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A Rise in Requests From Brokers to Wipe the Slate Clean



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Seth Lipner, a lawyer who represents investors in cases against brokers.

By SUSAN ANTILLA – June 10, 2013

If an investor checked the securities industry’s official regulatory database of complaints against brokers for the name of Michele Kief, a [Wells Fargo](#) broker in Naples, Fla., it would reveal nine client disputes — enough red flags to give a customer pause.

But on May 24, a panel of arbitrators for the Financial Industry Regulatory Authority granted a request to polish Ms. Kief’s record a bit. Although Wells Fargo had agreed to pay \$125,000 to settle a complaint brought by a client who had accused the bank of negligence and fraud related to Ms. Kief’s actions, the arbitrators said the investments at issue were “suitable and safe” for the client and agreed to recommend deletion of the complaint from her record. They drew the conclusion after a hearing at which only Ms. Kief was represented. The client, although invited, declined to attend.

Similarly, in February, three Finra arbitrators agreed to recommend deletion of a complaint against Kimon P. Daifotis, a former [Charles Schwab](#) executive who had run a fund called Schwab Yield Plus in which investors lost hundreds of millions of dollars. It was the eighth such recommendation by arbitrators for Mr. Daifotis since last August, despite the fact that he had agreed in a settlement with the [Securities and Exchange Commission](#) to be barred from the business and to pay \$325,000 in penalties and forfeited profits. Mr. Daifotis did not admit or deny wrongdoing and will be allowed to reapply for Finra membership in 2015.

As Main Street investors rely increasingly on Finra's online database, BrokerCheck, to vet professionals on Wall Street, brokers and executives like Ms. Kief and Mr. Daifotis are pursuing every means possible to remove negative information from their records. Ms. Kief, in fact, even went so far as to ask her arbitrators to expunge two unrelated arbitrations, which the panel declined to do.

"People are starting to use BrokerCheck the way they use TripAdvisor," said Seth E. Lipner, a professor of law at the Zicklin School of Business at [Baruch College](#) who represents investors in cases against brokers. "No broker wants these red flags on their record."

The effort to expunge records would be less critical if brokers were subject to the same legal exposure as other professionals who are defendants in lawsuits brought by customers, like doctors or lawyers, investor advocates say.

But as a result of a 1987 Supreme Court decision, brokerage firms have been able to insist that customers give up their right to sue in court before they can even open an account. The resulting transfer of investor lawsuits to private arbitration has meant that Wall Street firms and their employees have avoided the burden of a court record of claims against them for a quarter-century. Arbitration hearings are closed and documents are not available to the public. The information on BrokerCheck is thus the only repository of allegations an investor can mine.

BrokerCheck includes information about customer complaints, regulatory actions and brokers' criminal histories, liens and bankruptcies. Finra rules say brokers can obtain recommendations for deletions if arbitrators decide a claim is false or erroneous or the broker wasn't involved in the alleged misdeed. Sometimes a broker is named in a complaint, but has played no role in the suspected wrongdoing. A court confirmation is required after a recommendation.

Investors relying on BrokerCheck can take comfort that some warning flags always remain. BrokerCheck does not include all the complaints against Mr. Daifotis, for example, but it does reveal his settlement with the S.E.C. Ms. Kief's record shows nine complaints, including the one regulators recently recommended for expungement.



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Seth Lipner and other lawyers say too many bad brokers are getting complaints deleted.

Anthony Mattera, a Wells Fargo spokesman, said the company did not seek to have complaints removed unless it had “a high degree of confidence” that it met at least one of the Finra requirements. He said Ms. Kief declined to comment.

Audette Morales, a lawyer for Mr. Daifotis, said that arbitrators in many of the claims against him were aware of the S.E.C. action, adding that Mr. Daifotis had followed Finra’s guidelines for expungement. Brokers seeking expungement must go through a series of steps that can take one or more years to satisfy before an item is actually removed, said a Finra spokeswoman, Michelle Ong, and state regulators are informed when a local broker is seeking to remove information, giving them a chance to protest if they think a complaint should remain.

Last year, state regulators received 519 requests from brokers asking to be allowed to move forward with a panel’s expungement recommendation, up from 110 in 2009, according to Melanie Senter Lubin, the Maryland securities commissioner and chairwoman of the broker records steering committee for the North American Securities Administrators Association, a group of state securities regulators. Ms. Lubin attributes the increase in requests to soaring investor grievances in the wake of the credit crisis and says the 519 requests last year amount to a small number when considered in the context of total arbitration cases. Last year, 4,299 new cases were filed.

Ms. Ong said that Finra tracked the number of expungements granted, but would not disclose it. Some of the surge in requests is also the result of new disclosure demands by Finra. Until 2009, only brokers who were named as a party to a case had to disclose a customer complaint. Because most investors sue only the brokerage firm, that left a lot of accused brokers with clean records despite complaints that they had mishandled an account.

Finra closed that loophole, forcing all brokers to report complaints, whether they were named as a respondent or not. But the 2009 rule drew resistance from the securities industry, and Finra is expected to release a proposal in August that will make it easier for those unidentified brokers to scrub their records in cases where there has been a full hearing and a decision by the arbitrators.

The prospect of new opportunities for deletion has pitted Wall Street and Finra against investor advocates and lawyers like Professor Lipner, who say too many bad brokers are having their records erased. Professor Lipner analyzed 150 requests to purge information in the fourth quarters of 2011 and 2012 in cases that had settled before a hearing had begun and found that arbitrators granted recommendations for expungement in all but five cases.

Arbitrators have been known to clean up the records of multiple brokers in a single hearing. On Feb. 8, an arbitrator in Omaha recommended expungement of dozens of customer complaints against 22 brokers at Securities America. The decision was made after devoting only a half-day to hear the brokers' arguments. On May 23, six more Securities America brokers received an expungement recommendation from the same arbitrator.

Critics of Finra policies also say many brokers are simply purchasing a clean record by offering substantial money in return for the customer's agreement not to oppose an expungement request. If a broker seeks expungement after reaching a confidential settlement with a customer, Finra says arbitrators must review the settlement documents and hold a recorded hearing. When arbitrators meet to consider a request, they typically only hear the broker's side of the story, making it easier to conclude that accusations are false or erroneous.

From time to time, an arbitrator will protest that the process is flawed because a customer has been manipulated into agreeing to an expungement. In 2007, an arbitrator, Sidney Werner, wrote a dissent, noting that his panel had concluded a claim against a Maryland broker, Joseph R. Karsner IV, was erroneous or false despite having reviewed no evidence. It was clear that Mr. Karsner had conditioned the settlement on the investor's agreement to expungement, Mr. Werner wrote. "It is the responsibility of the panel to see through a ruse such as this."

A year later, after Mr. Karsner had obtained 18 expungements, the Maryland Securities Commissioner accused him of "dishonest and unethical practices" and he agreed not to seek a broker's license in the state until 2016. His BrokerCheck records include an example of the value of a customer's promise to approve expungement: Mr. Karsner wrote in his Finra records that an offer to settle with one customer for \$15,000 would be "automatically" reduced to \$9,999 if the expungement request was denied.

Finra is aware of concerns that arbitrators are sometimes making decisions without knowledge of problems in a broker's background. Ms. Ong says Finra has "determined to review whether we should broaden the types of documents that arbitrators should review" when they consider brokers' requests.