

Compliance Survivor

Simplifying Complex Regulatory Concerns

Online Seminar

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Regulatory Issues

Regulatory Issues

CONFLICTS OF INTEREST

- **Requirement to disclose material conflicts of interest in a full and fair manner to ensure your clients understand any material conflicts of interest before taking action**

Regulatory Issues

DUTY TO DISCLOSE

- **Under the Advisers Act, an adviser has a fiduciary obligation to act in the best interests of its client and to place its client's interest before its own**

Regulatory Issues

Examples of failure to disclose:

- Failing to disclose fees charged to a client
- How fees are charged; whether fees are negotiable
- Failing to disclose an affiliation with a broker-dealer, or solicitors

Regulatory Issues

Examples of failure to disclose (contd):

- Failing to disclose that the adviser recommends securities to clients in which he has a proprietary interest
- Failing to disclose the risk by having clients invest in private investments (Illiquidity is an issue)

Regulatory Issues

Examples of failure to disclose (contd):

- Failing to disclose the types of products and services it obtains through “soft dollar” arrangements
- Failing to explain to clients that they pay both a direct management fee to their advisers and an indirect fee to their advisers of their mutual fund

Regulatory Issues

Examples of failure to disclose (contd):

- Failing to amend its form ADV on an annual basis or updating information more frequently when it becomes out of date
- Stating that the adviser does not have custody and possession when in fact it does

Regulatory Issues

LACK OF INTERNAL CONTROLS

Regulatory Issues

POLICIES AND PROCEDURES

Regulatory Issues

REQUIREMENTS

- Monitoring employees' personal trading
- Adopting effective or relevant compliance policies and procedures

Regulatory Issues

VIOLATIONS

- **Front-running**
- **Scalping**
- **Trading on non-public information**
- **Taking investment opportunities for themselves**

Regulatory Issues

CUSTODY AND POSSESSION

Record Keeping

Record Keeping

BOOKS AND RECORDS

Record Keeping

ADVERTISING

- Performance based
- Adviser Act Rules prohibit use of testimonials from clients regarding an adviser's services

Record Keeping

ADVERTISING (contd)

- **Advisers cannot use any advertising that contains any untrue statements of a material fact, or which is otherwise false or misleading**

Record Keeping

**FAILURE TO ACCURATELY STATE
PERFORMANCE RESULTS**

Record Keeping

PERFORMANCE CLAIMS

Record Keeping

ADVISORY AGREEMENTS

Record Keeping

RISK IDENTIFICATION PROCESS

Record Keeping

EMAIL

Record Keeping

ELECTRONIC STORAGE

SEC Investor Complaints and Questions

SEC Investor Complaints and Questions

The SEC's investor assistance staff received 76,221 complaints, questions, and other contacts in 2005.

SEC Investor Complaints and Questions

COMPLAINT TYPE

1.	Advance Fee Fraud	2,219
2.	Spam: Unwanted Emails or Faxes	1,146
3.	Transfer of Account Problems	844
4.	Account Closing: Problems with Redemption, Liquidation, or Closing	841
5.	Manipulation of Securities, Prices, or Markets	741
6.	Bankruptcy or Issuer Reorganization	728
7.	Theft of Funds or Securities	697
8.	Unauthorized Transactions	653
9.	Account Records: Errors or Omissions	645
10.	Delivery of Funds or Proceeds	629

SEC Investor Complaints and Questions

COMPLAINTS AGAINST BROKER-DEALERS ONLY

1.	Transfer of Account Problems	622
2.	Unauthorized Transactions	533
3.	Account Closing: Problems with Redemption, Liquidation, or Closing	518
4.	Account Records: Errors or Omissions	433
5.	Unsuitable Recommendations	395

NASD Complaints: Dispute Resolution Statistics

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CONTROVERSIES INVOLVED IN ARBITRATION CASES

Type of Controversy	2005
Unsuitability	1,926
Misrepresentation	1,826
Online Trading	7

NASD Complaints: Dispute Resolution Statistics

SECURITY TYPES INVOLVED IN ARBITRATION CASES

Type of Security	2005
Corporate Bonds	106
Certificates of Deposit	31
Mutual Funds	888
Options	153

NASD Complaints: Dispute Resolution Statistics

SECURITY TYPES INVOLVED IN ARBITRATION CASES

Type of Security	2005
Common Stock	1,348
Limited Partnerships	24
Annuities	460

Suitability Revisited

Suitability Revisited

Key Considerations:

(Seminar for the Securities Industry Association, Compliance and Legal Division)

- **Does the activity make sense?**
 - Irrelevant that client agreeable, or
 - Account performing well

Digging the Hole Deeper

Or “No good deed goes unpunished.”

Digging the Hole Deeper

- **Admitting that a past strategy was not a good idea**
- **Offering to waive fees or give a discount for poor performance**

Digging the Hole Deeper

- **When a client does not have the stomach to take losses, don't fight him**
- **Sell a position that is going down and revise the questionnaire to reflect that the client "can't sleep" with certain investments**

Digging the Hole Deeper

Avoiding Digging the Hole Deeper

- **If you and a client no longer have the same ideas about investing, end the relationship**
- **Document any time that a client took an action against your advice**
- **Never admit that an investment was a bad idea or a mistake**
- **Never give a refund/discount for services due to investments performing poorly**

Dealing With A Customer Complaint

Dealing With A Customer Complaint

- Once a customer has made a written complaint, a reportable event has occurred
- DO NOT meet with the customer or communicate with the customer before speaking to an attorney
- Immediately notify any insurance carrier

**Hedge Fund and
Fund of Funds
Due Diligence (NTM 03-07)**

Hedge Fund and Fund of Funds Due Diligence (NTM 03-07)

- Disclosing that hedge funds / fund of funds often engage in leveraging and other speculative investment practices that may increase the risk of loss**
- Can be highly illiquid**
- Are not required to provide periodic pricing or valuation information to investors**

Hedge Fund and Fund of Funds Due Diligence (NTM 03-07)

- May involve complex tax structures and delays in distributing important tax information**
- Are not subject to the same regulatory requirement as mutual funds**
- Often charge high fees**

Hedge Fund and Fund of Funds Due Diligence (NTM 03-07)

- **Must perform due diligence to determine that the hedge fund or fund of hedge funds is suitable for any customer**

Hedge Fund and Fund of Funds Due Diligence (NTM 03-07)

- **“Heightened responsibility” to investigate, and “substantial due diligence” to perform**

Hedge Fund and Fund of Funds Due Diligence (NTM 03-07)

- Before making a recommendation to any customer, member firms must do at least the following:**
 - Investigate the background of the hedge fund manager**
 - Review the offering memorandum**
 - Review the subscription agreements**
 - Examine references**
 - Examine the relative performance of the fund**

Hedge Fund and Fund of Funds Due Diligence (NTM 03-07)

- **Must perform a customer-specific suitability determination**
 - **Customer's wealth is not an indicator of suitability**
 - **Wealth does not provide a basis for recommending risky investments**

Hedge Fund and Fund of Funds Due Diligence (NTM 03-07)

- **Furthermore, acting as a placement agent still may bring the firm within the definition of “recommendation”, citing NTM 96-60**
 - **The firm brought the specific hedge fund or fund of hedge funds to the attention of the customer**

CPE credit candidates, please key in your answer in the Q&A field to the following question:

How long is an investment adviser required to maintain books & records?

- a) 1 year**
- b) 2 years**
- c) 5 years**
- d) 10 years**

Answer:

c) 5 years

CPE credit candidates, please key in your answer in the Q&A field to the following question:

Rule 206(4)-3 allows for cash payments for client solicitations if:

- a) the adviser is registered
- b) solicitor cannot be subject to statutory disqualification
- c) cash fee must be paid pursuant to a written agreement
- d) disclosure must be made to the client
- e) all of the above

Answer:

e) all of the above

QUESTIONS?

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Answers to FAQ regarding our webinars:

- This presentation will be available for replay from our website at www.SNSFE-law.com along with a PDF of the PowerPoint slides within 48 hours.
- A 5-question participant evaluation will be emailed to you.
- Qualified CPE candidates will receive proof of attendance via email.

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THANK YOU

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