

Points of Emphasis/Best Practice Summary

When must you send your clients a copy of your firm's Brochure (ADV Part 2A) and Brochure Supplements (Part 2B)? The requirements changed this year and going forward. In light of the changes to the ADV, your firm was required to deliver a copy (not just make the offer) of its current Brochure and any all Brochure Supplements within sixty (60) days after the filing of its 2010 FYE annual update. Federally registered firms were given until July 21, 2011 to have their Brochure Supplements completed and sent out to new and prospective clients and were given until September 30, 2011 to send Brochure Supplements to existing clients. State-registered firms still had the 60 day requirement from the date of the filing of their first annual update on or after December 31, 2010.

For all subsequent ADV updates, you must deliver a copy of your firm's Brochure before or at the time you enter into an advisory agreement with a

client. Annually, you must deliver a current copy of your firm's Brochure within 120 days of your firm's fiscal year end. Alternatively, you can provide a summary of material changes along with an offer to provide the updated Brochure along with instructions for how to obtain a copy. In addition, you must promptly deliver an updated Brochure to all clients if information in Item 9 (disciplinary information) has been updated.

Supervised Persons' Brochure Supplements must be delivered before or at the time that supervised person begins to provide advisory services to a client. You also must deliver to clients any update to the Brochure Supplements that amends information in response to Item 3 of Part 2B (disciplinary information).

As a reminder, you must also provide, as applicable, your annual Privacy Policy notice to clients.

Advisors to pooled investment vehicles must also provide audit reports to investors of the pooled investment vehicles.



Firms must deliver a current copy of its Brochure within 120 days of its fiscal year end.

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.