

**What Every Investment Adviser Should Know
About Investment Product Suitability**

Alternative Investments...Annuities...Regulatory Hot Topics

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Regulatory Hot Topics: Top Ten Scams

Oil and Gas Investment Fraud

Regulatory Hot Topics: Top Ten Scams

Prime Bank Schemes

Regulatory Hot Topics: Top Ten Scams

Affinity Fraud

Regulatory Hot Topics: Top Ten Scams

Promissory Notes

Regulatory Hot Topics: Top Ten Scams

Penny Stock Fraud

Regulatory Hot Topics: Top Ten Scams

Unregistered Products

- **Sale and Leaseback Contracts**
- **Viatical Settlements**

Regulatory Hot Topics: Top Ten Scams

Private Placements

Regulatory Hot Topics: Top Ten Scams

Senior Investment Fraud

Regulatory Hot Topics: Top Ten Scams

Personal Information Scams

Regulatory Hot Topics: Top Ten Scams

Sales Practice Violations

***What's All The Fuss About Variable
And Equity-indexed Annuities?***

- **Increased regulatory scrutiny**
- **Rise in litigation/arbitration**

Considerations For Sale Of Variable Annuities And Equity-Indexed Annuities

- **Age of client**
- **Income/liquidity needs**
- **Tax considerations**

Considerations For Sale Of Variable Annuities And Equity-Indexed Annuities

- **Percentage of net worth**
- **Exchanges**
- **Sub-account suitability**
- **Commissions & fees**

The Regulators Are Watching And Customers Are Suing!

- **Recent NASD enforcement actions**
- **State Securities/Insurance Division actions**
- **Recent arbitration awards favoring investors**

***For Financial Advisors
Some Basic Considerations***

- **Disclosure, Disclosure, Disclosure!**
- **If in doubt, don't**
- **Suitability documentation**
- **Informed client acknowledgement**

What Every Customer Should Ask About Variable/Equity Indexed Annuities

- **Surrender period**
- **Compensation
(commissions and/or fees)**

***What Every Customer Should Ask About
Variable/Equity Indexed Annuities***

- **Other investments**
- **Firm approval**
- **Risks associated with
sub-account investments**

What Every Customer Should Ask About Variable/Equity Indexed Annuities

- Read investor education materials discussing annuities on the NASD website, www.nasd.com

What Are Hedge Funds??

- Investment vehicles traditionally catering to large institutional investors and ultra high net worth investors (assets of \$50 million or more)

What Are Hedge Funds??

- **Employ varied non-traditional investment strategies to pursue total return**
 - **Long-short**
 - **Event driven**
 - **Absolute return**
 - **Fund of funds**

What Are Hedge Funds??

- Utilize leverage
- Utilize instruments
 - Futures
 - Options
 - Other financial derivatives

What Are Hedge Funds??

- **Unique fee structure**
 - **Typically involving a management fee and a percentage of profits**

Hedge Fund Capital Inflows Continue

- Hedge fund investments in 2005 totaled \$1.5 trillion
 - Up from 36% from 2004
 - Up from just \$200 billion in 1995

Hedge Fund Capital Inflows Continue

- **Number of hedge funds exceeds number of mutual funds**

Hedge Fund Capital Inflows Continue

- Hedge fund awareness has transcended beyond institutional investors and ultra high net worth families
 - Includes the “mass affluent”

Positive Attributes Of Hedge Funds

- Potential for significant returns/profits
- Provide diversification
 - Low correlation with traditional asset classes

Concerns For Individual Investors

- **Risk – leveraging and other speculative investment practices can increase the risk of investment loss**

Concerns For Individual Investors

- **Taxes and fees impact returns
(multiple layers of fees with
funds of funds)**

Concerns For Individual Investors

- **The majority of funds have short track records, lack of operating history**
- **Dramatically varying returns**

Concerns For Individual Investors

- **Lack of transparency**
- **Limited regulatory oversight**
- **Illiquidity**

Considerations For Financial Advisors When Recommending Hedge Funds

Investor-Specific Suitability

- **NASD Rule 2310 (and Notice to Members 03-07)**
 - **Requires advisors to confirm that recommendation is suitable for the customer**

Considerations For Financial Advisors When Recommending Hedge Funds

Investor-Specific Suitability

- Must determine appropriate allocation (if any) of investor's portfolio**

Considerations For Financial Advisors When Recommending Hedge Funds

Product Specific Concerns

- “Reasonable-basis” suitability
 - Requires advisor to determine that product is suitable for any investor

Considerations For Financial Advisors When Recommending Hedge Funds

Product Specific Concerns

- Requires due diligence with respect to hedge fund or funds of funds

***Hedge Fund Due Diligence
Areas Of Inquiry***

- **Considerations discussed
within NASD Notice to
Members 03-07**

Hedge Fund Due Diligence Areas Of Inquiry

- SEC advice contained in its publication “Hedging Your Bets: A Heads Up on Hedge Funds and Funds of Hedge Funds” (available at www.sec.gov/answers/hedge.htm)

*Hedge Fund Due Diligence
Areas Of Inquiry*

- **Other considerations**

Questions ?

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Thank You

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