At A Glance

Broker-Customer Disputes

Overview

NERA economists work on behalf of counsel for both brokers and customers in disputes concerning investment activities. They bring to bear their training and experience from areas such as trading, risk management, academia, and consulting. Our economists use quantitative and statistical tools to provide objective analyses to address the questions that arise in these disputes.

Disputes between brokers and customers often center on the suitability of trades recommended by brokers or of decisions made by investment advisers. In many cases, the dispute relates to the question of whether the broker's actions resulted in an overly concentrated portfolio. Other disputes involve issues such as inappropriate securities given an investor's investment objectives, churning, excessive markups, or excessive use of leverage. Often, a series of complaints by customers is based on similar allegations against a group of brokers. Examples of this include claims that brokers pushed stocks recommended in bad faith by analysts at their firms, or claims that brokers improperly encouraged customers to use margin to exercise options.

Key Areas of Expertise

Different cases often require different sets of analyses. Issues that NERA has examined in broker-customer disputes include:

- Comparison of actual portfolio performance with that associated with proposed alternative strategies;
- Historical and projected volatility of actual and proposed alternative portfolios;
- Analysis of correlations of stocks with indices or with other securities to examine the feasibility of possible hedging strategies;
- Analysis of customer trading in other accounts and time periods to examine the level of customer sophistication;
- Comparison of portfolio turnover over time or between portfolios;
- Modeling the risks of a proposed portfolio strategy;
- Analysis of markups/markdowns or commissions;
- Valuation of derivative positions in a portfolio; and
- Valuation of illiquid positions in a portfolio.

Case Profiles

Alleged Failure to Hedge

A customer transferred a large block of the stock of his employer to a brokerage firm. The customer did not want to sell but as a condition of his employment, the customer was restricted from trading options on this stock. Following a large decline in the value of the stock, the customer sued alleging that he could have been protected against loss if the broker had recommended hedging with an index correlated with his employer's stock. NERA experts described the basis risk implicit in such a strategy and demonstrated that it could have resulted in significant losses. NERA experts were further able to show that, even had the customer agreed to diversify his holdings into other stocks, he likely would have incurred significant losses given the markets' performance during the period.

Investigating a Declining Portfolio

Heirs to an estate were concerned that the value of the estate portfolio had declined. NERA investigated and found that shortly after the original account holder died, the turnover rate in the portfolio increased and there was a large shift in asset allocation. NERA showed that had the original asset allocation and turnover ratio been maintained, the portfolio would have had a superior performance. NERA also showed that the account statements did not display all transactions, making the changes in the portfolio difficult to recognize.

Excessive Margin and Concentration

A customer who employed significant margin borrowing in concert with a concentrated stock portfolio experienced significant losses. He claimed that the strategy, and hence the loss, was due to recommendations from his broker. NERA was able to show that the claimant had used significant leverage with a similarly concentrated position in the same securities with a prior broker.

Leveraged Exercise of Stock Options

A customer used funds borrowed from a broker to exercise employee stock options. Subsequently, the stock market and the stock in question were very volatile and the customer experienced losses. The customer claimed that the strategy had been recommended by the broker and was inherently unsuitable. NERA was able to show that a number of other strategies all would have resulted in losses and to quantify the alleged excess loss due to the leveraged exercise strategy.

About NERA

NERA Economic Consulting (**www.nera.com**) is a global firm of experts dedicated to applying economic, finance, and quantitative principles to complex business and legal challenges. For over half a century, NERA's economists have been creating strategies, studies, reports, expert testimony, and policy recommendations for government authorities and the world's leading law firms and corporations. We bring academic rigor, objectivity, and real-world industry experience to bear on issues arising from competition, regulation, public policy, strategy, finance, and litigation.

NERA's clients value our ability to apply and communicate state-of-the-art approaches clearly and convincingly, our commitment to deliver unbiased findings, and our reputation for quality and independence. Our clients rely on the integrity and skills of our unparalleled team of economists and other experts backed by the resources and reliability of one of the world's largest economic consultancies. With its main office in New York City, NERA serves clients from more than 25 offices across North America, Europe, and Asia Pacific.

Contact

For more information or to contact our experts, please visit **www.nera.com/sec-brokercustomerdisputes**.