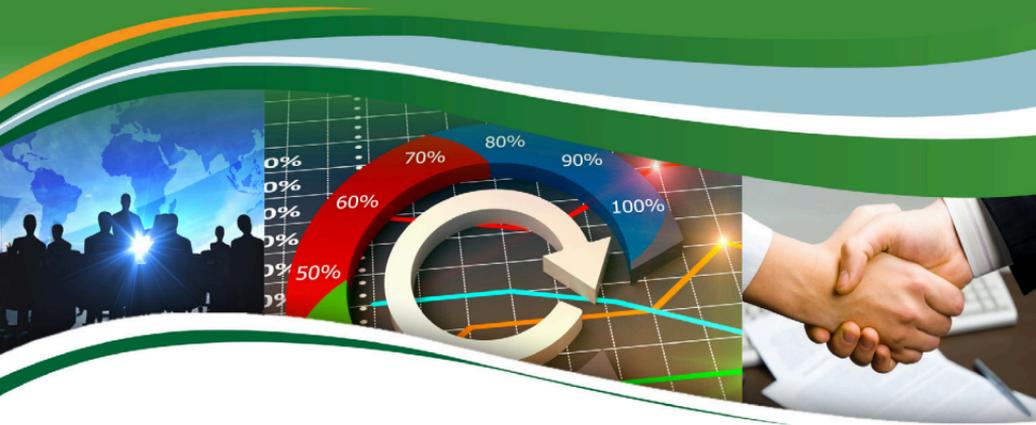


A Guide to Everyday Risk Avoidance Techniques and How To Address a Customer Complaint



Prepared and presented by

Joshua Horn, Esq.

and the Securities Industry Group

215.299.2184

jhorn@foxrothschild.com



Fox Rothschild LLP
ATTORNEYS AT LAW



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Introduction

Throughout the many years that I have defended financial advisors and their employers, we have often heard our clients ask, “I worked so hard and went out of my way for this client, so why I am being sued?” The answer to that question in most instances has nothing to do with the work ethic of the advisor.

The seeds of many customer-initiated complaints are not sown in malfeasance or negligence, but, frequently stem, instead, from customer selection and long-term client management, including a lack of adequate communication. When a client lodges a complaint, improper handling of that complaint exacerbates the problem, whether real or perceived.

This guide was created to highlight common pitfalls, problematic client conduct, unique issues when working with seniors and simple techniques that financial advisors may use to minimize their risk of being sued, and, if sued, provide a strong defense. It also addresses critical initial steps regarding the handling of a customer complaint.



Initiation of the Relationship – Where Most Problems Begin

The most recent bear market brought about improvements in the client intake process by requiring, among other things, greater fact-gathering from new clients to ensure that the more defined and heightened “know your customer” requirements are met at the initiation of the customer relationship, and, at least, on a yearly basis thereafter. Although the SEC has yet to adopt a uniform fiduciary duty standard for all advisors who provide retail investment advice, the SEC and FINRA are taking a harder and more critical look at the conduct of firms and individual financial advisors vis-à-vis their clients.

The best and most detailed-oriented client intake process will do nothing if the financial advisors using them do not take a more discerning approach to who they want as clients, and how they handle those individuals after they become their clients. In this highly competitive industry, financial advisors frequently succumb to the desire to build their client base and ignore red flags signaling potential trouble before the relationship even begins.

Three Common Pitfalls

1. Taking on the Free Agent Client

The free agent client has worked with a number of different advisors over a short period of time before coming to you. They are typically shopping for returns and the promise of a better day, and that trait, in our experience, should raise every red flag and ring every alarm bell. Although there are instances where it is necessary to change an advisor (e.g., personality conflicts or advisor retirement), constant turnover of advisors in a short period of time is indicative of a client who may never be satisfied and, in all likelihood, will be the first to initiate a lawsuit. If you think that you may have the answer to the free agent's past issues with advisors, you are setting yourself up for potential problems.

2. Shoehorning a Client to Your Investment Style

It is critical to recommend investments that are best suited for the client rather than trying to force a client into your personal investing style. A former financial advisor that we defended in multiple customer complaints and an enforcement matter characterized himself as a long-term buy-and-hold advisor who only recommended investments in individual equities. Many of his clients



became very wealthy in the bull market, but those same investors suffered in the bear market. He was a financial advisor best suited for the more affluent who can withstand wide fluctuations in the value of their accounts, not for a widow living off of a life insurance policy or an unemployed individual living off of a small family trust. Both of these descriptions fit “real-world” clients who brought claims against him for unsuitable investment recommendations. The lesson: If the advisor is unable or unwilling to modify his or her approach, to meet a client’s situational profile, then it is best for all parties involved to refer the client to an advisor who will better serve the client’s needs.

3. Placating Unrealistic Client Expectations

A client in her 40s, with \$500,000 in liquid assets, a self-characterized moderate investment style, who wants to retire early, is a disaster waiting to happen. No matter how much initial “know your customer” analysis you perform, this client has unrealistic expectations and it is best not to give in to them. This person cannot afford to retire early without taking substantial risk to grow her assets, and the advisor who takes on this client is unwittingly becoming a likely target of a lawsuit. If the client does not take substantial risk, the assets will not last through retirement, but if the client takes substantial market risk, the assets are at risk of another market downturn.



Regardless of whether an advisor decides to take on one of these potential problem clients, there are simple tools that all advisors can employ to better protect themselves. The next section focuses on issues involving a discreet group of clients: the elderly. The subsequent section details a common sense approach to minimize risk throughout the advisor/client relationship regardless of client age. The two hallmarks to this approach are communication and documentation.

Elder Clients – Unique Risks

Short of refusing to handle customers of a certain age, all of you will be faced at some point with dilemmas presented by older clients. The graying of our society presents some special considerations when it comes to risk avoidance.

As our investing populations ages, firms are on a more frequent basis being faced with clients suffering from dementia. Once a client is suffering from dementia, what is a firm to do? Unfortunately, there are not many great options if there has been no advanced planning by the client. First, the firm can fire the client at the first sign of some type of cognitive issue. Second, the firm could freeze the subject account, and petition the court to resolve whatever issues the firm has to address; i.e., unusual account activity by the account holder or a family fight over assets.

There are risks and practical considerations with each of these approaches. The first may not be feasible, particularly if the client is invested in proprietary and non-transferrable investments. The second is not without a cost and may present issues if the account is frozen when there is a market downturn and investments cannot be sold to avoid a loss.



The better practice is to address these issues at the time that the client hires the firm. Part of the initial financial planning/account opening process should be to cover a “what to do in the event of dementia” contingency. Firms should make it a best practice to train their financial advisors to make dementia planning a routine aspect of their services for their older clients.

For example, a firm may want to have a special account opening process for anyone who is 60 years or older. The process could include requiring another person such as a spouse, family member or trusted friend to have a formal power of attorney to handle the investments in the event that there is an issue with the account holder. This person should have to sign the account opening agreements and attest that he/she is a fiduciary to act on behalf of the account owner. By having this person serve as a “fiduciary,” he or she will have an independent legal obligation to protect the impaired customer. This will hopefully avoid the issue of a charlatan taking over an infirm client’s assets. This process could also be used for existing accounts when the record owner reaches a certain age, such as 60.

Still other options include, among others, requiring elderly clients to go under a periodic screening process to determine if they have the capacity to make financial



decisions, implement heightened supervision of accounts where the owner is of a certain age to make sure that the investments are suitable, and to have a firm committee whose purpose is to address elder issues. Again, there are risks and practical issues with any approach.

Whatever avenue you pursue when working with elder clients, the key is early planning before dementia or other problems arise.

Common Sense Risk Avoidance Techniques

Open, Honest and Frequent Communication

The simplest way to avoid problems with all clients regardless of age is to maintain open and frequent communication. This is rather self-evident: financial advisors who do not communicate with their clients become financial advisors who no longer have clients.

This takes on particular significance when working with clients of an older generation. With these clients, you should take particular care to provide them with additional detailed information, especially when it comes to the sale of complex products. The SEC and FINRA are critically reviewing those disclosures and the treatment of seniors in general, and taking action against those whose failure to provide adequate disclosures causes client harm.

When it comes to general communications, it is easy to share good news when the markets are performing well. Communicating after the markets retreat, however, is the key to survival and ultimate success. This approach requires more than just a dialogue; communication must be followed with documentation.

When a down market hits, clients often call their advisors to express concern, and often one of two things happens:



the client either does not receive a prompt return call or does receive a return call but the advisor comes across as unsympathetic. Clients are your lifeblood and, at times, they require some delicate hand-holding. By failing to respond to a client's call, a financial advisor will make a rather innocent issue fester into a major problem. Similarly, an inappropriate response may, in many ways, be worse than no response at all. Best practice is to return all phone calls every day and to treat each client the way you would want to be treated by your own financial advisor. If you find yourself speaking to your client in a way that would upset you, then you are not communicating properly with your clients.

Documentation: The Key to Survival

Document Communications

Equally important to maintaining communication is documenting communication. To illustrate this point, let us offer a real-life example: Some years ago, a widow claimed that her husband's advisor improperly allowed him to cash out a life insurance policy. The facts revealed that the husband wanted the cash to buy real estate in Florida. The advisor recommended against doing so until the husband cleared underwriting for a new policy, but the husband ignored this advice and cashed out the policy. Before completion of underwriting on the new policy, a bee stung



the husband, and he died of anaphylaxis. Fortunately, the advisor had detailed contemporaneous notes of all of his communications with the husband, including the warning against cashing out the first policy before completion of underwriting on the second. The simple act of taking detailed notes insulated the financial advisor and his employer from substantial liability.

Document Recommendations

Advisors must also document recommendations, especially the potential risks/rewards associated with those recommendations. This is particularly important when it comes to complex investment products as well as those directed to your older client base. In a customer-initiated arbitration, arbitrators are often faced with two divergent stories: the advisor claims full disclosure and the customer claims there was no disclosure. Avoid this “he said/she said” credibility debate by following up all verbal investment recommendations with a written confirmation. The advisor should not rely upon the fact that the client will receive a prospectus in the mail (after the investment is made), which the client will probably discard and never read. In the follow-up written communication, the advisor should simply recap the recommendation and highlight the risks and rewards



inherent in the investment. The level of detail associated with the disclosures should be directly proportional to the complexity of the product being recommended, as well as the age of the client: senior clients should get more detailed disclosures. The letter should conclude with a standard admonition, such as, “If you have any questions or need any further information about these recommendations, please contact me.” Doing this not only protects the client against making a mistake, but establishes written support of full disclosure on behalf of the advisor.

Document When a Client Disregards Your Advice

If an advisor prepared a financial plan and the client deviates from that plan, the advisor should caution the client in writing about the impact the deviation may have on the client’s financial goals and objectives. The most common situation where this occurs is when a client inexplicably withdraws substantial amounts of cash. In this scenario, the advisor should caution the client in writing against taking significant withdrawals and highlight the effect of continued high withdrawals. Should this client initiate a complaint at some future point, the stack of letters/e-mails cautioning the client against the suspect conduct becomes the best defense.

A Complaint: What Should You Do Next?

Customers lodge both informal complaints (verbal or written complaint) and formal ones (such as a statement of claim through FINRA). Handling a complaint properly in the earliest stages affects the ultimate outcome. Although the firm compliance manual should be the primary resource guide for the advisor faced with a complaint, this section highlights what an advisor should and should not do when first faced with a complaint.

Forward the Complaint to the Proper Personnel

All complaints, whether informal or formal, should be handled in the same fashion. An advisor should not try and take the matter into his or her hands. The advisor should immediately forward the complaint to those individuals designated to handle such matters, namely, a managing principal, compliance officer or legal department. Formal complaints, in particular, have set deadlines by when to respond. The failure to report a complaint in a timely manner may jeopardize available insurance coverage, among other things. Ignoring the complaint or treating it with therapeutic neglect will inevitably make the situation worse.

Cease Communication With the Client About the Subject Matter of the Complaint

An advisor with a longstanding relationship with a now-



complaining client may try to resolve the dispute with the customer outside of proper company channels. Such conduct not only runs afoul of the firm compliance manual, but also will only cause the advisor more problems than the complaint itself. Any communication may only inflame the situation, particularly due to the highly emotional reaction an advisor may have when faced with a complaint, so cease all communication with the client regarding the subject matter of the complaint. In situations where the client has not terminated the relationship with the advisor, who now is the subject of the complaint, the most prudent course is for the advisor to request that his/her managing principal reassign the client to another advisor. In short, once a client complains about your services, there is no need to continue the relationship.

Gather All Documents in the Client's File

Although a client's file should be current and complete at all times, it is particularly important for the advisor to ensure the accuracy of the file when faced with a complaint. Documents from all possible sources relevant to the client/broker relationship must be in the "file" (either hard or soft), including any documents that a managing principal may have in his/her possession regarding the complaining client. Compliance and/or legal will want to review the client file to analyze the substance of the complaint; an incomplete file hampers that review and may have a materially adverse impact on the defense of the



claim. In particular, failure to gather all documents relating to the complaining client could lead to an incomplete analysis of the complaint, or, worse, disclosure in the middle of a trial by the managing principal that he or she failed to provide certain client-related documents notwithstanding a prior certification that all such documents were produced in the course of the legal proceeding. Such a disclosure in the middle of a trial will irreparably damage an otherwise defensible claim.

Never Alter the Contents of Your Files

An advisor not only must gather all documents pertaining to the complaining client, but also must neither alter any of those documents, nor remove any documents from, nor add any documents to, the file. A proper analysis of any claim requires that the reviewer have a complete and accurate picture of the advisor/client relationship, not the picture that the advisor wants to portray. The advisor should never remove, for example, a completed know-your-customer questionnaire, or recreate notes of phone conversations that were never made in an effort to bolster his version of the events. Such conduct is not only dishonest, but also may destroy an advisor's credibility with his company and/or tribunal. In the end, the truth always prevails. An advisor should never try to play lawyer or compliance officer; there is a reason why those people are in their respective roles.



Continue Your Business as if There Were No Complaint

The most difficult yet essential thing for an advisor to do is to conduct business as usual, that is, as if there were no complaint. An advisor should not let the complaint control his or her life. The compliance department and legal team will address the complaint, and the advisor must trust the process, whatever the process may be. Any advisor who starts looking over his or her shoulder because of the existence of a complaint will not perform up to par, and a lack of focus on behalf of the advisor may only lead to new complaints.



About the Author:

Joshua Horn, Esq., is a partner in the firm's Litigation Department and is co-chair of the Securities Industry Practice Group. He may be reached by telephone at 215.299.2184, or by e-mail at jhorn@foxrothschild.com.



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