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FOX Member Community

Family Office Exchange (FOX) serves as a membership-based advisory firm that provides research, education, and advice to 500+ members in 22 countries. Founded in 1989, we strive to make wealth owners, family office executives and advisory firms more effective at preserving and enhancing their financial, human, and intellectual capital.

FOX family members own assets ranging from $25 million to several billion dollars.
On average, they own assets in excess of $350 million.
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Note: All data represented is drawn from our 2006 member community.

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Industry Trends

Reassessing the Endowment Model of Investing
In the wake of a difficult year that prompted some to question the endowment style of investing, a new paper from Family Endowment Partners reminds disappointed investors of the long-term record of performance and encourages them to be patient with this investment approach. full article »

A Long, Hard Slog in Early 2009
It will take time to get the world economy back on track and the process will be difficult, Barclays Wealth says in its annual outlook. Researchers for Barclays summarize their current macroeconomic views and the implications for asset classes and investment in 2009. They also present their asset allocation recommendations and more specific investment themes, both for the short and medium terms. full article »

The Entrepreneur in Adversity
Entrepreneurs have become increasingly important players in the global economy and have amassed fortunes in doing so. While a worldwide financial crisis would seem to work against them, some entrepreneurs see today's challenging economic environment as the land of opportunity. This report from Barclays Wealth explores what makes entrepreneurs successful in good times and bad. full article »

The Pros and Cons of Private Ownership
Researchers from the Bank for International Settlements delve into why some companies remain private and how well the philosophy has worked for them. While control seems to be a key factor in companies remaining private, research by BIS shows privately held companies operate as efficiently as those that have gone public. full article »

Biotech Financing Entering New Phase
A Rothstein Kass report finds that biotechnology executives are becoming more creative in their financing approaches, creating a climate ripe for consolidation and strategic alliances. Investors who viewed an initial public offering as an exit strategy are being replaced by those with longer horizons and by better capitalized industry participants eager to explore synergies. full article »

Intangible Infrastructure
Global investment in physical infrastructure has been a prime driver of growth in emerging markets, but sustained growth also requires investment in an intangible infrastructure that many emerging nations lack. Credit Suisse identifies five pillars of intangible infrastructure (education, healthcare, development of the financial system, technological investment and the penetration of business services) and singles out companies with the greatest growth potential within these pillars. full article »

The Serious Business of Carbon Trading
European firms have grown into formidable carbon competitors, due to the establishment of the EU Emissions Trading Scheme. That makes North

Upcoming Events

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March 12-13
Dallas, TX

Regional Roundtable
April 22
San Francisco, CA

Investor Network Dinner
May 12
New York, NY

Regional Roundtable
May 13
New York, NY

Fall Forum
October 20-22
Chicago, IL

Upcoming Webinars

2009 Estate Planning Update
February 25

Companies and Trusts and Partnerships – Oh My: Wealth Management Structures Part 1
March 4

Companies and Trusts and Partnerships – Oh My: Wealth Management Structures Part 2
March 11

Quarterly Economic/Markets Commentary
March 25

New Webinar Replays

Communication in Difficult Times: Families and Advisors on the Front Line
January 14

Lifestyle Management

Guide to Getting the Best Cancer Treatment
Individuals who have been diagnosed with cancer can do much to influence the course of their illness and improve their quality of life. This comprehensive guide from PinnacleCare can help patients navigate the healthcare system to get the best possible treatment outcomes.
full article »

Real Estate

Secondary Real Estate Markets Hold Promise
For those investors who are well positioned and well funded, there will be substantial opportunity this year to buy distressed commercial real estate or real estate debt in the United States. Baceline Investments believes investments in secondary U.S. markets will yield many favorable opportunities when compared to investments in primary U.S. markets. full article »

Opportunities in Commercial Real Estate Debt
The effects of the financial crisis and declining economic conditions are being felt across the commercial real estate sector, but property market fundamentals remain relatively sound. That, combined with banks and insurers taking a more cautious approach to real estate lending, has resulted in reduced liquidity and a potential opportunity for investors, says Babson Capital Management. full article »

Risk Management

An Inside Look at Corporate Fraud and Misconduct
An economic downturn can accentuate the drivers of fraud and misconduct within companies, according to KPMG's third national integrity survey. Researchers found that 75 percent of employees had observed or knew of wrongdoing within their organizations. Ethics and compliance programs seemed to make employees more willing to report the misconduct they observed. full article »

The Buck Stops with You
Trustees often are required to invest the assets of a trust or estate. In doing so, they may delegate power to an investment advisor or securities broker. If the advisor's or broker's investments result in losses, the trustees need to find and pursue any viable claim to recover the losses. Stein, Stein & Pinsky offers suggestions to help with this task, including details of the five main causes that form the basis for fraud and negligence claims against brokers.
full article »

Strategic Philanthropy

How to Succeed with Social Campaigning
Social campaigning, or advocacy, can bring societal wrongs to light and better humanity. But how can a charity or social group raise government and individual awareness of a societal problem enough to help many people in need and give a voice to the disadvantaged? This report from New Philanthropy Capital offers guidance for charities and their donors who want to take an active role in campaigning. full article »

The Buck Stops With You

When trusts or estates suffer investment losses, fiduciaries are obligated to identify and file viable claims against brokers.

By Craig D. Stein, Esq. & Joshua S. Pinsky, Esq., Stein, Stein & Pinsky, P.A., Boca Raton, FL.

Trustees, advisors and estate representatives are often required to invest the assets of a trust or estate. Depending on the jurisdiction, these individuals and entities may have the power to fully or partially delegate this responsibility to an investment advisor, securities broker or brokerage firm.

What if there are investment losses because of the investment advisor's or brokerage firm's negligence? The trustee is obligated to find and pursue any viable claim that can recover such losses. While trustees are not expected to have a complete working knowledge of securities litigation, or to evaluate a securities claim thoroughly, it is possible for them--and within their power-- to identify and file securities claims. It's therefore crucial for fiduciaries to understand exactly how to identify potential claims.

Initially, when a trustee reviews the current and past investment portfolios of a trust or estate, he or she should pay particular attention to investments that either lost money or significantly underperformed compared to standard market indicators like Dow Jones, NASDAQ and S&P500. Trustees also should note when large concentrations of securities are held without any effort to diversify or apply hedging strategies (even a portfolio that matches the volatility of the market many indicate a portfolio that was invested improperly, particularly when the investor's objectives and risk tolerances were more conservative.) Over-concentration can occur when someone invests too great a percentage of his portfolio in any one stock, industry or sector. This may occur even if he is invested too heavily in certain investment vehicles, such as equities versus fixed-income securities. It is more important to understand that over-concentration can, in certain cases, be as little as holding 10% of your investments in one stock, sector or type of security.

Just because an account or investment lost value does not necessarily imply that a stockbroker or firm acted improperly. Also, irrespective of losses, trustees should look for any periods of high activity within an investment account, or frequently paid commissions or fees. If any of these circumstances are discovered, the trust or estate may have a cause of action based on common securities claims including but not limited to: unsuitability (including over-concentration), churning, unauthorized transactions, negligence, fraud, breach of fiduciary duty, negligent supervision and any statutory claim that may apply.

DUTY OF BROKERS

A broker and an investor share a formal relationship based on trust and confidence. Not every jurisdiction agrees on whether or when a fiduciary relationship exists between a broker and an investor. But, as one Florida court put it: A broker must "act with the utmost honesty and good faith." [1] Generally, whether a broker is acting as a fiduciary relates to the function he performs for the investor. Each situation involving a broker-investor relationship must be carefully evaluated in accordance with controlling law, and with respect to the nature of the specific relationship.

In *Lieb v. Merrill Lynch, Pierce, Fenner and Smith,*[2] a federal district court in Michigan provided a detailed analysis of the broker's fiduciary duties to investors. The *Lieb* court distinguished discretionary accounts (in which the broker has a continuous obligation to manage the account) from non-discretionary accounts (in which the customer and the broker confer as to a particular transaction, but the broker has no continuing duty toward the account once the transaction is complete.)

While the broker's duty in a discretionary account is a bit more

obvious-as the broker retains significant continuous control-his duty in a non-discretionary account requires closer examination. In *Gochnauer v. A.G. Edwards & Sons, Inc.*,[3] the court used key factors set forth by the *Lieb* court to determine the following fiduciary responsibilities of an investment advisor in the one-time non-discretionary account scenario: "(1)the duty to recommend [investments] only after studying it sufficiently to become informed as to its nature, price, and financial prognosis; (2) the duty to perform the customer's orders promptly in a manner best suited to serve the customer's interests; (3) the duty to inform the customer of the risks involved in purchasing or selling a particular security; (4) the duty to refrain from self dealing; (5) the duty not to misrepresent any material fact to the transaction; and (6) the duty to transact business only after receiving approval from the customer."

Questions may exist as to whether the responsibilities of investment advisors or brokers rise to the level of fiduciary duties. But within the industry, there is little doubt as to what many of those responsibilities are. The six fiduciary duties listed in *Gochnauer* are similar to the duties or responsibilities of a securities broker established by the Securities and Exchange Commission (SEC) and the rules of self regulatory organizations, such as the Financial Industry Regulatory Authority (FINRA) and the New York Stock Exchange. While no independent cause of action exists for violation of industry rules, certain rule violations, such as unsuitability, over concentration, churning, etc., typically form the basis for negligence or fraud causes of action. These "duties" or "responsibilities" promulgated by industry regulators appear to be equivalent to, the generally accepted definition of "fiduciary duty," even if not termed as such.

CAUSE OF ACTION

While violations of financial industry rules may not be used as independent, private causes of action, they may form the basis for a negligence or fraud claim. In a negligence claim, the rules dictate the duty of the broker, and the broker's failure to follow those rules is a breach of this duty. Although violation of these rules may form the basis of a fraud claim, such claims often are controlled by statute and differ from state to state. For instance, under Florida's Securities and Investor Protection Act, [4] intent or knowledge is not required to prove a fraud claim. Similarly, in Newsom v. *Dean Witter Reynolds, Inc.*,[5] a Florida state court held that simply making unsuitable trades constitutes fraud.

Once it is determined that a cause of action exits, a claim should be filed in the appropriate forum. Previously, most securities claims were tried in either federal or state courts. However, the Supreme Court's 1987 decision in *Shearson/American Express, Inc., v. McMahon*,[6] held that claims under Section 10(b) of the Securities Exchange Act could be adjudicated under pre-dispute arbitration agreements. Most securities cases involving customers who have claims against brokers and brokerage firms are brought in arbitration operated by the Financial Industry Regulatory Authority (FINRA). Trying an arbitration case is different from civil litigation: Arbitration procedures disallow certain discovery mechanisms, limit the ability to appeal and do not provide for jury trials.

BASIS FOR CLAIMS

There are five main causes that form the basis for fraud and negligence claims against brokers:

(1) Unsuitability and over-concentration: "Unsuitability" is the basis for many negligence and fraud claims against brokers. Once losing or underperforming investments are identified, each should be reviewed individually and relative to the other investments in the account. The fiduciary also must assess the trust or estate portfolio for any securities holdings that appear to be over-concentrated or disproportionate to the rest of the portfolio.

Stockbrokers have a duty to know their customers financial situation and to recommend suitable investments.[7] FINRA requires its members to make efforts to obtain

specific relevant information about the customer. Brokers must evaluate the customer's financial status, tax status, investment objectives and, according to NASD Rule 2310 (NASD Rules are applied to FINRA members), "other such information used or considered to be reasonable by such [FINRA] member of registered representative in making recommendations to the customer."

Similar violations of industry often exist when brokers don't properly advise an investor who has an over-concentrated position in one company, one sector or one type of investment vehicle. A broker must advise such a client to sufficiently diversify or apply hedging strategies such as collars, forward sales or exchange funds. For instance, such a situation may occur when an investor who earns a modest salary,[8] suddenly has one investment appreciate exponentially in value to $10 million. As a result of the appreciation, the investor has the vast majority of his eggs in one basket. A prudent broker would have that investor diversify his portfolio, or apply a hedging strategy to protect the investor's new wealth.

(2) Churning: In *Arceneaux v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*,[9] the U.S. Court of Appeals for the Ninth Circuit ruled: "Churning occurs when a securities broker buys and sells securities for a customer's account without regard to the customer's investment interests, for the purpose of generating commissions." The court in *Newsom v. Dean Witter Reynolds, Inc.*[10] described churning as a "particularly vicious and fraudulent course of conduct deserving of the severest condemnation."

Two key elements in most churning cases are control and excessive trading. Control of the account is determined from the circumstances surrounding the relationship, as in *Kaufman v. Merrill Lynch, Pierce, Fenner & Smith*, and the excessiveness depends on the type of account, it's not expected in an investment account that exists to preserve its principal.

Certain patterns are indicative of churning. One involves selling a security and immediately buying back either the same security or another security that isn't much different. For example, a broker sells a technology stock, and then uses those proceeds to buy another stock in the same sector.

Ratios have been developed to help detect if there was excessive trading, and possibly "churning." The use of these ratios, however, is only applicable to accounts where there is at least some level of control on the part of the broker. Factors such as the broker's level of control, along with the investor's objectives and experience will determine whether use of these ratios is appropriate.

It is vital to note that churning can occur regardless of whether or not the account increased in value. Similarly, excessive trading can occur even when commissions are not earned.

(3) Unauthorized Transactions: Unauthorized trading can also form the basis of a fraud claim. A broker can execute trades in a customers' accounts only when directly authorized or if the broker has been granted discretion by the customer prior to the purchase or sale. Any breach of this requirement amounts to unauthorized trading.

(4) Misrepresentation: Misrepresentation or omission of a material fact may be a foundation for a cause of action in negligence, fraud or other statutory claims.[11] If a broker misrepresents himself, his firm or an investment opportunity, and an investor relies on that misrepresentation to his detriment, the investor may have a claim against the broker and his firm. If that misrepresentation was, for example, due to careless research or poor communication on the part of the broker, the investor still may have a negligence claim based on the broker's failure to uphold his duty to properly research or communicate with clarity. One recent example concerns brokers who sold preferred securities to investors, wrongfully claiming that the preferred securities guaranteed fixed-income and return of principal.

If the broker misrepresented material facts to induce a reaction

harmful to the investor, a common law fraud claim may exist. It is important to note that each state may have different interpretations as to what constitutes fraud with regard to securities transactions. Some states have securities fraud statutes, which reduce fraud in securities context to any misrepresentation including the sale or purchase of securities.

(5) Failure to Supervise: Generally, securities claims are filed against the individual broker who services a customer's account, along with the firm the broker was working for during the relevant period. Claims against the firm can include any, if not all, of the claims asserted against the individual broker.[12]

There are, however, some claims unique to firms or supervisory personnel, which are not brought against the individual brokers. Firms, and sometimes managers, face claims of negligent supervision. The SEC and self-regulatory organizations have strict rules regarding supervision of brokers and accounts. Managers are obligated to sign-off on many documents and most transactions, and are ultimately responsible for allowing transactions to occur. If negligent or fraudulent transactions occur with supervision, firms and managers can be liable for allowing those transactions. The firm also can be held liable if there is a complete failure to supervise transactions.

DAMAGES

No cause of action is complete without some version of damages. Each securities claim is unique and requires careful evaluation not only of the extent of the damages, but also the nature of the damages. "In a securities claim, there is great flexibility in awarding damages," noted the Ninth Circuit in *Arrington v. Merrill Lynch.*[13]

Churning claims are different than most other claims, in that the investor may have seen his portfolio grow despite the excessive trading. In that case, the investor still may claim a return of commissions for unnecessary transactions. Overall profitability does not excuse a broker of this liability.[14] If the investor lost money as a result of churning, he may claim those losses in addition to a return of commissions.

In suitability claims, the damages may be the losses incurred by an investor through investments that should not have been recommended under suitability rules. Similarly, if an investor should have been, but was not advised to sell an unsuitable investment, losses from those investments may be sought as damages.

The most common form of damages is referred to as "out-of-pocket" damages. If an investor opens an account with $10,000 and never funds the account further, then his out-of-pocket damages could never exceed $10,000.

An investor may also claim more than just out-of-pocket losses. If an investor parlayed his $10,000 investment into $1 million, only to lose $800,000 later, the may claim damages of $800,000, though only $10,000 is out of pocket.

As with many claims, an injured investor may seek well-managed portfolio damages, prejudgment interest, post-judgment interest, attorney fees and expenses. "The well managed account measure of damages purports to allow a plaintiff to recover the difference between what his portfolio was worth at the end of the defendant's fraudulent conduct and what his portfolio should have been worth had it been managed without fraud."[15] Additional requests are dependent on the jurisdiction.

Punitive damages also may be considered. In *Mastrobuono v. Shearson Lehman Hutton, Inc.*,[16] the U.S. Supreme Court stated that punitive damages are reasonable if the misconduct is willful and malicious.

It is widely understood that trustees and estate representatives owe a fiduciary duty to the beneficiaries and to the trust or estate itself. As a result of their duty and ability to bring a claim on behalf of the trust or estate, such fiduciaries must identify and pursue any securities claims if actionable. In *Jones v. Ellis,*[17] the Supreme Court of Alabama eloquently discussed the

"prudent advisor rule, " holding that "a trustee is under a duty to the beneficiary to exercise such care and skill as a man of ordinary prudence would exercise in dealing with his own property." The court went on to state that "unlike the good business judgment rule [applied to corporate director], there is no presumption of good faith with the dealings of a trustee; consequently, a showing of fraud is unnecessary to impose liability, because a trustee is liable for losses occasioned by his mere imprudent management of the trust." A Trustee has a duty to protect and serve the trust or estate, and therefore has a duty to thoroughly evaluate a securities claim, it is important that he understands how to identify a potential claim when it arises.

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1. *Hayden Stone, Inc. V. Brown, 218* So.2d 230, 235 (Fla. 4th DCA 1969).

2. 461 F. Supp. 951 (E.D. Mich. 1978).

3. 810 F.2d 1042 (11th Cir. 1987).

4. Fl. St. 517, *et al.*

5. 558 So2d 1076, 1077 (Fla. 1st DCA 1990).

6. 482 U.S. 220 (1987).

7. *See* NYSE Rule 405, which requires brokerage firms and associated persons to "be personally informed as to the essential facts relative to the customer and to the nature of the proposed account;" *also see* NASD Rule 2310, which states that "In recommending to a customer the purchase, sale or exchange of any security, a member shall have reasonable grounds for believing that the recommendation is suitable for such customer upon the basis of the facts, if any, disclosed by such customer as to his or her other security holdings and as to his or her financial situation and needs."

8. According to the U.S. Census Bureau report for 2007, the median household income was $50,233.

9. 767 F.2d 1498, 1501 (11th Cir. 1985).

10. 26 SEC 163 (1947).

11. *Interstate Securities Corporation v. Hayes,* 920 F.2d 769 (11th Cir. 1991).

12. This is nothing more than a claim upon the theory of *respondeat superior.*

13. 651 F.2d 615, 621 (9th Cir. 1981).

14. 636 F.Supp. 899 (N.D. Ill. 1986).

15. *Laney v. American Equity Investment Life Ins. Co.,* 243 F.Supp.2d 1347, 1352 (M.D. Fla. 2003).

16. 514 U.S. 52 (1995).

17. 551 So.2d 396 (Ala. 1989).