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Wall Street Settlements For Dummies

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Your best chance of collecting the highest possible compensation related to fraudulent Wall Street research is if you're an investment moron. That's my vernacular version of a consensus among arbitration attorneys I interviewed. They used words like "unsophisticated." But as we'll see, the distinction may be just matter of degree.

Until recently, most securities arbitration claims have focused on mishandling of an account by the broker. For example, loading with risky stocks the portfolio of an old widow dependent upon regular investment income; or "churning" trades to generate commissions.

In the wake of April's Global Settlement between regulators and Wall Street firms about conflict of interest between research and underwriting, many investors who actively participated in management of their portfolios want to claim compensation for losses stemming from fraudulent research. Successful class action approaches often return less than five cents on the dollar, and so far have proven difficult regarding research claims. So many investors who lost big bucks on Internet and new age telecom stocks are turning to arbitration sponsored by the major stock exchanges and the National Association of Securities Dealers.

Let's look at a hypothetical example that I constructed with input from arbitration attorneys, including the especially articulate Jeffrey Feinberg, Stuart Meissner and Jacob Zamansky, each of whom head New York-based firms in their names. Bear in mind their caution that each potential arbitration has its own wrinkles, which must be carefully evaluated.

Say that in the midst of the dot-com frenzy you packed your portfolio with one of the 108 stocks cited in the Global Settlement. When the bubble burst, losses in that stock sliced the value of your entire portfolio in half.

A prerequisite to claiming that you relied upon tainted research is that you bought the stock from a broker who distributed the reports. That was made abundantly clear in Federal Judge Milton Pollack's July 1 dismissal of a class action suit against Merrill Lynch brought on behalf of investors who weren't clients.

If you qualify, the next step is to convince an arbitration panel that the research was bogus. Brokers and analysts didn't admit or deny guilt in the Global Settlement. But the evidence that it made public is compelling. So odds are that you get to first base.

Then you have to show that you relied on the research in deciding to buy. At the least, there should be correspondence or recorded phone calls with your broker discussing the stock; and your broker didn't offer appropriate cautions. Ideally, the broker actually touted the stock and sent you a research report not long before you actually bought.

The final hurdle can separate small victory from fuller compensation. If your purchases accounted for a large percentage of your investment capital, and your broker didn't independently make that allocation for your account, the broker will argue that you ignored as boilerplate the risk and diversification warnings in the research reports. Of course there's a glaring inconsistency if your broker didn't mention them in discussing the stock with you. Still, it often isn't that simple.

If the broker can convincingly show that you actively participated in management of your investments for many years, arbitrators may conclude that you knew better, or should have, and are entitled to less compensation than if you were a neophyte. The average compensation in arbitration wins is around 60% of the claimed amount. But that's over a wide range. There's a big difference between a dedicated WarrenBuffetWarren Buffet wannabe and the client whom attorney Zamansky recounts saying that his broker-recommended, net-stock-devastated portfolio also included "Microscope"--Microsoft-- and drug company "Merkle"--Merck (which aren't cited in the Global Settlement).

Sometimes it can be even more complicated. For example, veteran investors often have accounts at more than one broker. Say you claim loss due to Morgan Stanley research, but actually bought the stock from Citigroup's Smith Barney, which also is party to the Global Settlement. Your case becomes more difficult, perhaps impossible, even if Smith Barney also wrote reports about the stock but sought no underwriting related to it. So far, there haven't been legal penalties for analysts being merely lemmings.

If you have a clean, well-documented case related to a stock and broker cited in the Global Settlement, you probably can make out okay on a claim as small as $50,000. Otherwise, and especially in big cities, a claim below six figures may not be worth the legal fees, expenditure of personal time and additional aggravation--especially if you're not a moron.