Everyone is familiar with the notion of the fox guarding the henhouse, but few are aware that the fox guarding Wall Street is the Financial Industry Regulatory Authority (FINRA). This self-regulatory organization (SRO) is charged with regulating brokerage firms. An SRO is not a government agency like the Securities Exchange Commission; it is a private corporation with the authority of a government agency. While FINRA is supposed to police Wall Street, many suggest that this cop is on the take, or perhaps, more kindly, that FINRA is Wall Street's own trade association. Madoff Whistleblower Harry Markopolos in his testimony before Congress describes FINRA as a "very corrupt self-regulatory organization."[1]

Follow up:

This is a rather strong allegation. However, Larry Doyle in his new book, In Bed with Wall Street, provides a sweeping view of FINRA's maleficence and substantiates Markopolos' characterization. In a chapter titled "Kangaroo Court", Doyle describes FINRA's mandatory arbitration process. FINRA claims that its arbitration process is a less expensive, less time-consuming process to settle disputes than civil court, and according to former FINRA Director of Arbitration George Friedman, it is "viewed as the model of fairness."[2]

Regarding fairness, Doyle writes,

"Anybody pursuing justice on Wall Street typically presumes that the facts will bear out his case and the truth will prevail. If only it were so."[3]

Unfortunately, I made this presumption and have first-hand knowledge about FINRA's mandatory arbitration process. Doyle provides a summary of my experience as whistleblower and dealings with FINRA arbitration, but the purpose of this article is to dive a bit deeper. What follows is a detailed account of just one part of this experience substantiated by evidence so you can decide for yourself whether FINRA's mandatory arbitration is the model of fairness Friedman describes, or a corrupt kangaroo court.

An imposition upon our largess

Imagine being on trial and at the end of the second day, twelve hours into the proceeding, the judge complains that he is not getting paid well enough to read all of the evidence. This is precisely what Panel Chairman William Pastor and Arbitrator David Harwi did at my mandatory FINRA arbitration on June 7, 2011. Harwi described his having to read our written closing arguments as,

"I don't want to say a burden, but an imposition upon our largess…"[4]

Imagine yourself in the same position, if you were on trial, would you be reassured if the judge said,

"We want to be fair to you - and the notion of, you know, since spending an entire day for free trying to come up with a decision as you know, that's what needs to be done

that's what needs to be done [sic] and we are all committed to that. At the same time it's just the way the rules are set up; it seems somewhat unfair when you're doing a substantial amount of work like that and not be compensated."[5]

There is irony in Harwi's claim that FINRA's compensation rules are unfair. FINRA arbitrators are subject to the ABA Code of Ethics which mandates that -

"Arbitrators who are to be compensated for their services or reimbursed for their expenses shall adhere to standards of integrity and fairness in making arrangements for such payments."[6]

The irony lies in the fact that Harwi's complaint contradicts all three of FINRA's ethical criterion intended to "preserve integrity and fairness."[7] These standards state that compensation must be established prior to accepting the appointment; communications regarding compensation should be made through FINRA; and only under extraordinary circumstances should arbitrators request increased compensation.

Despite these simple and straightforward standards, Harwi said,

"FINRA's rules in this regard are incredibly inconsistent with the rules associated with other arbitration forums."[8]

While it might be the case that FINRA's rules are inconsistent with other forums, they clearly address Harwi's and Pastor's concerns stating, although "arbitrators are often required to read and review lengthy materials in preparation for a hearing, or prior to rendering an award," they are only compensated for hearings and not for "study time."[9] Lastly, in FINRA's Frequently Asked Questions regarding arbitrator compensation we find the following question: "Can I demand my hourly rate, as I do in the other forums?" to which FINRA answers

"No. The arbitrators' honorarium is set at a fixed rate. Arbitrators should not ask the parties, or the FINRA staff member assigned to the case, to pay a higher rate."[10]

Technicalities

Before we proceed, it's necessary to understand two technical points. FINRA arbitration proceedings are conducted in segments called hearing sessions. FINRA defines a hearing session as "any meeting between parties and the arbitrators, including pre-hearing conference with the arbitrators, that lasts four (4) hours or less."[11] FINRA pays arbitrators $200 per hearing session and there are typically two hearing sessions per day. FINRA rules also describe executive sessions which are defined as "privately held discussions among the arbitrators outside the presence of the parties and their representatives, witnesses and stenographers."[12] FINRA pays no compensation for executive sessions.

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[The three arbitrators] each made a false report to FINRA apparently to be paid greater compensation than what FINRA allows.
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Perhaps under the duress of Harwi's and Pastor's veiled threat and not being aware of the FINRA rules above, both Morgan Stanley's and my attorneys agreed to limit their post-hearing briefs to "something in the neighborhood of 25 – 35 pages" and that they did not "have any problem with the panel getting together for an executive session to review the briefs and discuss the issues."[13]

The reason why it was important to explain these details is because Harwi, Pastor, and the third arbitrator, Michael Garry, each made a false report to FINRA apparently to be paid greater compensation than what FINRA allows. Does this constitute fraud? I won't venture a guess here, although there are plenty examples of employees being fired or having criminal charges of fraud filed against them for padding their expense accounts. Here are the facts so you can decide for yourself.

On the Award document signed by all three arbitrators, you'll find that they reported a total of eleven hearing sessions.[14] In fact, according to FINRA definitions, there were only seven hearing sessions, all of which occurred in June of 2011; i.e. seven sessions where the parties were present. The arbitrators reported that four additional hearing sessions occurred on July 13th and 14th. Neither I nor my attorneys were present at these alleged sessions; therefore, according to FINRA rules no hearing sessions occurred in July. It might be the case that the arbitrators conducted executive sessions to deliberate prior to rendering an award, but this fails on two counts. As noted earlier, FINRA rules do not provide compensation for the time required to deliberate, nor does FINRA pay compensation for executive sessions.

One Bad Apple?

There's a bad apple or three in every bunch, so some might believe that my particular arbitrators are an unfair representation of FINRA's arbitration system. While the issues above shed great doubt on FINRA arbitration being the model of fairness, please consider the following.

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The record I received … should have been approximately eighteen hours long [but] contained only ten hours and five minutes.
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FINRA Rule 12606 requires that all arbitration sessions be recorded, and that interested parties can obtain copies of these recordings. The record I received, which only contained testimony from the three and a half days of arbitration in June at which both parties were present, should have been approximately eighteen hours long; however, the DVD I received from FINRA Case Administrator Arthur Baumgartner contained only ten hours and five minutes. The missing eight hours of testimony was not a block missing from the beginning, middle or end; it was as if someone had redacted fourteen separate sections of

the record. These sections contained nearly all of the damaging testimony from Morgan Stanley witnesses necessary for me to file a successful motion to vacate.

After two and a half months and multiple requests for a complete copy of the record, and a complaint to the FINRA Ombudsman's office, Baumgartner explained that the missing portions of the record were "never recorded due to either human or mechanical error."[15]

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… it was as if someone had redacted fourteen separate sections of the record.
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Given this preposterous explanation, I asked Baumgartner to provide an explanation in writing. His written explanation makes no reference to human or mechanical error, or even acknowledges that anything is missing. In fact, in his letter he implies that nothing is missing when he writes that the record he had initially sent was "the full set of recordings of the hearings that we have on file."[16] Without the operative words "that we have on file" Baumgartner's letter constitutes a false official statement, but you can determine on your own if his letter is an attempted cover-up or not.

While missing recordings and what appears to be Baumgartner's cover-up is reminiscent of Watergate, what is more compelling is that Baumgartner was implicated in a second nearly identical scenario the very same month in separate arbitration. Baumgartner was the FINRA Case Administrator on Abdelnour et al. vs. Merrill Lynch et al. where Abdelnour's attorneys alleged a cover-up and "the partial destruction of an audio recording of one morning of the proceedings…"[17]
Just another Bad Apple?

One might argue that even if these FINRA arbitrators and this one FINRA Case Administrator are bad apples, that doesn't prove that the FINRA arbitration process is a Kangaroo Court. To quote Doyle again: "If only it were so."[18] After an additional three months of complaints and then only after I had another attorney write to FINRA, in January 2012 FINRA Northeast Regional Director Katherine Bayer responded in writing. Her letter contradicted Baumgartner's October 2011 letter with,

"I apologize that portions of testimony are missing from the recordings for the June hearing sessions and for any perceived miscommunications from the FINRA staff about the status of the recordings."[19]

Please read Baumgartner's letter linked at footnote 16 and decide for yourself whether his letter is a perceived miscommunication or an intentional cover-up.

Bayer goes on to acknowledge that the arbitrators made a false report for additional compensation when she writes,

"The award included fees for hearing sessions in July at which only the arbitrators appeared."[20]

As outlined above, according to FINRA sessions at which the parties are not present are not hearing sessions; rather they are only executive sessions for which there is no compensation.

Although Bayer claims to have "listened to the recordings several times" she ignores the arbitrator's veiled threats and their having violated several FINRA rules when she writes:

"In light of this unusual arrangement, we have decided to waive the fees assessed in connection with these hearing sessions."[21]

Regardless of whether or not the attorneys gave in to the veiled threats, this "unusual arrangement" is still a blatant violation of FINRA's rules and merely waiving the fees for these sessions is certainly not a model of fairness.[22]

Bayer goes on to contradict Friedman's model of fairness claim when she writes,

"FINRA staff was not aware that this agreement had been reached…"[23]

This is explicit acknowledgment that the arbitrators violated one of FINRA's own fairness practices which requires that communication related to compensation should be made through FINRA.

Bayer also wrote that FINRA takes "all allegations of arbitrator misconduct very seriously" and that FINRA was -

"fully investigating all of the allegations concerning the arbitrator's actions and are taking appropriate action."[24]

At best, Ms. Bayer is disingenuous given that these issues were first reported to FINRA five months prior in September 2011; her response acknowledges wrongdoing by the arbitrators; and according to FINRA's Arbitration Awards Online, Mr. Pastor and Harwi have continued to act as FINRA arbitrators.[25] Lastly, if she indeed listened to the recordings several times as she claims in her letter, she heard the arbitrators' veiled threats for herself.

If you read Bayer's letter you will see references to allegations that Arbitrator Garry discussed my case with a third party, allegations that Morgan Stanley fabricated evidence, and allegations that several Morgan Stanley witnesses committed perjury. These allegations will be addressed in a second article, but rest assured that article, like this one, will contain links to the evidence substantiating these allegations.
How many victims of this model of fairness?

Just as some might believe that my particular arbitrators are an unfair representation of FINRA's arbitration system, some might also believe that my particular experience is an unfair representation. Unfortunately, I have spoken with and heard the detailed stories of several of the FINRA victims Doyle has mentioned; however, dozens more have contacted me with outrageous stories of arbitrators ignoring their evidence, and arbitrators ignoring proven acts of perjury during their arbitration.[26]

One of the whistleblowers referenced in Doyle's book is Leyla (Basagoitia) Wydler who blew the whistle on the Stanford Ponzi Scheme. Similar to my experience at Morgan Stanley, Wydler refused to sell products she knew to be fraudulent. After firing her for refusing to betray her clients' trust, Stanford filed an arbitration claim against her. Despite her allegation that Stanford was "engaged in a Ponzi scheme to defraud its clients," in 2003 these arbitrators ignored her evidence and ruled in favor of Stanford.[27] Stanford, who was not caught until six years later in 2009, was found guilty of defrauding investors of $7 billion.[28]

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FINRA allowed Morgan Stanley to file well over 100 promissory note suits without Morgan Stanley actually owning the note.

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The largest number of FINRA victims of which I am aware are other former Morgan Stanley advisors. Akin to banks that did not own the mortgage notes fraudulently foreclosing on homeowners, FINRA allowed Morgan Stanley to file suits against these advisors even though Morgan Stanley did not own the promissory notes on which these suits were based.

According to FINRA Awards Online, between 2009 and today, FINRA allowed Morgan Stanley to file well over 100 promissory note suits without Morgan Stanley actually owning the note.[29] According to one report, Morgan Stanley "houses the roughly $6 billion in loans it has made to its financial advisers outside its broker-dealer unit" in an entity named Morgan Stanley Smith Barney FA Notes Holding LLC.[30] Apparently, Morgan Stanley's motivation for assigning these notes to an outside entity, in something of an Enron-esque off the books accounting trick, was to avoid capital reserve requirements.[31]

One of the few former Morgan Stanley advisors aware that Morgan Stanley did not own his promissory note is James Eastman. Eastman successfully argued that Morgan Stanley had no standing and his FINRA arbitrators dismissed Morgan Stanley's claims against him.[32] Unfortunately, Morgan Stanley had already amended their complaint by adding the FA Notes Holding entity and the arbitrators ruled in favor of FA Notes Holding. Although the Department of Justice has taken some action against the banks for fraudulent foreclosures, FINRA has taken no action against Morgan Stanley.

Conclusion

Nobel Peace Prize recipient and Holocaust survivor Elie Wiesel wrote,

"There may be times when we are powerless to prevent injustice, but there must never be a time when we fail to protest."[33]

Every FINRA victim I've spoken with has been powerless against FINRA's injustice; perhaps Doyle's, In Bed with Wall Street and this article are examples of the type of protest Wiesel suggests.

Unfortunately, no number of books or articles will stop what Secretary of the Commonwealth of Massachusetts William Galvin characterizes as -

"an industry-sponsored damage containment and control program, masquerading as a juridical proceeding."[34]

The only hope of fairness and true protection for American investors is if enough of us bring this to the attention of our Representatives and Senators. Please don't hesitate to send them this article and demand that they investigate all of the issues you'll discover in In Bed with Wall Street.