admitted nor denied FINRA's findings, still works at Morgan Stanley. The firm directed inquiries to Lampart.

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FINRA in most cases prohibits brokers from making such trades - a practice known as "using discretion" - without clients' written approval. Brokerage firms typically want to approve such arrangements in advance as well. Some may even bar the practice.

Yet, Greenberg is among a growing number of brokers who have been penalized by the watchdog for trading on clients' behalf without first getting permission to do so in writing, showing why, when in doubt, advisers would be well-advised to err toward getting their paperwork in order.

FINRA has disciplined 17 brokers since January for violations stemming from its rule about improper use of discretion. That is nearly twice the number of cases involving such violations during the same period last year. In all, FINRA sanctioned 47 brokers last year, in part, for not following its rule about discretion.

The penalties, which can include fines and short-term suspensions, can have serious consequences for brokers. Even a brief, five-day suspension, for example, can be a roadblock to finding a job later, especially at a big-name brokerage.

"Don't do it," said Michael Sullivan, a lawyer in Morristown, New Jersey, who advises brokers. "The rules are pretty clear."

The risk of getting slapped by FINRA could make brokers think twice before intervening in a major market shift, such as the 2010 "flash crash," when their clients may stand to lose - or gain - a bundle. The rules also create practical headaches for brokers and clients - when one of them is on vacation, for example.

"It introduces a real monkey wrench," said Joe Romano, president of Romano Brothers & Co, a wealth management firm in Evanston, Illinois. The rule should take into account whether the trade helped or harmed the customer, he added.

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The overall number of enforcement cases involving paperwork slipups are rare. The regulator oversees about 630,345 brokers and 4,270 brokerages.

Susan Axelrod, head of FINRA's member regulation unit, said in an interview that prior approval from the client is a key element of trust.

Without that approval, customers will be pleased with winning transactions, but complain about losing ones, she said. Axelrod declined to comment on recent enforcement actions.

The only exception to the rule is when brokers make the trade on the same day that the client gives them a verbal nod, according to Francis Curran, a New York-based securities lawyer who advises brokerages on regulatory issues.

In that case, the broker can decide the time at which to trade in a security or the price for certain quantities of securities. Even then, a brokerage may not allow the practice.

To be sure, not all the brokers sanctioned by FINRA were trying to honor clients' wishes. Some brokers cross the line into an offense known as "unauthorized trading." The brokers may think they are getting a good share price, for example, but never discuss the move with their client. Others may even try to boost commissions by conducting extra transactions, say lawyers.

CHASING CLIENTS

Brokers' troubles often begin when clients are either not available or reluctant to give them broad authority to make decisions on their behalf.

Some clients sign documents when opening their accounts, explicitly giving brokers such authority. But many do not.

Some worry that brokers may abuse the authority, while others know their brokers only through telephone conversations, said Richard



Roth, a New York-based lawyer who defends brokers in enforcement cases.

Roth added that brokers should also always remember to check the firm's policy on use of discretion.

Brokers can try to ease clients' worries by writing specific instructions about when the permission begins and ends, and circumstances under which the broker can trade.

For example, a client who is going away can give permission for the broker to buy \$5,000 of a stock if it goes below \$80 per share during that time, Roth said.

(Reporting by Suzanne Barlyn; Editing by Paritosh Bansal and Tim Dobbyn)

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