

# Reports

## *Out, Damn Spots*

The fight over the anti-expungement rule lives on—think to some brokers and their clever lawyers.

**In April**, the NASD instituted a rule meant to prevent stockbrokers from, in effect, buying their way out of client complaints—and a dinged Form U4—by settling, out-of-court, with their clients for money.

But already stockbrokers (with the help of legal counsel, no doubt) have located a loophole that substantially weakens the effectiveness of the so-called anti-expungement rule, NASD Rule 2130.

Few would argue the pure intent of the NASD rule: to stop bad brokers from ducking legitimate client complaints and the blemished U4s those complaints cause. Yet, the rule may not completely close the door on that.

The apparent and, to the NASD, annoying loophole is an affidavit signed by aggrieved clients essentially revoking their allegations—and settling the claim out-of-court. In March, five Merrill Lynch brokers managed to successfully expunge complaints from their U4s by getting their clients to say in an affidavit that the brokers did nothing wrong and weren't involved in the alleged wrongdoing.

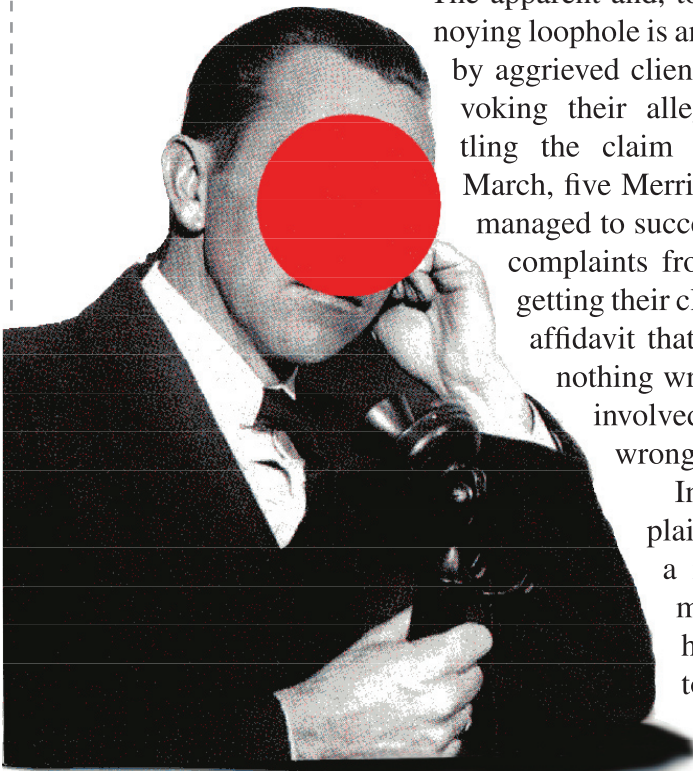
In return, the complainants received a monetary settlement without the hassles of going to arbitration. The complainants signed the

affidavits even though the initial complaint specifically accused the brokers of “unsuitable and unauthorized” investments in their accounts. (Merrill, sued for failing to supervise the brokers, settled the claims against it for an undisclosed amount; Merrill was not involved in securing the affidavits.)

Even though the cases were settled just before the rule went into effect, the NASD acknowledges that the affidavit is an effective way around it. And the NASD is not amused, saying it “disapproves” of the use of affidavits in exchange for out-of-court monetary settlements. But the regulatory body has not yet decided whether to challenge individual cases or to attempt to strike down any other loopholes through the judicial system. For now, the NASD says it doesn't expect the practice to become “too prevalent.”

Lawyers who represent financial advisors say the use of affidavits is perfectly acceptable and will hold up under further judiciary scrutiny.

“If a broker's [guilt] is dismissed by a complainant, if the facts support that [not guilty] conclusion, cleaning that U4 is just a logical, obvious step,” says Bill Singer, a partner with the law firm of Singer Frumento in New York (Singer is a Registered Rep. columnist). “This is something that could become, if not common, at least a possible step.”



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## *Information from the Front*

Defense attorneys say that it is absolutely necessary, since brokerages are sometimes more eager to settle with a complaining client than a broker is. Indeed, Armand Salese, of Salese & McCarthy in Tucson, Ariz., who represented four of the Merrill brokers in the case, says it is imperative for registered reps to have their own counsel during initial discussions with embittered clients for the very reason that a broker/dealers' and a broker's interests may not always dovetail during such proceedings.

"The broker/dealer doesn't care one way or the other; they just want to minimize their own damages," Salese says. "If the rep doesn't have a counterclaim going, he's helpless, he's out of the loop." If a broker can't be represented by his own lawyer and get his own affidavits, broker/dealers will, in some cases, simply seek to protect their own interests, Salese says.

Yet it's worth noting that even with this so-called loophole, erasing complaints from a permanent record is considerably more difficult than it was a month ago. The NASD directive allows advisors to erase past claims only if they are "factually impossible or clearly erroneous," or if the broker had nothing to do with the malfeasance. That's difficult enough when dealing with a current claim. When a case is settled, it's nearly impossible to correct.

"At the end of the day, expungements are harder to come about, and the brokers are the ones who pay," says **Richard Roth**, founder of **The Roth Law Firm** and an occasional Registered Rep. contributor.

Some lawyers say that the use of affidavits could lead to an avalanche of work for the NASD. If clients signing no-fault affidavits became commonplace, it could devalue the whole purpose of Rule 2130, which was to permanently

mark brokers rightly accused of malfeasance. The NASD could find itself forced to battle settlements involving affidavits that it finds suspicious, and that's a battle that could become time-consuming.

"It's something that could be abused, and the NASD has to know that," says Roger Crane, a partner at Nixon Peabody in New York. "They might have to develop some threshold for suspicion, and that could be more work than they can handle."

The fear: Brokers (and, eventually, broker/dealers) could potentially request no-fault affidavits as part of any settlement. Then, no matter how much they pay out in a settlement, they could claim that they're

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not guilty and not have a black mark on their U4. After all, they have an affidavit.

Salese believes it won't matter what the NASD's reaction is. "I don't think there's a way for them to close this," he says. "How can they say the registered rep can't protect himself?" But others aren't so sure. Saul Cohen, a partner in the broker/dealer practices arm of New York law firm Proskauer Rose, thinks with all the work that went into vetting Rule 2130, the NASD isn't just going to sit back and watch the rule be decimated. "If they see a sign that a lot of these affidavits are happening, they'll take action," he says. "They'll have to."

***-Will Leitch***