ADVISOR PRACTICE MANAGEMENT | ADVISOR NEWS

Retiree Wins $800K Arbitration Award Over Apple Options Strategy

BARRON'S

By Andrew Welsch Follow

Aug. 19, 2022 1:12 pm ET

Charles Schwab and Pinnacle Associates, a registered investment advisory firm, were ordered to pay a former customer roughly $800,000 over an options strategy that the customer claimed was misrepresented, went awry, and ultimately forced her to sell hundreds of shares of Apple (ticker: AAPL).

A three-person Finra arbitration panel issued the award in favor of retiree Maria Fernbach Aug. 16, after a lengthy legal battle involving 51 hearings, according to the award. Fernbach filed her arbitration claim in December 2020, accusing Charles Schwab and Pinnacle of omissions and misstatements, breach of fiduciary duty, negligence, failure to supervise, and other misconduct, according to the award.

Signage is displayed outside a Charles Schwab Corp. location in New York, U.S.
Michael Nagle/Bloomberg

In addition to siding with Fernbach, the arbitrators also ordered Pinnacle to reimburse Charles Schwab for its part of Fernbach's award and to pay Schwab $352,000 in attorneys' fees pursuant to the firm's contract with the custodian.

Fernbach's attorney, Stuart Meissner, says his client is happy with the award and hopes it serves as a cautionary note to other investors about the risks of options-trading strategies. "She's an unusual client in that she was almost more focused on the principle of what happened here than the money," Meissner says.

A spokesman for Charles Schwab said in a statement: "As always, we work to deliver exceptional experiences to all our clients and serve them as a trusted partner along their financial journeys." The firm declined to comment further.

Pinnacle's attorney, James Nealon, a partner at law firm Withers Bergman in New York, wouldn't comment on the details of the case, citing client confidentiality, but said in a statement: "The arbitration award should be considered in the important context that this was the first ever award during our firm's nearly forty-year history. The claim was brought by an experienced investor who was suitable for the strategy, who ultimately received less than half of the amount claimed, and for whom no punitive damages were awarded."

Both firms denied her claims during the arbitration case, according to the award.

Fernbach, 69, is a retiree who began acquiring shares of Apple in 1997, accumulating about 17,500 shares, which comprised more than 99% of the assets in her Roth IRA, according to her attorney. In retirement, she has relied on a small pension, Social Security benefits, and the dividends that Apple paid.

Fernbach became a Charles Schwab client in 2017. In March 2019, her Schwab broker introduced her to Pinnacle Associates, a New York-based RIA that was founded in 1984 and currently has about $7.7 billion in assets under management. Pinnacle custodies clients assets at Charles Schwab and participates in the company's client referral program. RIAs that participate in the program pay Charles Schwab a participation fee based on a percentage of the value of the assets in the client's account.

Other custodians have similar referral programs, which are popular with advisors because they provide a steady stream of new clients and assets.

At the March 2019 meeting, Fernbach's Schwab broker allegedly suggested that she meet with Pinnacle because the firm could help her boost her retirement income, according to her attorney. Fernbach agreed to do so. At a subsequent meeting with two representatives of Pinnacle and her Schwab broker, Fernbach stated that she did not want to sell any Apple shares or risk losing any, according to her attorney. The representatives allegedly assured her that a proposed laddered covered-call writing strategy would not risk her Apple stock, the attorney says.

"They portrayed it as extra income and you get to keep the shares. The best of both worlds," Meissner says, whose law firm, Meissner Associates, is based in New York.

After the meeting, Fernbach agreed to become a Pinnacle client and signed up for an advisory account at the firm. Her assets remained custodied at Schwab.

A covered-call involves selling someone else the right to purchase a stock you already own at a specific price within a specific time period. It has the potential to generate additional income for the call seller. However, the strategy involves risks, such as the stock soaring above the call price, resulting in the option holder exercising their option to buy the stock and the seller missing out on the gains above the strike price.

In Fernbach's case, she allegedly explicitly stated she did not want to be forced to sell shares of Apple, which is what happened, according to her attorney. Shares of Apple rose that summer and into the fall, surpassing some of the laddered strike prices.

"The stock kept going past the strike prices, and she was inquiring what's the strategy? She got evasive responses. At one point, an advisor said there is a 1% chance the stock will be exercised," Meissner says.

She made complaints to Charles Schwab and Pinnacle. The firms terminated their relationship with Fernbach in October 2019, forcing her to move her accounts to another custodian, according to her attorney.

Representatives of Charles Schwab and Pinnacle declined to comment on the end of their relationship with Fernbach, citing confidentiality.

Fernbach moved her assets to TD Ameritrade, and was ultimately forced to sell more than $420,000 worth of Apple shares in order to cover calls, her attorney says. Charles Schwab acquired TD Ameritrade in October 2020.

Both Charles Schwab and Pinnacle opposed her claims during the arbitration case, disputing the allegations, and asked the arbitration panel to dismiss her claims, according to a copy of the award.

Eighteen-months after filing her arbitration case, the three-person panel ruled in Fernbach's favor. Her more than $800,000 award included about $436,000 in compensatory damages and interest; $304,000 in attorneys' fees; and $74,400 in legal costs. Fernbach had originally requested $908,000 in damages, according to the arbitration award.

The arbitrators also stuck Pinnacle with the $65,000 bill for the hearings. In addition, they ordered the firm to pay a $10,000 sanction for failure to timely produce documents, according to the award.