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MARKETS

Stockbrokers Fail to Disclose Red Flags

WSJ Analysis Shows More Than 1,600 Stockbrokers Have Bankruptcies or Criminal Charges in Their Past That Weren't Reported

Investor Robert Mazzella said he lost most of his life savings through the actions of a stockbroker who failed to disclose a bankruptcy and other issues. *PHILIP MONTGOMERY FOR THE WALL STREET JOURNAL*

By **JEAN EAGLESHAM** and **ROB BARRY**
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In less than two years, stockbroker Marcos D. Leiva racked up a personal bankruptcy, a tax lien, a court judgment for unpaid debt and a criminal guilty plea relating to a false report to law enforcement.

Each should have been promptly disclosed to investors. None was.

Mr. Leiva is one of more than 1,600 stockbrokers whose records failed to disclose bankruptcy filings, criminal charges or other red flags in violation of regulations, without regulators noticing, according to a Wall Street Journal analysis.

These same brokers have also accumulated more disciplinary actions by regulators and complaints from clients, on average, than other brokers, the Journal's analysis of hundreds of thousands of stockbroker records shows.

The findings reveal a significant hole in regulation of the brokerage business. Brokers' records are something investors expect to be able to learn before entrusting money. In Mr. Leiva's case, a 75-year-old client claimed he lost most of his life savings through the broker's actions, recovering only a fraction.

Mr. Leiva, who was working on New York's Long Island, couldn't be reached for comment.

The Financial Industry Regulatory Authority, a self-regulatory body commonly called Finra, requires brokers and the firms that employ them to report a wide range of issues, including bankruptcies and criminal charges brokers have faced. This is meant to enable investors to look up brokers on a Finra website called "BrokerCheck" and quickly find out their professional history.

"We are deeply concerned by these reporting failures, which are inconsistent with the regulatory responsibility of both firms and their registered persons," a Finra spokeswoman said. "This situation is unacceptable."

The regulator said it would seek to ensure that its database is updated and will focus on potentially "bringing swift disciplinary actions where appropriate."

Finra, which describes itself as the "first line of defense" to protect investors, can impose penalties including fines and exclusion from the industry for reporting failures. Finra said that it often has taken disciplinary action against individuals and firms that break the rules, and that brokers risk being barred if they willfully fail to report required information.

The Journal took a unique database, gathered from 21 states, of more than 500,000 stockbrokers who were still working in the industry last year and compared it with criminal and bankruptcy-court filings. This revealed more than 1,500 brokers with personal-bankruptcy filings from 2004 through 2012 that aren't in their regulatory records, and 150 brokers whose records don't include criminal charges or convictions that should have been reported. Brokers' records should show personal bankruptcy petitions filed within the last 10 years.

While a bankruptcy filing in itself doesn't suggest dishonesty, brokers who had unreported bankruptcies had worse disciplinary records than the industry norm, on average. For example, they were more than twice as likely to have been fired. About one in 33 had three or more other black marks such as customer complaints or terminations on their regulatory histories, a rate more than 65% higher than other brokers.

Finra requires brokers to tell their employers about any felony charges or convictions, as well as about finance-related and certain other misdemeanor charges. The scores of unreported charges uncovered by the Journal include burglary, forgery, larceny, theft, bad checks, identity theft, assault with a deadly weapon, stalking, sexual battery, false imprisonment, bail jumping and drug offenses. Firms are required to pass brokers' disclosures along to Finra.

Firms must check whether new employees have a criminal history by sending the new hires' fingerprints to Finra, which uses the Federal Bureau of Investigation to run a records check.

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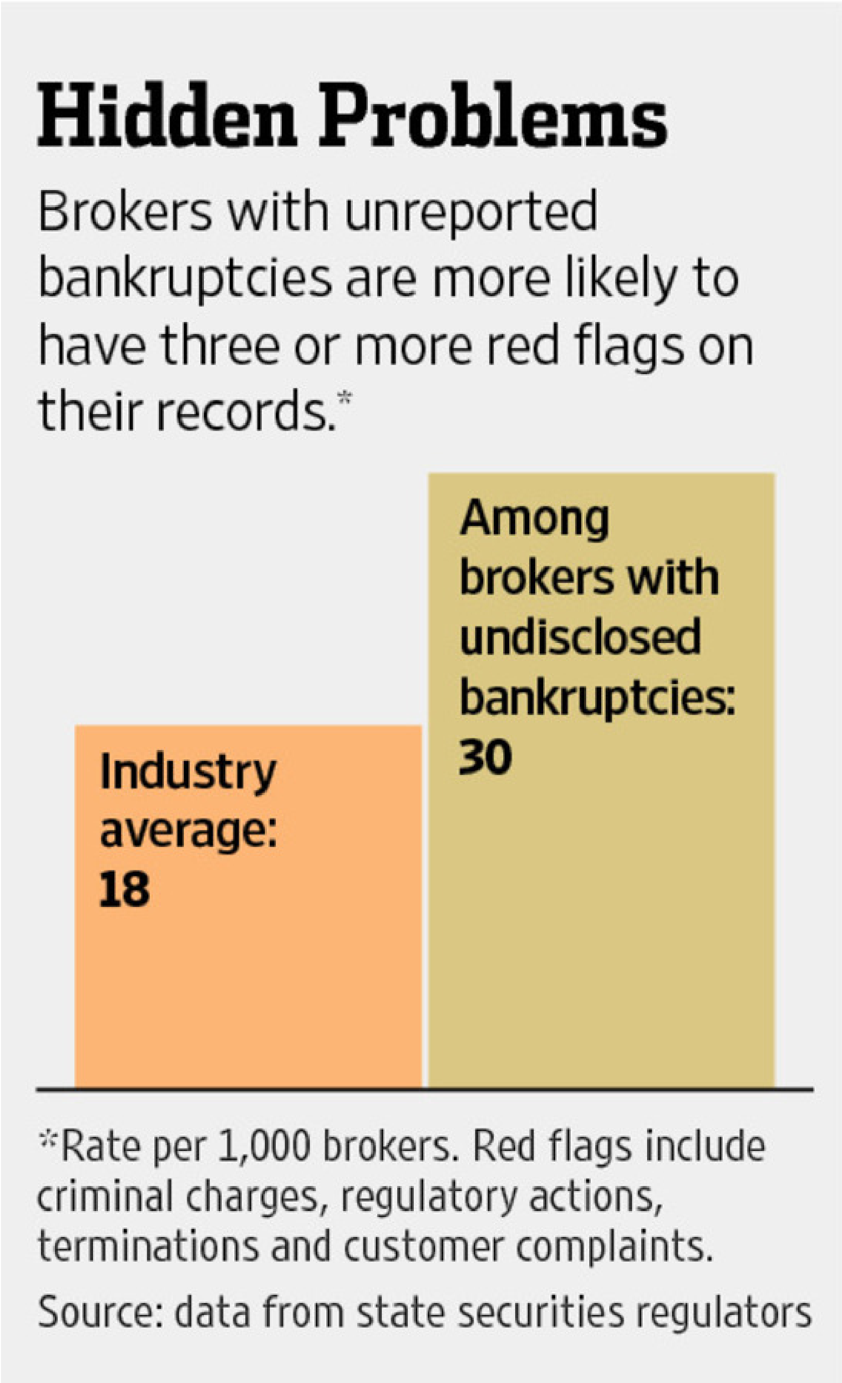
This system is far from foolproof. In the case of Mr. Leiva—the broker whose regulatory record failed to include a judgment for unpaid debt and a criminal guilty plea—the 2010 plea should have barred him from selling securities for a decade, according to Finra. Mr. Leiva, 38, pleaded guilty to filing a false report to law enforcement while facing traffic-related allegations in a Scottsdale, Ariz., court.

Regulators didn't know about the plea. It was only after 75-year-old New York investor Robert Mazzella filed an arbitration complaint in 2012 that Finra stepped in. Among Finra's allegations: that Mr. Leiva had improperly paid Mr. Mazzella a total of $800 in 2010 and 2011 to try to persuade him not to complain about losing his $200,000 savings.



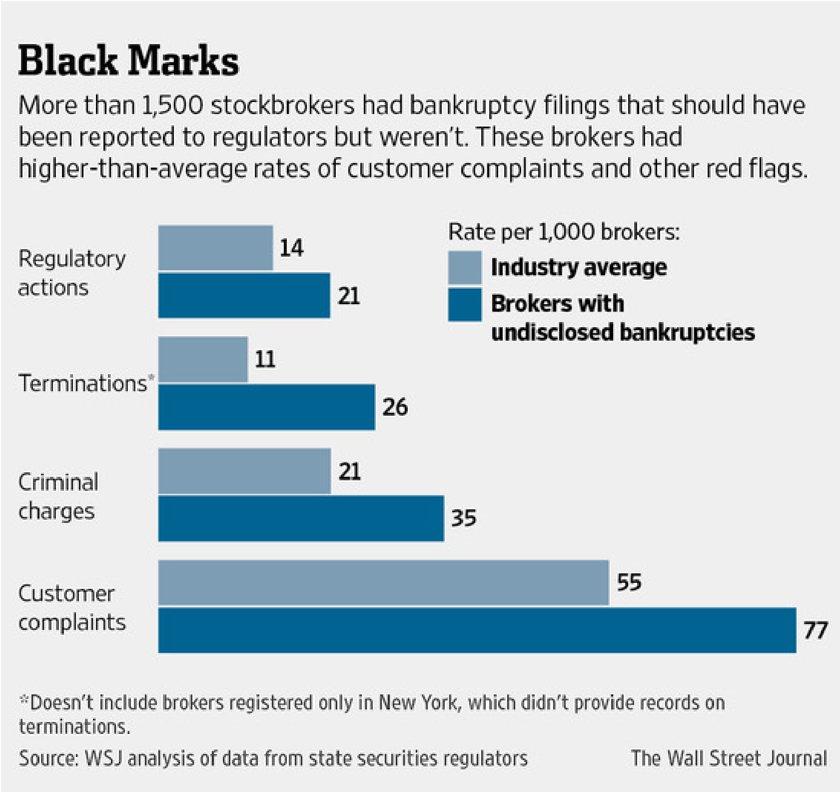
Finra suspended the broker for 13 months and fined him $10,000, a sanction Mr. Leiva agreed to without admitting or denying the allegations. Finra said the firm that employed Mr. Leiva at the time, on New York's Long Island, didn't know about the alleged $800 payment. That firm, Newport Coast Securities Inc., didn't respond to a request for comment.

Finra's action against Mr. Leiva "doesn't help me at all," Mr. Mazzella said. "I've lost my life savings because I was duped by this person," he said.

Mr. Mazzella's 2012 arbitration complaint alleged that his investment had been "handled aggressively, producing exorbitant commissions...until it was nearly worthless." One of Mr. Leiva's former employers settled the matter for about $15,000, said people familiar with the confidential agreement. This former employer, Trident Partners Ltd., declined to comment.

Mr. Mazzella's lawyer, Kevin Conway, said it was difficult to recoup his client's full loss because Mr. Leiva was bankrupt and his employer when most of "the damage was done," a firm called Basic Investors Inc., had left the industry.

At a Phoenix law firm that represented Mr. Leiva in his bankruptcy case, Leonard V. Sominsky Esq PC, a woman who answered the phone declined to pass on a request for



comment to Mr. Leiva, saying: "We're not going to hunt him down for you."

Under Finra rules, brokers' employers have an obligation to report information they know or should have known. They aren't generally required to do further background checks after they have hired a broker. Finra puts the onus on individual brokers to report relevant events.

The Securities and Exchange Commission, which oversees the Wall Street self-regulator, has said in rulings on disciplinary proceedings that Finra "must depend on its members to report to it accurately" because its membership of over 4,000 firms and 635,000 brokers means it "cannot investigate the veracity of every detail in each document filed with it." The SEC declined to comment on the gaps in reporting.

Finra last year took disciplinary action against 129 brokers and firms for "reporting and filing violations," said a spokeswoman.

Reporting gaps aren't confined to brokers at small firms. The 10 largest brokerage firms in the Journal's analysis employ at least 450 people with bankruptcy filings that should have been reported, but weren't.

One of Finra's biggest recent fines was $500,000, imposed on Merrill Lynch in 2012 for not making timely reports of more than 650 customer complaints, regulatory actions, felony charges, convictions and other issues concerning brokers.

Merrill paid the fine without admitting or denying wrongdoing. A spokesman for Bank of America Corp., which owns Merrill, referred to what it said at the time: that it had enhanced its policies and procedures to address the issues raised.

Firms can fail to pick up on reporting failures even when they are named as defendants in a broker's bankruptcy.

After broker Nicholas J. Hoetmer and his wife filed for bankruptcy in 2010, the trustee sued him and the pension plan of his employer, J.P. Morgan Chase & Co., alleging Mr. Hoetmer had put money into the plan that under bankruptcy rules should have been used to pay certain debts.

The complaint described Mr. Hoetmer, now 54, as "employed as an investment adviser with JPMorgan Chase Investments in Indianapolis, Indiana." The bankruptcy filing didn't appear on Mr. Hoetmer's BrokerCheck report until after the Journal contacted J.P. Morgan.

Mr. Hoetmer, still a broker there, didn't respond to requests for comment. A J.P. Morgan spokeswoman said, "We require our advisers, through annual training, certifications and reminders, to report disclosures within a timely manner." She declined further comment.

A bankruptcy judge dismissed the trustee's complaint against the J.P. Morgan pension plan and upheld it against the broker.

In some instances, multiple bankruptcy filings or felony charges escape reporting.

Stockbroker Ronald J. Garabed didn't report four bankruptcy petitions he filed between 1997 and 2007, according to a disciplinary action against him by Finra. The regulator also alleged that Mr. Garabed borrowed $15,000 from a customer in 2006, in breach of the policies of his employer, a brokerage unit of MetLife Inc. MetLife didn't detect the problems until 2010, when it fired Mr. Garabed, the records show.

Finra suspended Mr. Garabed, now 63, from acting as a broker and fined him $10,000 the following year. Mr. Garabed, who settled the Finra case without admitting or denying the findings, couldn't be reached for comment.

MetLife said it requires its brokers to attend annual compliance meetings and training. "When any of our advisers engage in behavior that calls their integrity into question, we investigate and, if warranted, take disciplinary action," the company said.

The Journal found at least 103 brokers still working last year who had managed to enter the industry without their regulatory records showing that they had filed for bankruptcy.

A broker's reporting failures can be a warning sign of future regulatory problems. Former J.P. Morgan stockbroker Tiara Monique Jones filed a bankruptcy petition in

2010, which she didn't report, according to a Finra disciplinary action against her. The next year, Ms. Jones allegedly withdrew $1,000 from two customers' joint account without their knowledge, according to the Finra action.

When they complained, she repaid the money and was fired, Finra said in the disciplinary action.

Last year, Finra barred Ms. Jones, now 33, from the industry. She couldn't be reached for comment. J.P. Morgan said it wouldn't comment on a former employee but reiterated its commitment to proper disclosure.

Some brokers said they had made disclosures to their employers and assumed the firms would alert Finra.

Edwin Brent Lundgren said in an interview that he reported a bankruptcy filing in October 2010 to J.P. Turner & Co. when the firm hired him that month. "I told them about it, and they said they'd take care of it," he said.

A spokeswoman for J.P. Turner said Mr. Lundgren "signed or acknowledged at least 10 times" that he didn't have a bankruptcy filing. She said the firm "takes measures to ensure we are aware of any reportable issues and certainly report them as we learn of them."

J.P. Turner fired Mr. Lundgren last year after receiving several complaints with "allegations of misrepresentation, unsuitability and forgery" related to his sales to clients of stakes in an oil-and-gas partnership while he was at two previous firms, according to his BrokerCheck record.

In September, North Dakota's securities regulator refused to register Mr. Lundgren in the state, citing the unresolved customer complaints.

Mr. Lundgren, 61, rejected the misconduct allegations in a statement in his BrokerCheck file. "There was no forgery on my part," he said there, adding: "I feel bad for the [customers] and especially how they feel about me."

One of his former customers, Mary Ohlhauser of Bismarck, N.D., said she didn't know he had filed a bankruptcy petition.

Mrs. Ohlhauser said she and her husband would love to "see anything, even a buck," of the $50,000 she said Mr. Lundgren persuaded them to invest.

Even if Finra's requirements were followed to the letter, the system wouldn't detect everything about a broker's background that investors might want to know.

George Salameh is set to face a trial this year for his alleged involvement in what the Florida Department of Law Enforcement called an "organized theft ring." Prosecutors accuse Mr. Salameh, formerly employed by a brokerage unit of Allstate Corp., of using his business bank account in St. Johns, Fla., to cash fraudulent tax-refund checks. Mr. Salameh, 55 years old, has denied wrongdoing and is fighting the charges, which were reported and appear on his BrokerCheck file.

This isn't his first brush with the law. He pleaded guilty to a felony theft charge in 1992, according to Duval County court records, which were ordered sealed in 1997 but which the Journal nonetheless was able to view. He was placed on five years' probation under a "withholding of adjudication" that meant he wasn't formally convicted, the records show.

A lawyer for Mr. Salameh, Mark Rosenblum, declined to comment on his behalf.

This 1992 felony charge isn't reported on Mr. Salameh's regulatory filing. Allstate said Mr. Salameh told it before joining in 2000 that he had no criminal record. The firm—which said no brokerage customers were affected—said it "ran Salameh's fingerprints with the FBI and they came back clean." The company said this might be because of the withholding of adjudication and court's order to seal case documents.

Indeed, a Finra spokeswoman said the 1992 criminal charge didn't need to be reported. It said the sealing of the case under Florida law has the "same net effect as an expungement."

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