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## COMPLIANCE WATCH: Expulsion Shows Risks Of Outside Accounts

By Suzanne Barlyn

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NEW YORK (Dow Jones)--An adviser's recent expulsion from the securities industry serves to remind brokers of the care required in using a trading account outside their firm and of the responsibilities of firms to monitor such accounts.

Miguel A. Chavez, a former adviser for Allstate Financial Services LLC, the broker-dealer arm of Allstate Corp. (ALL), was barred by the Financial Industry Regulatory Authority, or Finra, from associating with firms that sell securities after he allegedly opened an outside account in 2006 without disclosing it to his employer, among other reasons.

Chavez also didn't notify the firm that gave him the account, Franklin Ross Inc., that he was a broker, according to a Finra decision announced Thursday in its October disciplinary report. Efforts to reach Chavez for comment were unsuccessful.

While there are circumstances where outside accounts are useful, Finra rules are strict about disclosures - and for good reason.

"They're very strict about it because you don't know if a broker could be preparing a scheme," says George Brunelle, a New York-based securities lawyer who represents brokers in disciplinary cases. An undisclosed outside account could be used to trade on inside information or manipulate the market, he said.

The rules also require that brokers notify their employers in advance about a trade in an outside account, and whether they expect to receive compensation for the trading.

Rules also apply to brokerages that open accounts for brokers who aren't their employees. These brokerages must notify the employing brokerage about the account in writing, and typically provide duplicate confirmations and statements.

Trading through an undisclosed outside account, however, circumvents that regulatory oversight. "Any time I've ever seen this happen, the person involved was immediately fired and regulators then tore him limb from limb," says Brunelle.

Finra began its investigation of Chavez after it uncovered an irregular trading pattern in a penny stock, revealing that he bought and sold a large quantity of the stock through his Franklin Ross account, according to the decision.

In a separate case in 2007, Finra expelled Franklin Ross of Princeton, N.J., from the business of selling securities for, it says, repeatedly violating anti-money laundering rules, by failing to investigate and report certain suspicious transactions and obtain adequate background information on new customer accounts, according to a Finra news release. A phone number for Franklin Ross was no longer operating.

Finra's decision on Chavez, which bars him associating with brokerages that sell securities, says he completed a compliance questionnaire for Allstate in 2006 and reported that he didn't have an outside securities account. Chavez also failed to report an outside business activity, and didn't appear before regulators for interviews, according to the decision. Finra said Chavez did not respond to its complaint or to a motion in which Finra sought to enter a decision by default, that is, without Chavez's input.

Holding a securities account at another brokerage isn't a widespread practice, but is sometimes done for legitimate reasons, say lawyers. For example, a broker who works for an investment bank that specializes in private placement work may want to trade options and open an account at a shop with that expertise.

Brokers who are contemplating a job change may want to move their assets to another brokerage if they anticipate a dispute about money owed for a signing or retention bonus, which are typically secured by promissory notes, according to Thomas Lewis, an employment litigation lawyer for Stark & Stark in Lawrenceville, N.J. Advisers usually agree, upon their employment, to have their in-house accounts frozen if they owe money to a brokerage when they leave.

Brokerages may adopt outside account policies that are more restrictive than Finra's rules, and some even prohibit them, says Lawrence Cohen, a lawyer specializing in broker-dealer regulation for Gibbons P.C. in New York.

"If I was a chief compliance officer, I would be very concerned about activities that were taking place at other firms. The responsibility of monitoring that may not be worth granting permission," he says.

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