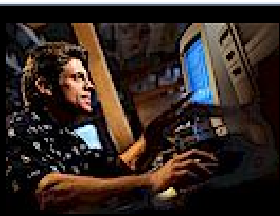

Online Investor Complaint Center

The original resource guide for the dissatisfied online investor

SEC, N.Y. attorney general acknowledge online brokers' serious problems but fail to take enforcement action

Do regulators protect investors or brokers?

By Online Investor Complaint Center
Originally appeared on March 22, 2000, on our previous website

"Investing obviously has risks, but those risks should not include wondering whether an online broker is capable of providing promised services," said New York's attorney general, Eliot Spitzer, in February 1999, when he had just begun his nine-month investigation of the online brokerage industry. Responding to "numerous" customer complaints against online brokers, Spitzer launched his inquiry supposedly to protect online investors from trading system outages and delays, false and misleading advertising, and resulting substantial losses. Now that the New York attorney general's office and Securities and Exchange Commission (SEC) Commissioner Laura S. Unger have released their long-awaited, separate special reports on online trading, online investors should ask the following questions:

1. Is it worthwhile to complain about online brokers to state and federal securities regulators?
2. Was a recent visitor of Online Brokers' Trading Systems Failures Web Page correct when he said, "Why bitch, I've been screwed and can't do a thing about it unless I want to put my attorney's kids through college!"?
3. Do securities regulators vigorously protect online investors?
4. If not, then why?
5. And what can online investors do to protect themselves and all online investors?

The online trading reports of the New York attorney general's office and SEC Commissioner Unger show that these regulators are aware of online brokers' serious and growing problems but are reluctant to aggressively and

One of "the best" online trading sites.
—*Consumers Digest* July/August 1999

"I love your site... it is a great service to the investing public."
—Mark E. Maddox, Former State of Indiana Securities Commissioner

SEC Criticizes Brokers
Schwab Class-Action Lawsuit
Schwab Fee Controversy
Datek-Mohr Controversy
Schwab Apology
SEC, NY Atty. Gen. Failures
SEC Privacy Violation

immediately protect online investors. According to Unger's November 22, 1999 95-page report, *On-Line Brokerage: Keeping Apace of Cyberspace*, the number of online trading complaints that investors filed with the SEC surged from 259 in 1997 to 1,207 in 1998 to almost 3,300 in 1999. The 1999 complaints included account access problems, order processing failures and delays, order execution problems, account record errors, account transfer problems, margin position sellouts, inaccurate quotes, fund withdrawal problems, and false and misleading advertising.

In addition, the November 22, 1999 200-page report by Spitzer's Investor Protection and Securities Bureau, *From Wall Street to Web Street: A Report on the Problems and Promise of the Online Brokerage Industry*, discusses many online brokers' "aggressive," "glib and unrealistic," and "misleading" advertising. Spitzer's report also discusses the "dramatic surge in complaints" about "financial harm," order execution problems, poor telephone customer service, and trading system outages that "are still frequent enough that just this month [November 1999] an analyst commented that 'the reality is everybody's site crashes about once a week.'"

However, according to his report, Spitzer had "not commenced any enforcement actions regarding these events." In fact, both Spitzer and the SEC have failed to enforce against and penalize problem online brokers and to require them to make amends with their customers.

As a result, many aggrieved online investors have found that complaining about their brokers to state or federal securities regulators is frustrating and futile. For example, in December 1998, an Ameritrade customer complained to National Association of Securities Dealers (NASD) Regulation that he had received almost $8,000 less than he should have for shares sold due to a November 30, 1998 failure to execute and an improper cancellation of his good-till-canceled sell-stop order. The customer also complained that Ameritrade had given him different and implausible explanations for the order execution failure and cancellation.

Then in a June 1999 letter to the customer, NASD Regulation District 4 acknowledged that Ameritrade had indeed presented different explanations and that "there is no question that errors occurred with respect to your order." However, NASD Regulation District 4 concluded, "There is insufficient evidence to establish that a violation of securities regulations occurred, or any apparent activity that warrants disciplinary action against Ameritrade. Therefore, this matter is being filed without action."

In addition, some online investors have learned that taking the time to gather evidence and complain to multiple state and federal regulators is equally futile. In one case in early 1999, an online investor filed a detailed, documented complaint against Datek Online with five different regulators: Spitzer's Investor Protection and Securities Bureau; the SEC's regional office in New York City; Jodie Bernstein, director of the Bureau of Consumer Protection at the Federal Trade Commission (FTC); NASD Regulation District 9B, in New Jersey; and NASD's ombudsman. The Datek Online customer claimed a loss of over $15,000 due to account access problems at the market open on November 30, 1998, an inability to cancel an unexecuted order, and exaggerated advertising claims.

The customer documented these claims with the following: copies of 35 similar customer complaints about Datek Online's access problems at the market open on November 30, 1998; TheStreet.com's November 1998 "Online Brokers Survey," saying that Datek Online was "plagued by continuing access problems at the opening bell"; Datek Online executives' acknowledgment of system glitches and outages in November 1998, including a system problem at the market open on November 30, 1998; a cell phone bill showing a 38-minute call to Datek Online's customer service line at the market open on November 30, 1998; copies of Datek Online's advertising claims; and citations to various laws and regulations.

In spite of all of this detailed evidence, the SEC merely responded with a form letter and has taken no enforcement action. Bernstein's office has never responded. NASD Regulation District 9B "concluded that the evidence obtained does not sufficiently establish a violation of securities regulations. Therefore, we have filed this matter without action." NASD's ombudsman responded by telephone, referred the complaint to another NASD department, but has failed to follow up with the customer.

And the now-former deputy bureau chief of Spitzer's Investor Protection and Securities Bureau, Mr. William H. Mohr, showed interest in the complaint and communicated with the customer for many months, wrote letters to Datek Online on the customer's behalf, cited the customer's complaint in Spitzer's online trading report, but then dropped the complaint and took no enforcement action against Datek Online.

Mr. Mohr recently left his position to be an assistant general counsel of Datek Online Holdings Corp. specializing in "technology and government relations issues."

Instead of protecting online investors by strictly enforcing existing regulations and laws and adopting new binding rules appropriate for today's online brokerage industry, securities regulators have merely cooperated with, accommodated, advised, jawboned, and monitored online brokers. For instance, the SEC advised online brokers on trading systems capacity in the nonbinding SEC Staff Legal Bulletin No. 8. The SEC has proposed, but not adopted, "due to commenters' concerns," a new operational capability rule in proposed Rule 15b7-2. And in his "Plain Talk about On-line Investing," SEC Chairman Arthur Levitt urged online brokers to provide high-quality customer service, best execution of trades, forthright customer agreement disclosures, and unexaggerated advertising claims. In addition, NASD Regulation advised online brokers on disclosures of online trading risks and on operations of order execution systems in NASD Notice to Members 99-11 and Notice to Members 99-12, respectively.

Finally, although Attorney General Spitzer has considered enforcement action, according to "N.Y. Eyes First Enforcement Action over Online Capacity," in the August 16, 1999 *Compliance Reporter*, his online trading report states that he has decided to cooperate with the online brokerage industry on an investor education campaign, make recommendations to the industry and investors, and "monitor the performance of online brokerage firms."

Why are the SEC, NASD Regulation, and the New York attorney general's office reluctant to aggressively protect online investors? These regulators believe that if they aggressively protected investors by immediately cracking down on online brokers' violations, their enforcement actions would jeopardize the growth or existence of the online brokerage industry. And because these regulators appear to place the industry's business interests before consumers' interests, they definitely do not want to take any aggressive, restrictive enforcement actions against online brokers. Securities regulators would rather try a slow, hands-off approach and hope that online brokers voluntarily comply with their jawboning.

For example, in "Studies Address Online Trading," in the November 23, 1999 *Washington Post*, Sandra Sugawara writes, "Despite the enormous impact online trading is having, regulators say they must move carefully to keep from killing the industry." According to this article, SEC Commissioner Unger said, "I don't want to stamp out the online brokers, and I think if we came down too hard on online brokers, and I think if we came down too hard on them right now, that's what we'd do." Furthermore, Attorney General Spitzer's online trading report states that the "government should avoid placing regulatory 'handcuffs' on the online brokerage industry." Finally, according to the November 29, 1999 "Regulators Fret over Online Brokerage Ads," by J. Alex Tarquinio in *Forbes*, Charles Schwab's president and co-CEO, David Pottruck, complained, "I frankly think that our regulatory process for stopping some of this egregious advertising is very slow and needs to be stepped up dramatically. Outrageous claims are sometimes made, and when we complain to regulators the responses we get are not very effective, and consumers are not being well served."

In spite of this inadequate protection, online investors can take steps to protect themselves. They can refuse to participate in unfair, risky, poorly regulated financial markets. If, however, they want to risk participating, they can minimize their risks by contacting the New York attorney general's Investor Protection and Securities Bureau, their own state securities regulator, or NASD Regulation's Public Disclosure Program to request prospective online brokers' Central Registration Depository (CRD) records. With CRD records, online investors can find out important information about online brokers, including civil and criminal charges and proceedings, regulatory and disciplinary actions, formal investigations, serious customer complaints, arbitrations, and settlements. (Investors should note that CRD records from state securities regulators may contain more information than CRD records from NASD Regulation.)

In addition, online investors can search Internet message boards dealing with online brokers to find out which online brokers have a pattern of legitimate customer complaints. By obtaining CRD information and searching the message boards, investors then can be wary of online brokers with arbitration losses (e.g., Ameritrade Holding, Datek Online, and E-Trade), class-action lawsuits against them (e.g., E-Trade), regulatory troubles (e.g., Datek Online), or customer service problems. Investors can also choose professional, reliable, reputable, well-financed online brokers that *generally* provide satisfactory to excellent customer service and that know how to stay out of trouble, such as Fidelity, Vanguard, T. Rowe Price, Muriel Siebert, and DLJdirect.

Online investors can take additional steps to try to improve the protection of themselves and all online investors:

1. They can complain about the inadequately regulated online brokerage industry to members of Congress who have shown a commitment to protecting online investors. For example, investors can contact U.S. Democratic Representatives John D. Dingell (Mich.), Ron Klink (Pa.), Edolphus Towns (N.Y.), and Edward J. Markey (Mass.). They can also contact the U.S. Democratic senators who introduced Senate Bill 1015, the Online Investor Protection Act of 1999: Charles Schumer (N.Y.), Paul S. Sarbanes (Md.), Richard H. Bryan (Nev.), and Tim Johnson (S.D.).

2. Online investors can urge these members of Congress and their own representatives to influence state and federal regulators to strictly enforce existing laws, regulations, obligations, and securities and consumer protection statutes. These include NASD Rule 2210 and Rule 2110; SEC Staff Legal Bulletin No. 8; Section 17(a) of the Securities Act of 1933; Sections 10(b), 15 (b)(7), 15(c)(1), and 15(c)(2) of the Securities Exchange Act of 1934; Section 5 of the FTC Act; and New York's Martin Act and General Business Law Sections 349 and 350.

3. Online investors can also urge congressional leaders to introduce and enact new legislation and advocate new SEC and NASD regulations (e.g., SEC's proposed Rule 15b7-2) to increase the protection of the investing public.

4. Online investors can contact influential financial and business reporters in the mainstream media so that they will warn current and prospective online investors about the serious risks of online trading.

5. Aggrieved online investors who are victims of significant money losses can contact securities or consumer law attorneys about representation in class-action lawsuits or arbitration cases against online brokers.

6. Online investors can complain directly to Attorney General Spitzer about his inadequate regulation. When he released his online trading report, his office said, "If ... problems continue in the areas of disclosure, advertising, and system capacity and support, he [Spitzer] reserves the right to consider more serious remedies to ensure that consumers have the knowledge and protection they need to safely trade online."

7. Finally, online investors can urge Attorney General Spitzer, SEC Chairman Arthur Levitt, NASD Regulation President Mary L. Schapiro, and FTC Director Bernstein to beef up protection of the investing public by strictly enforcing the laws and regulations governing online brokers, by penalizing violating online brokers with more than a slap on the wrist, and by forcing violating online brokers to make their aggrieved customers whole.

In conclusion, the results of Attorney General Spitzer's nine-month, extensive investigation of the online brokerage industry are disappointing. Spitzer encouraged online investors and investor and consumer protection advocates when, on February 8, 1999, after the well-publicized spate of online trading system outages, he addressed the serious problems of online brokers and acknowledged that "a number of on-line brokers have experienced technical problems that caused consumers to lose thousands of dollars when their buy or sell orders did not go through." Spitzer led investors to expect that he would thoroughly investigate the customer complaints and losses and aggressively enforce the law when he announced that he had just begun his investigation of online brokers "in an effort to protect online investors from situations like this." After all, Spitzer claims to be "the People's Lawyer [who] is dedicated to aggressively prosecuting and defending the interests of all New Yorkers." He is also charged with the responsibility of enforcing New York's securities and consumer fraud statutes.

However, even though after his investigation, Spitzer acknowledged that "the information superhighway can be filled with potholes for the unsuspecting, unprepared or uninformed," Spitzer has failed to adequately protect online investors who have driven down this highway. In other words, Spitzer, who said that "we hope to smooth out as many rough spots as possible on this section of the information superhighway," has not been tough enough or courageous enough to enforce existing statutory rules of the road, require online brokers to immediately smooth out the rough spots, penalize the violators, and require violating online brokers to pull over and help the thousands of online investors who have already driven into the potholes, crashed, and burned.

Instead, Spitzer has given online brokers a license to speed by and leave thousands of crash victims in the dust. As a result, many more online investors will hit potholes, crash, and burn. And many online brokers will continue to speed by these crash victims until Spitzer and the online brokerage month, extensive investigation of the online brokerage industry are disappointing. Spitzer encouraged online investors and investor and consumer protection advocates when, on February 8, 1999, after the well-publicized spate of online trading system outages, he addressed the serious problems of online brokers and acknowledged that "a number of on-line brokers have experienced technical problems that caused consumers to lose thousands of dollars when their buy or sell orders did not go through." Spitzer led investors to expect that he would thoroughly investigate the customer complaints and losses and aggressively enforce the law when he announced that he had just begun his investigation of online brokers "in an effort to protect online investors from situations like this." After all, Spitzer claims to be "the People's Lawyer [who] is dedicated to aggressively prosecuting and defending the interests of all New Yorkers." He is also charged with the responsibility of enforcing New York's securities and consumer fraud statutes.

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