

Points of Emphasis/Best Practice Summary

FINRA has issued a Regulatory Notice reminding firms of their obligations regarding the supervision of registered persons using senior designations, specifically the use of certifications and designations that imply expertise, certification, training or specialty in advising senior investors. FINRA is encouraging firms to adopt the practices that are outlined in the Regulatory Notice to strengthen their written supervisory procedures, as appropriate. In January 2011, FINRA surveyed retail broker-dealer firms to better understand the use and oversight of senior designations. The survey results indicated that while some firms ban senior designations outright, it is more common for firms to permit the use of senior designations pursuant to specified supervisory procedures.

Firms, at a minimum, must have supervisory procedures in place reasonably designed to prevent their registered persons from using a senior designation in a manner that is unethical or mislead-

ing. Firms that allow the use of any title or designation that conveys an expertise in senior investments or retirement planning where such expertise does not exist may violate FINRA Rule 2010, NASD Rule 2210, and possibly the anti-fraud provisions of the federal securities laws and FINRA rules. As with all supervisory procedures, these procedures should be written, clearly communicated to employees, effectively enforced, and they should cover how approved designations may be used.

Firms may also want to consider implementing certain other practices and procedures, such as prohibiting designations that do not have the following: a rigorous curriculum; an emphasis on ethics; continuing education requirements; a

method for determining the registered person's status regarding the designation; and/or a public disciplinary process. To avoid the use of misleading designations, or designations that have not been earned or approved, by registered persons, firms may want to consider only allowing the use of business cards and stationary that has been prepared and approved by the firm. Finally, firms should consider requiring registered persons to attend training sessions and sign an annual attestation certifying the designations

that they use; that the designations are not self-conferred; that they meet the continuing education requirements; and/or that they are in good standing with the organization that has conferred the designation.



Firms may consider requiring attendance at training sessions focused on retirement planning, ethics in working with senior investors, and/or the proper use of senior designations in advertising, sales literature and correspondence.

Regulatory Corner

FINRA is implementing a redesigned S201 Regulatory Element Program. The S201 Regulatory Element Program (i.e., the Supervisors Program) is required for supervisory/principal registrants. Individuals who schedule an S201 session on or after January 2, 2012 will see the redesigned program, which includes new story-based cases and an updated user interface. Two key changes to the program are: (1) individuals must demonstrate their proficiency in the content of each case in order to successfully complete a module; and (2) the new program will include written story-based cases, rather than full-length video sessions.

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The Regulatory Element requires all registered persons to participate in a prescribed computer-based training session within 120 calendar days of their second registration anniversary date and every three years thereafter. The Regulatory Element is designed to cover significant subject matter that is broadly applicable to all registered persons. The Regulatory Element focuses on compliance, regulatory, ethical and sales-practice standards. Its content is derived from rules and regulations, as well as standards and practices widely accepted within the industry.

The new program, which has been streamlined to

include only four modules, integrates a range of topics, such as ethics and business conduct, compliance, registration/licensing and reporting requirements. Participants must demonstrate proficiency in each of the four modules and will be provided a maximum of two cases in each module to demonstrate proficiency. Participants who do not demonstrate proficiency in any one module will not be able to complete the Regulatory Element requirement within that session. In the event a module is not completed, participants may terminate the incomplete session or may continue to review the remaining material for the added educational benefit. In either event, participants will not be able to complete the Regulatory Element requirement in that session and must schedule another session in order to satisfy the requirement.

Word on the Street

FINRA has sanctioned eight firms and ten individuals for selling interests in troubled private placements without conducting reasonable diligence. The firms and individuals sold interests in several high-risk private placements which ultimately failed, causing significant investor losses. FINRA found that the firms did not have adequate supervisory systems in place to identify and understand the inherent risks of these offerings. As a result, many of the firms failed to conduct adequate due diligence for the offerings and some firms did not have reasonable grounds for establishing suitability for any of their customers. FINRA ordered the firms and individuals to pay more than \$3.2 million in restitution.

In light of these and previous sanctions imposed on other firms, it is important as ever that firms conduct and document proper due diligence when participating in a private placement offering. Equally as important is documenting the suitability of the investments for the investors to which the interests in the private placement are sold. In April 2010, FINRA issued a Regulatory Notice reminding firms of their obligations to conduct reasonable

investigations in Regulation D offerings. This Notice describes Regulation D, regulatory responsibilities of firms to engage in a reasonable investigation of a Regulation D offering, and describes practices that some firms have adopted to help them discharge their reasonable investigation obligations.

At minimum, firms should conduct a reasonable investigation concerning: the issuer and its management; the business prospects of the issuer; the assets held by or to be acquired by the issuer; the claims being made; and the intended use of the proceeds of the offering. Firms must conduct a reasonable investigation in connection with each offering, notwithstanding that a subsequent offering may be for the same issuer. Firms should retain records documenting both the process and results of its investigation.

In the context of a Regulation D offering, Rule 2310 requires broker-dealers to conduct a suitability analysis when recommending securities to both accredited and non-accredited investors that will take into account the investors' knowledge and experience. The fact that an investor meets the net worth or income test for being an accredited investor is only one factor to be considered in the course of a complete suitability analysis. The firm must make reasonable efforts to gather and analyze information about the customer's

other holdings, financial situation and needs, tax status, investment objectives and such other information that would enable the firm to make its suitability determination. Firms must also be satisfied that the customer fully understands the risks involved and is able to take those risks.



The sanctioned principals did not have reasonable grounds to allow the firms' registered representatives to continue selling the offerings, despite the numerous "red flags" that existed regarding the private placements.