

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

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

Online Seminar April 25, 2006

PRESENTED BY:



Sharon



April J. Lindauer



Ross

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Regulatory Hot Topics: Top Ten Scams

Oil and Gas Investment Fraud

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Prime Bank Schemes

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Affinity Fraud

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Promissory Notes

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Penny Stock Fraud

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Unregistered Products

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

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Private Placements

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Senior Investment Fraud

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Personal Information Scams

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Sales Practice Violations

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

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

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***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

Jeffrey M. Gershon April J. Lindauer Ronald M. Amato
JGershon@snsfe-law.com ALindauer@snsfe-law.com RAmato@snsfe-law.com

312.621.4400

Shaheen, Novoselsky, Staat, Filipowski & Eccleston, P.C.
20 N. Wacker Drive, Suite 2900
Chicago, IL 60606

www.SNSFE-law.com
www.FinancialCounsel.com

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