

Brokerage Firm's Failure To Supervise Highlight Areas For Investor Concern

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Investors at LaSalle and elsewhere ought to be on guard for fraudulent schemes by their brokers who are selling non-traditional investments away from their brokerage firms.

Securities regulators require brokerage firms to zealously supervise all remote office locations. NASD Regulation strongly delivered that message recently when it fined Illinois-based LaSalle Street Securities \$200,000 and permanently barred Gerald Martin from any supervising activities in connection with the firm's failure to prevent and detect several Ponzi schemes that LaSalle Street's broker, Frank Devine, had perpetrated on customers of the firm.

As Frank Devine begins serving his 13-year prison sentence, NASD Regulation did not have kind words for LaSalle Street Securities: "Devine's misconduct escaped detection in large part because of the firm's supervisory system and procedures," said James Shorris, NASD Executive Vice President and head of Enforcement.

Let's examine the misconduct of the broker. The broker had a history of misconduct, beginning with engaging in unauthorized and undisclosed outside business activities, including the sale of viatical contracts to customers at his previous brokerage firm. At LaSalle Street Securities, Frank Devine "operated several fraudulent schemes," according to NASD Regulation. These schemes included the purchase and sale of luxury automobiles, the sale of real estate, and the sale of an initial public offering. NASD Regulation determined that Devine had convinced friends and acquaintances to "invest" in these schemes, only to then convert their money to his own personal use.

When LaSalle Street Securities noticed that Devine's commission production had declined precipitously (from 6 figures to under \$1,000) in 2003 and 2004, LaSalle inquired as to the reason. Devine explained (and LaSalle accepted without further investigation) that he was being paid "very, very well" by the U.S. Government as a political consultant but could not provide details! Of course, in truth, Devine's commission production plummeted because he was pre-occupied with perpetrating and pocketing the profits from his fraudulent schemes in what is known as "selling away."

The regulatory basis for selling away cases is found in NASD Rule 3030 and NASD 3040.

Rule 3030 provides that a broker may not engage in any outside business activity unless he has provided prompt written notice to his or her brokerage firm. Rule 3040 provides that a broker must not engage in private securities transactions (that is, selling away) and states the procedures that a brokerage firm must follow to approve of such investments. Once approved, the brokerage firm must supervise these private securities transactions.

However, normally, as here with LaSalle Street Securities, the brokerage firm has no knowledge of such sales and activities. Lawyers representing investors must demonstrate that the brokerage firm failed to establish and/or failed to implement reasonable supervisory procedures, or failed to follow-up on red flags. If so, then the brokerage firm is held responsible for the investors' losses in the "investments" even though the brokerage firm did not know of the sales.

What were the supervision failures of LaSalle Street Securities? There were several according to NASD Regulation. First, Frank Devine disclosed to LaSalle Street Securities that the NASD was investigating the fact that his previous firm had terminated his employment for engaging in unauthorized and undisclosed business activities. Indeed, LaSalle Street Securities knew that Devine maintained a separate business account and operated various outside businesses. Nonetheless, the firm allowed Devine to work from his home with no on-site supervision.

Second, as a result of Devine's selling viatical contracts without the knowledge of or authorization from his prior brokerage firm, Devine was suspended for 90 days, fined and ordered to requalify for his securities licenses. Despite these red flags, NASD Regulation found that throughout that time, and indeed his entire 6 year tenure with the firm, LaSalle Street Securities continued to allow him to work from home, never placed him on heightened supervision, and never inspected his office.

Third, in addition to accepting Devine's bizarre explanation that the U.S. Government was paying him for secret political consulting, Devine's supervisor had actual knowledge of two of Devine's schemes. NASD Regulation found that Devine's supervisor, Gerald Martin, personally had invested about \$80,000 in two of Devine's schemes, but did not inform LaSalle Street Securities of his investment nor determine whether any of LaSalle's customers also had invested.

Fourth, NASD Regulation determined that LaSalle Street Securities "failed to establish an adequate supervisory system and procedures for supervising the activities of brokers working in small, geographically dispersed offices, including brokers with disciplinary histories." NASD Regulation observed that although LaSalle had a "goal" of inspecting larger, non-branch office locations once every 3 years, LaSalle had no procedure, plan or goal in place to supervise brokers like Devine who worked in remote office locations. Likewise, NASD Regulation was not pleased with the fact that LaSalle "did not provide supervisors with any formal instruction or training, and there was no supervisory manual or supervisory procedures for managers to follow." ■

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Devine will pay nearly \$3 million in restitution to victims.