



THE UNSCRUPULOUS MANAGER

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Question:

A colleague of mine recently left our firm and the business, asking me to take care of a few of his clients. One client about whom he was concerned happens to be his cousin. My colleague was new to the business, and his manager handled setting up the cousin's retirement plan. After discussing the plan with my former colleague and other colleagues, and doing my own analysis, I've concluded the plan was not set up in a manner that is in this client's best interest. A big commission payout appears to have been the motivating factor behind the type of plan she's in.

How should I proceed? I want to get this transaction canceled without any surrender charges and put my client into a retirement plan that is in her best interests. After all, every decision I make should be in the client's best interest. In order to have this done, though, I would have to get that manager in trouble. How do I stay loyal to my company and my client at the same time?

Answer:

First, let me commend you on your sincere desire to correct what you believe to be an unsuitable investment in a client's account. At some point, every registered representative is faced with the conflict of generating fees or commissions versus recommending suitable investments for the client. However, a large commission does not automatically make a particular investment unsuitable.

NYSE Rule 405 states “[e]very member organization is required...to use due diligence to learn the essential facts relative to every customer, every order, every cash or margin account.” Nowhere does the rule prohibit the recommending of investments with larger-than-average commissions. Rather, Rule 405 specifically guides registered persons to use the totality of a customer's situation — for example, age, income, investment objectives, risk tolerance and level of investment sophistication — to determine the suitability of every recommendation.

If all investment products with commissions higher than, for instance, Treasury Bills, were deemed unsuitable, *per se*, then reps could not recommend an annuity to someone looking for guaranteed fixed income in retirement. Nor could you or your colleagues recommend a mutual fund with solid performance and an upfront load to parents wishing to invest for their children's future college tuition. If, after careful analysis, the investment itself is suitable, then the concomitant commission will not render it otherwise.

However, selling a security to a client simply for the sake of earning a large fee violates Rule 405, parallel NASD rules and, as you appropriately stated, the broker's duty to put the interests of the

client first. You state that earning a large fee “appears to be the motivating factor” for the client you described. Unless the broker expressly admitted to you or your colleagues that a “big commission” was the sole motivation for the transaction in question, you can only guess that his reasons were less than appropriate.

While you do not describe the security in question, you do say that your own analysis indicates a suspect motive for the transaction. If you are certain the investment itself is unsuitable for the client, large fee notwithstanding, then I would ordinarily recommend that you consult with your branch manger. However, since, in this case, you believe that your manager was involved in recommending the unsuitable investment, you would be well advised to consult with your compliance department about the situation and may choose to refer to it as a hypothetical situation.

Once you receive guidance from your compliance department, you should then proceed accordingly. No one can or should fault you for investigating what you believe to have been unethical conduct or for following the advice of your firm's compliance department.

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