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March 29, 2010

Enforcement Alert

Live up to tasks WSPs assign to you or face consequences, case shows

If you're assigned certain tasks and discretion under your firm's written supervisory procedures, make sure you exercise the authority granted to you. A recent case involving one firm's executive vice president for risk management illustrates what can happen if you don't.

Melvin Peterson, the executive vice president for risk management at **Emmet A. Larkin Co.**, of San Francisco, recently was suspended for supervisory failures after FINRA determined he failed to act on red flags that indicated excessive trading by three reps in branch offices. Peterson failed to contact the customers of the questionable reps, even though the WSPs gave him the discretion to do so, according to FINRA. The reps – **Richard Mentz**, **Kelley Wright**, and **Anthony Chatman** – have since been barred for fraudulent activity.

Peterson was fined $15,000 and suspended from acting as a supervising principal for one year. The firm withdrew from FINRA membership last year, according to BrokerCheck.

"It drives home the importance of understanding what you're delegated to do in your WSPs, and to make sure that you not only implement [those tasks], but you document your implementation to protect yourself," says **Louis Dempsey**, founder and president of **Renaissance Regulatory Services, Inc.** of Boca Raton, Fla. Many people come into jobs and don't read the WSPs to see what tasks have been assigned to that worker, he says.

Best practices indicate you should send letters to customers if there's questionable activity in the customer's account. Make sure you get the customer's response, he notes. If questionable activity is still going on, call the customer and document what was said in that conversation, he suggests.

The case

Between January 2003 and April 2005, Emmet Larkin's WSPs said that Peterson was responsible for reviewing daily trade tickets, including option trades, made by the firm's reps, according to the FINRA settlement document. The WSPs also said Peterson was responsible for the monthly review of all active options accounts. Peterson, however, wasn't a Registered Options Principal during that time.

In addition, the WSPs described a report called a Monthly Surveillance Activity Report (MSAR) that would be generated for accounts that had 10 or more trades, $1,500 in commission charges, three or more Regulation T requests, or a 10% or $20,000 decline in equity in a given month. Any account that appeared on the MSAR for two of three consecutive months would be subject to "active account surveillance," which required a review of: a) account agreements and account statements, b) month-to-date gross commissions, and c) the quantity and principal amount of buys and sells.

For such accounts, the firm's compliance department created spreadsheets that included information such as turnover, account profit and losses, and commissions, which were e-mailed to Peterson, FINRA says. Peterson was responsible for contacting reps whose accounts appeared on reports sent to him and investigating the activity. The WSPs also gave Peterson the power to contact customers as part of the investigation.

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Peterson *(cont. from pg. 1)*

The names of Mentz, Wright, and Chatman repeatedly appeared on those reports between January 2003 and April 2005. Despite the red flags about Mentz's handling of an account, Peterson merely relied on Mentz's unsubstantiated and false claims and order entry records that showed that the customer initiated all the trades, FINRA says. Peterson didn't contact the customer or restrict trading in the account, a failure to reasonably respond, FINRA determined.

Peterson also failed to take reasonable steps to address red flags regarding 10 accounts handled by Wright and Chatman, FINRA says. Peterson also failed to contact the customers or restrict trading for those accounts. Instead, he merely relied on Wright and Chatman's unsubstantiated claims that the customers were financially sophisticated and satisfied with their accounts, FINRA says.

Steve Candela, a consultant with **SEC Compliance Consultants** in Philadelphia, says, "In my opinion, any client paying commissions in excess of 20% of his equity, regardless of profits in the account, or who is directing the trades, should get a letter or call from a supervisor, and the client response needs to be documented. This should be done as often as conditions necessitate, but at least annually."

One approach to head off problems like those that arose in the Peterson case is to have two people review the excessive trading documents and concur on what to do, or to have a letter to the client be automatically generated based on the report, Candela says. Because the reps would know when the letters would be sent, the firm should require written responses from the clients, he explains. If there is no response from the client, withhold any commissions earned by the rep on the account until things are resolved, Candela recommends.

He adds that if one client is generating more than 5% of an experienced rep's income, the firm should look at that activity, whether or not it hits an activity report. Also, consider rotating the duty for this kind of trade supervision on a quarterly basis, he recommends. ■

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