CORPORATE CRIME REPORTER

Cuneo Gilbert Out to Disinfect FINRA with Some Sunlight

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They say sunlight is the best disinfectant.

If so, then Jonathan Cuneo is on a campaign to disinfect FINRA.

Cuneo and his law firm – Cuneo Gilbert & LaDuca – have three lawsuits pending against the Financial Industry Regulatory Authority (FINRA).

In each, FINRA is being represented by F. Joseph Warin of Gibson Dunn & Crutcher.

"FINRA is the largest private regulator for all securities firms doing business in the United States, yet it is run like a secret society," Cuneo told *Corporate Crime Reporter.* "The organization claims to promote transparency in the financial industry, while simultaneously fighting a battle to hide very basic information from its members and the public. Our lawsuits challenge this secrecy and aim to bring accountability to this organization."

Two of the lawsuits – Benchmark Financial Services v. FINRA and Standard Investment v. FINRA – allege that FINRA member firms are due more than the $35,000 they received as part of the 2007 merger between National Association of Securities Dealers (NASD) and the regulatory arm of the New York Stock Exchange – a merger that resulted in the creation of FINRA.

At the time of the merger negotiations, NASD told its members that because it was a non-profit, the most it could pay each firm was $35,000.

But in March 2007, the Internal Revenue Service (IRS) issued a private letter ruling which indicated that in fact NASD could pay a lot more than $35,000.

How much more is a secret.

Earlier this month, the Second Circuit Court of Appeals ruled that amount of money the IRS said NASD could pay each firm was confidential.

The NASD told its members at the time of the merger negotiations that the source of the $35,000 "was projected future savings resulting from anticipated efficiencies of the consolidated entity."

"This was false," the *Benchmark* lawsuit declares. "The true source of the funds was an over $1 billion fund that constituted a portion of NASD's member's equity, a pool of cash that had been amassed largely as a result of the development and sale of the NASDAQ stock trading system."

"The misrepresentation was designed to deceive members into believing that they should accept the amount offered lest they upset the NASD's projections of future efficiencies and cause difficulties for the consolidated entity going forward. Defendants

knew that if they told members the truth – that they would be paid $35,000 each (or a total of $175 million) out of their own equity fund of more than $1 billion – they risked a wide-open evaluation demand scenario that would have delayed, invited more scrutiny concerning – and potentially even threatened – the whole transaction."

The *Benchmark* lawsuit alleges that one motivation for the merger was to secure higher executive compensation for officers.

Mary Schapiro is currently the chair of the Securities and Exchange Commission (SEC).

Before leaving to the SEC, Schapiro was CEO of NASD, then FINRA.

In 2006, before the merger, Schapiro's compensation was $1.9 million.

In 2007, as head of the newly created FINRA, her compensation jumped to $3 million.

"The amounts of total executive compensation are eye-popping by any measure, but are especially staggering for a non-profit institution," the lawsuit alleges.

The third lawsuit – Amerivet Securities v. FINRA – was brought by a firm owned by an African American California Army Reserve officer and Green Beret – Lt. Colonel Elton Johnson Jr.

Johnson has served two tours of duty in Iraq and is about to be deployed to Afghanistan.

He's had a long running battle with FINRA.

FINRA suspended him as a supervisor from December 2006 to June 2008 for failure to properly manage an employee.

Johnson claims that FINRA was retaliating against him because he complained publically about how FINRA was treating him.

As a member of FINRA, Johnson's company – Amerivet – wants FINRA to open its books.

In particular, the lawsuit seeks to find out where FINRA has invested its many hundreds of millions of dollars – and why.

It wants a federal judge to rule that Delaware Code Section 220 allows members of FINRA to inspect the company's books.

According to the lawsuit, in 2008, FINRA lost $568 million, or 26.5 percent of its investment portfolio.

"These losses wiped out the reported investment returns over the previous four years," the lawsuit alleges.

"FINRA has been reckless in pursuing high-risk strategies inappropriate to preservation of capital," the lawsuit alleges. "It appears that, despite the fact that FINRA requires investment earnings as a supplement to other sources of funds (e.g. member payments, fines), its emphasis on short-term investment returns and apparently risky vehicles was unwarranted, quite costly and a waste of its assets."

The lawsuit alleges that "while FINRA has been reasonably vigorous in its oversight of smaller member firms, frequently devoting substantial resources to dealing with insignificant technical infractions, FINRA has, due to conflicts of interest, given a virtual 'free pass' to large member firms and their affiliates such as Bear Stearns, Lehman, Merrill, Madoff, Sky Capital and Stanford."

"In Madoff's case, there appears to have been a particularly cozy relationship between Madoff and senior FINRA executives which resulted in virtually no oversight of Madoff and its affiliates or its $65 billion Ponzi scheme," the lawsuit alleges. "It appears that due to the personal relationships between Bernard Madoff, members of his family and FINRA executives, there was a 'hands off' policy in place to his activities and those of his firm, which allowed their Ponzi scheme to flourish."

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