

Stockbrokers' Money Games

Clients Often Victims of Hucksterism, Insider Says

4/22/95
By David A. Vise
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One day last year, Washington stockbroker Les Silverstone walked into the sixth-floor corner office of Securities and Exchange Commission Chairman Arthur Levitt Jr. and told him that Wall Street's biggest brokerage firms routinely cheat investors through what he described as deceptive and unethical business practices.

Silverstone, an industry veteran whom Levitt now refers to as "Deep Throat," said brokerage firms take advantage of consumers in numerous ways they cannot detect. The problem is not just a few bad apples, Silverstone said, but a rotten operating style that pervades the brokerage industry.

Among his revelations:
■ Behind the firms' genteel facades, a crude form of hucksterism prevails. His longtime



BY KENTH JENKINS—THE WASHINGTON POST
Les Silverstone says brokers too often push what benefits them.

BROKERS, From A1

millions of investors. "We're a factory," Silverstone said. "We think bigger is better."

The 56-year-old Silverstone, a lifelong Washingtonian and graduate of Woodrow Wilson High School in Northwest Washington, does not fit the whistle-blower mold. The SEC typically gets tips from bitter former employees, jilted lovers and jealous co-workers. Silverstone, instead, is a successful millionaire who blasted the business that made him rich because, he said, its practices have been bothering him for years.

"The consumer is getting ripped off, he doesn't know it, and I just can't sit idly by," Silverstone said in an interview. "The things

that are going on are indefensible. I'm not talking about the extremes. I'm talking about what is going on every day with reputable brokers."

Silverstone, who officially retired last year but maintains an office in Dean Witter's Chevy Chase branch, said he kept quiet until now because he feared ostracism. He also acknowledged that his drive to achieve financial security kept him from speaking up sooner. For decades, he worked long hours and pressed to get ahead, serving as branch manager of Dean Witter's first Washington office. Later, he returned to the front lines as a broker, where he could ignore the firm's edicts to sell high-fee products he disliked.

"If I waited too long to speak up, so be it," said Silverstone, who spent more than 40

hours in interviews describing the industry while reviewing thousands of pages of documents and notes. "You have to step back from the rat race to see this."

Silverstone has had a large influence on the SEC's efforts to force Wall Street to clean up its sales practices. Though Levitt does not share Silverstone's stinging criticism of the industry, he agrees that practices cited by the broker are troubling. And the SEC chairman has used many of Silverstone's insights in his speeches and other aspects of the agency's consumer program.

"He has given me a number of useful ideas," Levitt said. "He is very intelligent. He knew the industry. He was clearly zealous. . . . I thought he had a great deal of courage in coming forward."

Dean Witter spokesman Timothy Lee de-

See **BROKERS**, A12, Col. 1

Dean Witter spokesman Timothy Lee de-

clined to comment on Silverstone's criticism and his decision to meet with SEC officials. Lee said the firm will make a wide-ranging announcement next month about changes in broker compensation in response to Levitt's campaign to improve the way Wall Street firms treat customers.

Marc Lackritz, president of the Securities Industry Association, said brokerage firms deal with investors fairly. He also said the industry has responded to Levitt's focus on consumer issues by embarking on efforts to improve how it sells investments and pays brokers.

"There is a very strong commitment of the leadership of the industry to put the customer's interest first and to provide the highest quality products and services," Lackritz said. "... The fundamental relationship between a customer and a broker is one of trust. And trust is built up lots of different ways. The overwhelming majority of brokers build up trust with their clients by giving them good counsel and good advice."

A Washingtonian magazine poll ranked Silverstone as one of the city's leading stockbrokers last year, and executives at several local firms described him as an industry expert. Gordon Macklin, who served as president of the Washington-based National Association of Securities Dealers, said he often consulted with Silverstone on industry matters.

"I always looked on him as a professional's professional who built an in-depth knowledge of securities markets," Macklin said.

Slick Marketing

Silverstone said one of the most "abusive" hidden marketing practices at Dean Witter and some other brokerage firms is the use of sales contests, which reward brokers with trips and other prizes for selling high-fee investments to unsuspecting consumers.

Over the last few years, Silverstone said, Dean Witter has given brokers televisions, home computers, stereo systems, clothing, sports and lottery tickets and other prizes for selling selected financial products during contests. Investors are unaware that many brokers' recommendations are influenced by contests, Silverstone said.

"At Dean Witter, contests are rampant," he said. "Nearly every single new mutual fund is sold via a contest and there is always at least one contest going on."

A few years ago, New Jersey investor Salvatore F. D'Amato sought financial advice from a Dean Witter broker when he needed a secure investment to provide retirement income. He said he was told Dean Witter had a stable mutual fund that competed with ultra-safe bank certificates of deposit. What D'Amato didn't know, Silverstone said, was that Dean Witter was con-

ducting a sales contest to encourage brokers to sell the high-fee fund, which turned out to be much riskier than described.

By early this year D'Amato's original \$22,000 investment had plunged in value by 36 percent, and Dean Witter had cut the dividend payments. "The fund was very, very aggressively sold," Silverstone said. D'Amato recently reached an agreement with the firm that prohibits him from commenting. Dean Witter declined to comment.

Silverstone said Dean Witter also has sponsored holiday contests. In one Dean Witter Valentine's Day contest, brokers were encouraged to submit their "sweet-heart's name and address" when they phoned in orders so the firm could send flowers and Godiva chocolate.

"If you sell something near Thanksgiving, your wife gets a turkey. If you sell something near Valentine's Day, your spouse gets a dozen roses. It is one thing if a bucket shop [a small, fly-by-night firm] is doing it. But when Dean Witter is doing that kind of stuff, we have gone too far."

Silverstone said contests distort the advice that brokers give customers. "Would you want to go to a doctor who was trying to win a contest by writing certain prescriptions? The contests create a certain culture and it is detrimental to the consumer. What you need from your broker—his best thinking about how to achieve your long-run financial goals—is exactly what the contest is forcing the broker not to give you."

Despite the conflicts, Silverstone said contests thrive because they motivate brokers to sell investments that generate big commissions. "The client should write to his broker and say, 'Even if your firm runs contests, I want you to renounce your participation,'" Silverstone said, adding that he participated in contests as a young broker and branch manager and regrets it.

Some brokers and firms defend contests as a way to motivate brokers to open new accounts and work hard.

Under prodding from Levitt, some of the other major national firms, such as Merrill Lynch and PaineWebber, have been pulling back from their reliance on sales contests, while Dean Witter continues to use them heavily, Silverstone said.

"They are now calling contests 'rewards for asset gathering,'" Silverstone said. "The words have been twisted. It is a contest."

A Dean Witter spokesman said the issue

of contests is under review at the firm but he could not predict the outcome.

Legal Loopholes

Silverstone said that some of the most egregious practices in the industry involve clever exploitation of legal and regulatory

loopholes.

Brokerage firms must comply with rules limiting written promises about investments that can be made to customers. But stocks and mutual funds typically are sold on the telephone. Dean Witter and some other firms avoid the legal restrictions by distributing hyped phone sales scripts internally to their brokers, who use them to market an array of products by phone to investors, Silverstone said.

By stamping the materials given to brokers "for internal use only" or "not for public distribution," Dean Witter avoids the legal restrictions and frees its brokers to operate in aggressive ways by phone that run counter to the spirit of the law, Silverstone said.

"The brokerage firm is propagandizing the broker all day long," Silverstone said. "And then the broker verbally propagandizes the client."

A spokesman for Prudential Securities Inc. said the firm had acknowledged in litigation that it used misleading internal sales literature, causing brokers to make false statements to customers about the risk of investing in energy partnerships.

Dean Witter also used aggressive internal sales literature to push some limited partnerships, resulting in losses for customers, according to Steve Gard, an Atlanta lawyer who won a \$67,000 arbitration award against the firm on behalf of a Chattanooga, Tenn., retiree. Gard had argued that the firm's brokers, who generated hefty commissions, told his client that aircraft leasing and railroad car partnerships were secure investments but failed to explain the risks. Dean Witter declined comment on the matter.

The legal loopholes extend beyond sales scripts. Silverstone has a stack of internal Dean Witter documents, called "In Focus Memorandums," that the firm distributes to brokers in response to press reports and other matters. "These are things they want you to tell your clients that can't legally be put in writing to your clients," he said. "It is propaganda. . . . It is not full and fair disclosure."

Sales scripts are used in many industries as an accepted way to generate business. But Silverstone said brokerage sales scripts often get around the intent of SEC regulations and lead to bad advice for customers.

Hot Buttons

Silverstone credited Wall Street's sophisticated approach to marketing and sales, and the soaring stock market, with lulling investors into a false sense of security. He said consumers need to be as cautious dealing with stockbrokers as they are when they buy a car.

"When you go to buy a car or you go to buy a house, you play games with the salesman, you bargain with him, you don't show him your mind and you keep him at arm's

length," Silverstone said. "When you go to your broker, you tell him everything about you. He learns all your hot buttons. You drop your guard. You are trusting this broker who is, in effect, trying to sell you something at a nice fat commission."

Lackritz said Silverstone "insults the professionalism" of stockbrokers throughout the industry, who value their relationships with clients. "If our customers do well, the industry prospers," he said.

A conservative, single businessman, Silverstone has metal file cabinets filled with

brokerage documents in his kitchen, where he does more research than cooking. He spends his days and nights collecting articles, reading brokerage documents, attending seminars and talking with SEC officials and consumer experts about abusive brokerage practices.

While he still advises some longtime clients and owns hundreds of thousands of dollars worth of Dean Witter's stock, Silverstone said retiring gave him the freedom to speak out. But the bespectacled broker does not advocate new regulations; instead, he wants to expose the sales techniques that he said major firms employ so individual investors can protect themselves.

"It is a lot slicker than it used to be, so the consumer has to be very, very careful," he said.

Hidden Fees

Silverstone said the monthly brokerage statement mailed to investors conceals vital information about fees and investment performance.

For example, neither the monthly statement nor the brokerage trade confirmations show any commission or fees when individual investors buy Treasury bonds or tax-exempt municipal bonds, even though brokerage firms may mark up the price of these bonds by as much as 3 percent to 5 percent, Silverstone said. A customer who attempted to sell municipal bonds right after buying them would suffer losses because of the hidden costs, he said.

At other times, Dean Witter offers its brokers "specials," or higher fees for selling difficult-to-move bonds that the firm holds in its inventory. Such fees typically are not disclosed to investors who buy the securities, Silverstone said.

Dean Witter aggressively promotes bank certificates of deposit, even when Treasury securities pay higher interest rates, because the firm and its brokers receive fees from the banks, Silverstone said. Customers are told they pay no commission when they purchase new issues of stocks, bonds or mutual funds, but special fees paid to the broker by the firm encourage them to recommend new issues, he said.

While the monthly brokerage statement

gives a snapshot of the value of investments, it typically does not measure performance over time, Silverstone said. It also does not show all relevant commissions and mutual fund fees, which reduce investment results.

Silverstone said that if enough consumers demand that brokerages include more information about fees and performance on their monthly statements, firms will comply.

Mass Marketing

Dean Witter's promotional literature says the firm's brokers are committed to putting the "customer first," and the firm projects a folksy image in its television ads. But Dean Witter and other major retail brokerages develop mass market products that can be sold profitably to legions of customers, Silverstone said.

Silverstone said Dean Witter and other firms give brokers impressive-sounding titles, such as financial consultant, account executive or vice president, that portray them as unbiased financial professionals. "What the industry is doing is misrepresenting itself," Silverstone said. "This is a conscious effort to tell the consumer that this person is not simply a commission sales person. A broker is trained to be a salesman."

One of the brokerage industry's greatest marketing coups, he said, has been persuading millions of individual investors to keep much of their money in cash management accounts

with brokerage firms. (At Dean Witter, these are called Active Asset Accounts.) The accounts, which consumers favor for their convenience, combine investments, credit cards, checking, savings, bill paying and efficient record keeping.

But the accounts also provide brokers with valuable information about a person's spending habits and how much money is available for investment, Silverstone said. "What individual investors have done is give the broker information that is priceless," he said. "What the client doesn't understand is that when he dumps all his assets in one account, he is going to get more pressure."

Another mass-marketing triumph has been "wrap accounts," which have attracted more than \$100 billion by giving individual investors the chance to pick a professional investment manager for a fixed annual fee. Brokerage industry officials say that wrap accounts offer investment expertise from skilled professionals and avoid the conflicts associated with paying brokerage commissions. It also is convenient for the customer because the professional decides what investments to make.

But wrap accounts have numerous

**ONE INVESTOR
AT A TIME
OR ONE CONTEST
AT A TIME?**

A selection of Dean Witter contest materials demonstrates the incentives stockbrokers have to push certain products to clients. In addition to periodic promotions, Dean Witter produces an awards catalogue filled with everything from home electronics to leather goods to jewelry for top-selling brokers.

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Selection	Description	Prizes Awarded For Sales Of
A)	The Get Together 4 (Box.) Filet Mignons 8 (Box.) Gourmet Burgers	\$50,000
B)	6 (4.5oz.) Stuffed Steaks with Seasonings and Toppings	\$20,000
C)		
D)		

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Wednesday, February 9th
All Day

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flaws, Silverstone said, beginning with annual fees so high that most investors will underperform the stock market averages. "Anyone who pays 3 percent a year in fees is destined to do worse than the market average," he said.

He also said Dean Witter's wrap account agreements lead investment advisers to execute nearly all of their trades through the firm, which means trades may not be done at the best possible price. "There are hidden execution costs," he said.

Watch the Calendar

Silverstone said consumers should be aware that the final week of the "commission month" is more dangerous than others for dealing with brokers. At Dean Witter, the commission month ends about five business days before the calendar month, which means the week to avoid brokers is the third week of the calendar month, he said. (It varies at other firms.) During the final week of the commission month, brokers striving to meet sales goals often become more aggressive, Silverstone said.

"We do much of our business in the last week of the commission month," Silverstone said. "I want consumers to understand the danger."

The pressure to sell can be intense because many stockbrokers are paid almost entirely on commission. The average broker in the industry earned about \$117,037 last year after generating gross commissions, which are shared with the firms, of \$279,077.

Silverstone said the last month of the year, or the final days of a contest period, can be perilous for investors too. "People are walking around the last two weeks of December saying, 'I need \$12,000 gross to become a senior vice president,'" he said.

In addition to eyeing the calendar, Silverstone said investors should be wary of brokers who re-

cently switched firms, because their new employer will pay them higher fees for a period of months. The higher fees, which are concealed from investors, give brokers a strong incentive to recruit old clients and generate commissions.

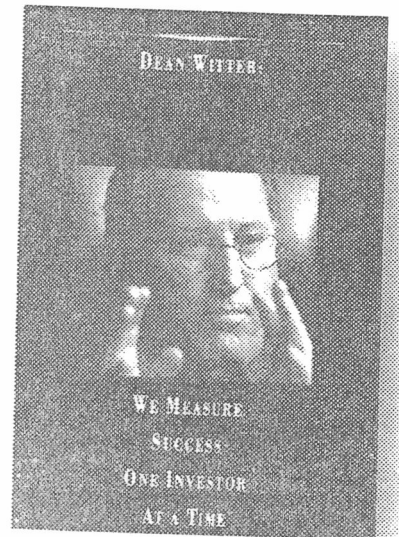
Dean Witter is planning to address the recruitment issue by changing the way it pays new brokers. Some other firms have taken similar steps.

The SEC is investigating a branch manager of one brokerage firm who offered a newly recruited broker a cash bonus every time one of his clients invested in a certain mutual fund. The broker put nearly all of his clients into the same fund, without regard for whether it was a suitable investment. "It is a perfect example of compensation run amok," a source familiar with the case said.

Silverstone said Dean Witter pays its brokers a higher commission to sell the firm's in-house mutual funds than for selling funds sponsored by other firms. He said this causes brokers to recommend the firm's proprietary mutual funds even when they are poor investments. Silverstone cited recent Morningstar Inc. rankings that placed Dean Witter's domestic stock mutual funds at the bottom of 15 major firms, when measured by performance and risk. The firm tells its brokers that it can better monitor the quality of its own funds and wants at least three-quarters of sales to be in Dean Witter products, Silverstone said.

Morningstar analyst Carolyn Whitfield said Dean Witter is a defendant in lawsuits in New York and California over the performance of Dean Witter "term trusts," poorly performing mutual funds sold by brokers on the basis of their safety and investment income. Dean Witter said in court papers that the poor performance was due to market conditions that could not have been foreseen. The firm also said the risks were adequately described.

The New York state attorney general's office is investigating the firm's marketing of the billion-dollar funds, which plunged in value



A Dean Witter spokesman said the firm intends to remain a leader in meeting the needs of individual investors. Above, the familiar face from the firm's television ads and motto: "We measure success one investor at a time."

and had considerable risk. Dean Witter declined comment.

"I've spoken to a number of investors who feel they were duped into buying something they didn't understand," said Whitfield, who has analyzed the funds.

One investor, Sam Benun, a 66-year-old Idaho retiree, said he put \$150,000—25 percent of his savings—into the product after his brother, a Dean Witter broker, told him it was a safe way to earn a good yield. But the investment fell by 30 percent and the dividends have been cut. "I never would have put that much into it had I thought there was any risk," Benun said. Dean Witter declined comment.

Merrill Lynch and PaineWebber, two of the largest brokerages, said earlier this year that they had stopped paying brokers more to sell the firms' own mutual funds. Dean Witter may join them next month by ending its practice of paying its brokers a premium for selling the firm's proprietary funds.

Silverstone said Dean Witter continues to pay brokers hidden fees, known as "trailers," for keeping investors in Dean Witter mutual funds over the years. "It is a terri-

ble conflict of interest," Silverstone said. "What broker is going to advise his clients to sell a poorly performing fund when he is getting paid thousands of dollars a year to keep them invested in it?"

Silverstone said one way investors can protect themselves is by avoiding commission-hungry brokers and turning for advice to fee-only financial planners, registered investment advisers and trust departments of major banks. Unlike traditional brokers, they typically are paid fixed fees linked to their time or the amount of money invested.

But bank trust departments generally cater to more affluent clients and there aren't enough fee-only planners to go around, since much of the investment industry operates on commission. Levitt, for his part, said compensation practices alone do not make someone a good broker or financial planner.

'Stop Looking the Other Way'

Silverstone is not limiting his crusade to the brokerage industry. He is founding an organization called SLOW, for "Stop Looking the Other Way." He wants to encourage people in other fields to come forward, as he has done, and tell the public what is happening inside their industries.

"When you see things that are wrong, you have to speak out," he said. "Watergate couldn't have happened if good people didn't look the other way."

By going public with his views on the brokerage industry, Silverstone said he has entered a new stage of life that he dreamed about for years. "My money-making days are gone," he said. "I'm shooting at much bigger problems. I only have so many years left. This is the right thing to do."



Les Silverstone, with Dean Witter for decades, is officially retired but still has an office in the firm's Chevy Chase branch. Below, Silverstone in his Porsche 911.

*'The consumer is getting
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and I just can't sit idly by'*

