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# Firms Should Beef Up Surveillance for Senior Investors

Arbitration

By Antoinette Gartrell

Oct. 4 — Broker-dealer firms are getting a wake-up call to be especially careful in handling senior investors and other vulnerable clients, or risk being slapped with punitive damages in a Financial Industry Regulatory Authority arbitration proceeding.

“Firms' surveillance programs should be on steroids when dealing with clients over the age of 55,” New York attorney Matthew Farley of Drinker Biddle & Reath LLP told Bloomberg BNA Oct. 4.

Federal and state regulators have been cracking down on fraud against senior clients and other investors with diminished capacity, and it appears that FINRA arbitrators are, too (73 SLD, 4/16/15) (62 SLD, 3/31/16) (101 SLD, 5/25/16). In June, the third-largest FINRA customer arbitration award of the year included $2,000,000 in punitive damages against a broker who allegedly took advantage of an elderly investor. The remedy is often requested but rarely granted, a FINRA spokeswoman told Bloomberg BNA Sept. 30.

### ‘Off the Charts.'

Punitive damages are an unusual component of an award, New York attorney Allan N. Taffet, chair of Duval & Stachenfeld LLP's FINRA arbitration practice, told Bloomberg BNA Sept. 28. Having served as an arbitrator in the forum, he said that type of punishment is very case specific and usually only handed down when evidence of “outrageous” conduct is established at the hearing, such as evidence of elder abuse or forgery.

Jacob H. Zamansky of Zamansky LLC, New York, who represents investors in FINRA arbitrations, agreed that punitive damages are reserved for “egregious” situations when the alleged conduct is “off the charts.” Most FINRA arbitrators seek to make the customer whole again through compensatory damages and associated costs and fees, he said. Boston lawyer Christopher F. Robertson of Seyfarth Shaw LLP added that punitive damages also are meant to deter bad conduct and send a message. They usually only apply when there is “outright fraud,” he said.

Punitive damages are just one tool used to protect older investors. FINRA launched its Securities Helpline for Seniors in April 2015. As of December 2015, the call center had recovered nearly $750,000 in voluntary reimbursements from firms (01 SLD, 1/4/16). Additionally, the industry self-regulatory organization has proposed elder exploitation rules that would require firms to take specific action if they believe customers are being financially exploited (201 SLD 201, 10/19/15).

### Two Steps

Firms need to take proactive steps to avoid being a candidate for punitive damages, Farley said. First, they need to have a “robust” surveillance program that flags items for review based on predetermined criteria. Firms also should conduct inspections and report in writing the action taken, the examiner's reasoning and the conclusion, he said. “It's not what you expect, but what you inspect.”

Branch managers should also make a habit of contacting customers to make sure they're satisfied and document that, too, Farley said. Firms should also have “checks and balances” procedures in place to make sure that clients understand the services being provided and receive account statements, Robertson added. Additionally, they need to get confirmation from a guardian for clients with diminished capacity, he said.

### ‘Blatant' Violations

FINRA awarded punitive damages in the case of Denis Doyle and his now deceased wife, Gloria, who filed a claim against

Morgan Stanley Smith Barney LLC and others alleging that the broker made unauthorized trades in unsuitable investments (Doyle v. Morgan Stanley Smith Barney, LLC, Case No. 15–01700, 6/1/16 ). They requested more than $6 million in compensatory damages, as well as punitive damages, fees and costs.

The Doyles suffered from “serious disabilities” in addition to their old age, according to Los Angeles lawyer Aaron M. May of Huang Ybarra Singer & May LLP, who represented them in the proceeding. He said the case involved “blatant” violations of FINRA rules and that even though the market was rising at the time, his clients lost money while MSSB and its brokers collected more than $2 million in fees.

MSSB's compliance department saw red flags and let the broker “slide by” for a long time without taking enough action, he said. Although the punitive damages award could have been larger, May said, it was enough to send the right message. Overall, his clients were pleased that justice was served, he said.

The all-public panel found MSSB and the brokers liable and ordered them to pay $6,114,857 in compensatory damages, attorneys' fees and costs. The panel also awarded the Doyles $2 million in punitive damages because of the financial elder abuse.

Counsel to MSSB in the proceeding didn't respond to a request for comment.

### Highest Customer Awards

Here's a look at the other highest awards customers have received so far this year:

- $34,387,778 — Speer v. Morgan Stanley Smith Barney, LLC, Case No. 13–00549, 3/21/16 — In February 2013, the personal representative for the estate of Roy M. Speer, co-founder of Home Shopping Network, filed a claim against MSSB alleging that Speer's account was churned, MSSB didn't adequately supervise its brokers and violated a state law against exploitation of vulnerable adults. The estate requested $118,658,059 in compensatory damages, $355,974,177 in punitive damages, interest, disgorgement and $1,547,777 proceeding costs. MSSB requested dismissal of the claim and all defense costs.

  The all-public panel found MSSB and the brokers liable and ordered them to pay $32,840,000 plus interest and $1,547,777 in costs and witness fees.

- $10,000,000 — Montfort v. C.L. King & Associates, Inc., Case No. 12–01987, 6/7/16 — In May 2012, the estate of John Montfort filed a claim against C.L. King & Associates and others alleging misconduct stemming from the collapse of a hedging strategy that held thinly traded stocks of small companies while shorting a major index. C.L. King allegedly contributed to the collapse by providing excessive leverage and not telling the customers what it was doing. The estate requested over $30 million in compensatory damages, interests, attorneys' fees and other costs. C.L. King requested dismissal of the claims with prejudice and $5.9 million in compensatory damages plus interest.

  The all-public panel held that only C.L. King was liable and should pay $10 million in damages. It also dismissed the counterclaim and denied the estate's requests for interest, costs and fees.

- $3,586,989 — Melton v. Morgan Stanley Smith Barney, LLC, Case No. 14–00829, 6/15/16 — In March 2014, Keith Melton, a spy novelist, alleged that MSSB committed fraud and other securities violations relating to his investments in Petrobras stock and gold vectors. He also alleged that the firm made misrepresentations about the balance in his accounts.

  The all-public panel held that MSSB didn't properly supervise an advisor who made unsuitable investments, committed fraud and breached his fiduciary duty. The two were ordered to disgorge $993,989 in fees plus interest and to pay Melton $2.6 million—the difference between the actual account balance and the value reported by the advisor.

- $2,250,000 — Lee v. Citigroup Global Markets, Inc., Case No. 14–00199, 1/6/16 — In January 2014, Kenneth L. Lee filed a claim against Citigroup Global Markets Inc. and others alleging multiple violations stemming from a hypothecation loan in which Lee's shares of United Parcel Service stock served as collateral for the line of credit from CGMI. Lee requested approximately $13.6 million in compensatory damages, as well as punitive and underperformance damages, costs, fees and interest.

  The majority-public panel held that CGMI was responsible and ordered it to pay Lee $2.25 million in compensatory damages.

Customer award data and ranking is valid as of Sept. 9.

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