

Fictitious FINRA Arbitration Statement of Claim Excerpt No. 2

by Jeremy A. Hillpot

PARTIES

Claimant Regina Sample: At the time of this filing, Claimant Regina Sample is a resident of Ft. Lauderdale, Florida, where she has lived since 1978. She is currently 70 years of age and retired. As of three years ago, she is also a widow. Her husband, Capt. John Sample, passed away on June 18, 2007. Prior to his death, Capt. Sample was employed as a U.S. Navy captain aboard the U.S.S. Caine. During their 40-year marriage, Mr. and Mrs. Sample raised two daughters and had four grandchildren.

Claimant Regina Sample has never had a formal career, nor does she have any kind of education beyond high school. She spent the last 40 years as a devoted homemaker, mother, and grandmother, caring for her family while her husband was away at sea. During this time, she had never dealt with a brokerage firm, nor did she possess any kind of knowledge with regard to investing. At all times relevant hereto, Mrs. Sample was a novice investor who relied on the professional advice and expertise of Respondent for the investment and safekeeping of her retirement assets.

Respondent BarkleySmith Global, Inc. (CRD#0001): Respondent Barkley-Smith Global, Inc. is an NASD-member broker-dealer and investment advisory firm that offers its clients various investment and insurance products and services. The Claimant established her investment account with Respondent at the BarkleySmith branch office located at 1000 Wall Street Circle, Suite 100, Portland, Oregon 10000.

The BarkleySmith investment advisor assigned to the management of Claimant's retirement assets was Mr. Joseph Smith. Mr. Smith is not a named respondent in the instant matter.

FACTUAL ALLEGATIONS

Background on Claimant's relationship with Respondent:

Prior to her relationship with Respondent BarkleySmith, Claimant Regina Sample had always relied on her husband, Capt. John Sample, to select investments for their retirement savings. Invariably, he chose an asset allocation consisting of municipal bonds, CD's, and a small percentage of blue-chip stocks. These investments were held at

DiscountBroker, Inc. in an investment account that Capt. Sample had managed for more than 30 years. On June 18, 2007, when Capt. Sample died in a naval skirmish off the coast of Saudi Arabia, the Sample family retirement assets were still invested in the above-described, highly conservative fashion.

In July 2007, shortly after the death of her husband, Mrs. Sample traveled to Portland, Oregon to stay with family and sort out personal affairs. While in Portland, she discovered that DiscountBroker, Inc. did not offer any kind of investment advisory services and therefore her retirement funds were entirely unsupervised. Mrs. Sample was distraught over the loss of her husband, and having never dealt with investments before, the problem of knowing what to do with her retirement funds was overwhelming.

On July 27, 2007, concerned that no one was monitoring her assets, Mrs. Sample visited the Portland offices of Respondent BarkleySmith Global to inquire about the investment management services offered by the firm. At BarkleySmith, Claimant met with investment advisor Joseph Smith. Joseph Smith asked Mrs. Sample numerous questions pertaining to her personal situation, investment goals, and financial needs. Mrs. Sample answered that she was retired, 68 years of age, recently widowed, and that she had never dealt with a brokerage firm before. As per Claimant's hand-written notes from the meeting, she also stated that her primary goal was "to maintain what I have while earning a modest income to supplement my social security" (Exhibit A).

At Mr. Smith's request, Mrs. Sample allowed him to view her DiscountBroker account statements via the Internet. The statements showed a portfolio allocated with municipal bonds, CD's, and a small percentage of blue chip stocks. At the time, the value of Mrs. Sample's portfolio was approximately \$3,041,000 (Exhibit B). These assets represented the entirety of Claimant's net-worth, aside from her one-bedroom condominium in Ft. Lauderdale, Florida. They also represented a lifetime of hard work and sacrifice on the part of she and her husband.

After completing the interview, Joseph Smith advised Claimant to immediately transfer all of her DiscountBroker holdings to the care of BarkleySmith. He promised that BarkleySmith would choose conservative investments to generate a modest income while protecting her from investment declines. He further stated in a follow-up letter dated August 28, 2007, "I will invest your retirement in the most conservative fashion possible" (Exhibit C).

On September 1, 2007, Mrs. Sample opened two BarkleySmith investment accounts: Active Investments Account #000-0001 and Individual Retirement Account #000-0002. Into these accounts, Mrs. Sample deposited all of her retirement savings (approximately \$3,041,000) for safekeeping and investment. Upon the transfer of her assets, Mrs. Sample reiterated in a letter dated November 2, 2007, "...this money is all the money I have. Please choose only the safest investments. I do not want to grow my money, only to preserve what I have while making an income of about \$40,000 a year to supplement my social security" (Exhibit D).

Upon Mr. Smith's recommendation, Claimant signed paperwork that provided Respondent with discretionary authority to buy and sell securities without consulting her. When completing her managed account paperwork, Mrs. Sample selected the risk tolerance level "Ultra Conservative" and the investment goal "Income and Preservation" (Exhibit E).

Respondent unsuitably concentrated 100% of Claimant's portfolio into stocks from the most volatile sector of the economy:

Unfortunately, during Mrs. Sample's relationship with Respondent, Respondent completely ignored her most fundamental objectives and needs. Even though Respondent and its agent were fully aware of Claimant's status as a 68-year-old retiree and widow, and even though Claimant requested ultra-conservative investments, Respondent's agent invested Claimant's accounts in a high-risk and speculative fashion. At no time did Respondent notify Claimant of the high degree of risk associated with the investments Respondent chose, and at all times Claimant was unaware of the highly unsuitable nature of the securities in her accounts.

By September 30, 2007, Respondent's agent, Joseph Smith, had utilized his discretionary authority to concentrate 60% (approximately \$2,002,000) of Claimant's accounts into the following stocks and stock-based mutual funds:

INTERNATIONAL BUSINESS VENTURES EQUITY FUND
SUB-PRIME MORTGAGE FUND
FINANCIAL SERVICES EQUITY FUND
HIGHLY LEVERAGED BANKING, INC.

ZANZABAR FINANCIAL SERVICES & CO.
MORTGAGES R US, INC.

He concentrated the remaining 40% (approximately \$1,039,000) into the following reverse convertible bonds:

CHICAGOBANKING, INC.,
INVESTMENT BANKER, INC., and
INTERNATIONAL FINANCING, INC.

As confirmed by the securities listed above, Respondent's agent had invested all of Claimant's retirement into stocks, stock-based mutual funds, and reverse convertible bonds. Since reverse convertible bonds are tied to the performance of underlying stocks, for all intents and purposes, Respondent had invested 100% of Claimant's portfolio into the stock market. Even worse, all of the above-described investments were from the financial services sector, which was *the* most volatile sector of the economy at the time.

Respondent's above-described asset allocation failed to provide Mrs. Sample with any kind of protection in the event of an economic downturn; and, when stock market forces changed for the worse, so too did the value of Claimant's account. Ultimately, Respondent's investment choices caused Claimant to suffer more than two million dollars (\$2,000,000) in stock market losses.

All of the above-described losses could have been avoided. Indeed, Mrs. Sample would not have lost a single penny if Respondent had continued with the same tried and true investment practices that had been consistently employed by Mrs. Sample's late husband for more than 30 years.

Respondent unsuitably concentrated 40% of Claimant's portfolio into reverse convertible bonds:

Reverse convertible bonds are highly complex and highly speculative investments. Notwithstanding Claimant's lack of sophistication, even experienced investors do not commonly know what they are buying when they purchase a reverse convertible bond. For this reason, reverse convertible bonds are also referred to as "Nest

Egg Slashers” – a term first coined in the Wall Street Journal when referencing this high-risk investment.

When an investor purchases a reverse convertible bond, the investor is essentially providing an unsecured loan to a financial institution while at the same time writing an out-of-the-money put option on a corporate individual stock. Reverse convertible bonds are short-term, unsecured bonds issued by banks and/or highly-leveraged financial institutions, such as Respondent BarkleySmith. Typically, they are linked to the performance of a stock and pay higher yields than the average fixed income investment. Once the bonds mature, the investor is supposed to get his or her full principal back; however, if the value of the underlying stock falls below a specific level, called the "knock-in" level, then the shares get *converted* into shares of the devalued stock, which the investor receives in lieu of his or her initial investment.

Prior to the stock market turndown in 2008 and 2009, reverse convertible sales increased markedly, and nearly doubled in 2006 and 2007. Recently, news reports have suggested that some brokerage firms targeted senior citizens and other conservative, risk-averse investors in their efforts to sell reverse convertible bonds. Reverse convertible bonds were often misrepresented as safe, income generating investments suitable for retirees; however, when the stock market declined in 2008 and 2009, reverse convertible investors suffered massive financial losses.

In the instant case, Respondent misrepresented and omitted material facts to Mrs. Sample regarding the safety of her reverse convertible bonds and the safety of her portfolio as a whole. In fact, Joseph Smith told Mrs. Sample that he was purchasing the reverse convertible bonds to preserve her investment principal while earning a retirement income. However, these “Nest Egg Slashers” were tied to the performance of stocks, and they did not provide any degree of balance to Mrs. Sample’s already extreme exposure to stock market volatility.

Respondent’s decision to invest Mrs. Sample into reverse convertible bonds caused her to lose more than eight hundred thousand dollars (\$800,000) of her retirement assets. However, while Mrs. Sample has suffered, the Respondent has benefited. All of the reverse convertible bonds that Respondent purchased for Claimant (ChicagoBanking, Inc., Investment Banker, Inc., and International Financing, Inc.) were proprietary investment products issued by Respondent BarkleySmith. Clearly, the Respondent’s

interest in selling these risky bonds extended beyond its consideration for the welfare of its client. In selling the reverse convertible bonds to Claimant, Respondent generated investment banking capital, bonuses, and profits for itself. Mrs. Sample has suffered the consequences.

As a result of Respondent's actions Claimant has lost 70% of her retirement assets:

When stock market forces changed for the worse, Claimant lost a massive portion of her retirement, but Respondent was remiss in not alerting Mrs. Sample when her accounts began to decline. Further, the Respondent failed to take any action to mitigate her losses. Neither Respondent nor its agent made any changes to Claimant's asset allocation during the two-year history of Claimant's accounts. Why did Respondent neglect to take action, when it was clear that Mrs. Sample's retirement was in jeopardy?

By April 2008, within five months of Claimant opening her accounts, the value of Mrs. Sample's retirement portfolio had declined by more than \$600,000. On April 27, 2008, she contacted her BarkleySmith investment manager, Joseph Smith, to ask what could be done to make it stop. Instead of immediately restructuring Claimant's portfolio into more suitable investments, Respondent did nothing. Respondent told Mrs. Sample that her losses were only temporary and that the accounts would recover in 60 days, but the losses continued. On January 28, 2009, Claimant contacted Respondent again to ask about the losses, but Mr. Smith convinced Mrs. Sample again to maintain her investments as they were. Unfortunately, Claimant's accounts continued to decline. On November 1, 2009, she liquidated all of her investments and terminated her relationship with Respondent in order to mitigate the risk of losing more.

As a direct result of Respondent's actions (and failures), Claimant has suffered losses totaling **\$2,120,000**. In only two years, Mrs. Sample lost more than 70% of her retirement assets, which took a lifetime to save and earn.

Conclusion:

In late 2007, Respondent ignored Claimant's age and status as a widowed retiree, investing 100% of her portfolio into stocks from the financial services sector. Respondent made these unsuitable purchases at a time when media reports were running rampant about the sub-prime mortgage crisis and the pending collapses of major banks

and financial institutions. Completely failing to diversify Mrs. Sample's portfolio, BarkleySmith disregarded the most important aspect of a sound investment strategy. In fact, Respondent did the opposite of diversifying Mrs. Sample's portfolio. Respondent liquidated an already diversified portfolio of municipal bonds and CD's to overconcentrate its client into the most volatile sector of the economy. Respondent further misled Claimant regarding the sale of its proprietary reverse convertible bonds to Claimant. Why did Respondent disregard the welfare and goals of Mrs. Sample in this case?

Respondent contravened Mrs. Sample's goals of preservation and safety listed in her managed account documentation. Respondent contravened Mrs. Sample's written and verbal requests for conservative investments that would generate an annual income of approximately \$40,000. At the time she opened her accounts, Mrs. Sample's portfolio totalled \$3,041,000. This means that the Respondent needed to generate an annual income of less than 2%. There was no need to risk Mrs. Sample's retirement in the fashion Respondent chose. Clearly, Respondent's choices on behalf of Mrs. Sample were entirely unsuitable.

As a FINRA-registered broker-dealer organization, Respondent and the individuals employed by Respondent owed Claimant a fiduciary obligation to recommend and purchase suitable investments that were in line with Claimant's best interests and needs. In the instant case, Respondent's fiduciary obligation was elevated by the discretionary authority that allowed Respondent to buy and sell securities without first consulting Mrs. Sample. The Respondent should have selected more secure investments for Mrs. Sample, such as municipal bonds and/or fixed income securities. By recommending and purchasing unsuitable and speculative investments; by omitting material facts from Claimant pertaining to the risks involved; and by placing its own interests before the welfare of its client, Respondent BarkleySmith and its agents breached their fiduciary obligation to Claimant.

In light of the obvious and egregious misconduct and supervisory and compliance failures, Claimant respectfully submits to the Panel that an award of punitive damages against the Respondent is entirely merited.