COMPLIANCE WATCH:
SEC Suggests Execs On The Hook For Brokers

By Suzanne Barlyn September 1, 2009

NEW YORK (Dow Jones)--Mary Schapiro's curious missive to the retail brokerage industry's chief executives has one clear message: The buck for improper sales practices stops at the very top.

Other aspects of the U.S. Securities and Exchange Commission chairman's open letter, such as its timing, are less obvious. Sent on Monday to brokerage heads, it warned that some compensation arrangements for brokers, such as large upfront bonuses and enhanced commissions for sales of certain investment products, could ultimately pose risks to customers.

"I want to remind broker-dealer firms and their CEOs of the significant supervisory responsibilities you have under the federal securities laws to oversee broker-dealer activities, particularly with respect to sales practices," she wrote. Straightforward enough.

She also says rich compensation and commissions can pressure brokers "to believe that they must sell securities at a sufficiently high level to justify special arrangements that they have been given," wrote Schapiro. Brokers may, for example, be motivated to churn customer accounts to receive extra compensation for hitting commission targets, she wrote.

Schapiro's remarks don't carry enforcement power, but they strongly suggest that executives run a clean shop from the top down, or face possible legal action. "Under supervisory responsibilities, everything flows uphill," says David Sobel, chief compliance officer for Abel/Noser, a New York-based broker dealer. The chief executive is ultimately responsible for making sure that everyone is performing their functions, he says.

Generous signing bonuses - and the years-long commitment to a brokerage that goes with them - are nothing new in the industry. So it's the timing of Schapiro's message that's important here.

Some brokerages offer more such enticements during tough economic times, to beef up their sales teams in preparation for a market turnaround, says **Richard Roth**, a New York-based attorney who represents brokers in promissory note cases. "Brokerages have anti-trend thoughts. Now it's, 'Bring as many brokers as you can now because when the good times roll, we'll have a full staff,'" he says.

At the same time, with the market still weak, it's hard for brokers to produce and earn as much as they did before the ongoing economic crisis began.

Schapiro is positioning herself as a proactive leader, while taking aim at industry chief executives, says former SEC Chairman Harvey Pitt. "Given what's going on, I think Mary wants to demonstrate that she's acting 'ahead of the event,' rather than waiting for a problem to arise," he says.

Her message stops short of indicating any reform of broker compensation practices, an issue that's often raised amid the debate over harmonizing regulatory standards for broker-dealers and investment advisers.

Schapiro also reminded the brokerage executives to maintain "sufficient" compliance and supervisory infrastructure as their sales forces increase.

"The Chairman's letter was a signal designed for the absence of doubt," says Christopher Geczy, a finance professor and academic director of the Wharton Wealth Management Initiative at the University of Pennsylvania's Wharton School.

"The Commission is watching broker dealer behavior and holding top managers accountable for breaches. In an arena where conflicts are organic and ubiquitous, the letter sends a fairly strong message," he says.

(Suzanne Barlyn writes Compliance Watch, a column that focuses on compliance and regulatory issues affecting financial advisers. She can be reached at 201-938-4546 or by email at suzanne.barlyn@dowjones.com)