

Volatility calls out for warning about tax ramifications, taking care with U5s

Provide reps with disclaimers about tax consequences to give to not-yet-retired customers who want to sell out of their retirement accounts, suggest **Ethan Cohen** and **Laura Pruitt** of **Schiff Hardin LLP**. That's just one of several tips proffered for coping with compliance issues that might arise out of the recent high level of volatility.

Cohen and Pruitt said the disclaimer should say something like: "There could be a penalty imposed by the IRS and applicable state tax authorities as well as income tax ramifications for selling securities from your retirement account. You should check with your personal tax advisor regarding the potential consequences to you if you sell from this account." The disclaimer can be among the policies and procedures your firm follows for addressing early-withdrawals from retirement accounts, they said.

Similarly, there could be additional penalties exacted if other things are sold from accounts such as mutual funds that were held a short time, Cohen and Pruitt note. "The firm may want to provide guidance to the reps as to what types of instruments in retirement accounts should be liquidated before others," they advise.

Form U5s

Given these tough economic times in the industry, terminated reps might try to sue the firm

for defamation or tortious interference so they can get some money, Pruitt and Cohen warn, especially if it's going to be tough to find another job as a rep with something bad on their U-5.

Compliance should be involved in the termination process to make sure the firm can meet the appropriate standard of review, they warn.

Compliance could conduct an internal review on the basis of the termination, they said, and look at e-mails and talk to the rep's supervisor to make sure there's a reasonable basis for the statements on the U5.

New York provides absolute immunity for statements on a U5 but other states have limited immunity, Cohen and Pruitt note.

More complaints

Complaints from customers will increase in the current environment. "They're going to see their portfolios dropping significantly, and they're going to start coming in and say, 'What happened and why?'" said **Laura Crosby-Brown**, director of compliance at the consulting firm **Regulatory Compliance, LLC**, in Londonderry, N.H.

How you handle complaint letters and complaint calls should be included in your written supervisory procedures, Crosby-Brown said. "It might be a good time to revisit those procedures" so that reps know what to do and how to do it, she said.

In addition to reviewing those procedures, pay particular attention to advising senior management about trends found among the complaints, advises the law firm **Sutherland**, which released an "issues list" for broker-dealers responding to market events.

You also should document how your firm responded to individual complaints because this might come up in litigation or arbitration later, warns **Amy Lynch**, president of **FrontLine Compliance, LLC**, a regulatory compliance services

(Coping with volatility, continued on page 2)

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firm based in Alexandria, Va.

Compliance can follow up to separate reportable customer sales practice complaints that would go on a U4 and 3070 from generalized reactions about the down market, Cohen and Pruitt said. Compliance could call or write to the customer, and then send the customer correspondence to confirm conversations and conclusions, they said.

Suitability review

Your firm should conduct a suitability review of your customers, especially seniors, Cohen and Pruitt said. Look out for those instances where reps kept customers in unsuitable investments because the reps got higher compensation for those investments.

“Perhaps compliance can review a subset of accounts (such as seniors with the highest percentage of losses in their accounts over the last year) for suitability. If it notices any trends or patterns, it can at least keep those reps involved on its radar screen,” they said.

Consider reviewing the checklists and procedures your firm uses for 1035 Exchanges, in light of the greater chance for aggressive exchanges from insurers in financial trouble, Sutherland says. You also might want to emphasize in training that workers aren’t allowed to provide inaccurate information about the financial status of an issuing insurer, and alert them to the regulatory scrutiny placed on certain exchange transactions, Sutherland said.

Counterparty risk

If your firm had contracts with the likes of Bear Stearns or Lehman, assess the validity of those contracts today, Lynch advises. And at larger firms in particular, there should be regular meetings with compliance officials from the firm’s different business units so that none of the areas of risk are missed, Lynch said.

Also check whether your firm’s net capital P&Ps need to be updated in light of the problems in the market, Sutherland said. ■

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