

FINRA Targeting Complex Products

By: Bettina Eckerle

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Complex products remain one of FINRA's top compliance concerns, according to CEO Richard Ketchum. Other areas of interest cited by Ketchum included conflicts of interest and exams.

Speaking at the SEC's National Compliance Outreach Program for Broker-Dealers, Ketchum stated that products such as closed-end funds, private REITs, private placement securities and "exotic" ETFs "have driven way too many enforcement cases" and hence require "heightened supervision."

Ketchum acknowledged that investors increasingly seek out these complex products "because they typically pay income regularly in the form of dividends, interest income, capital gains and/or return of capital." However, they require "enhanced supervision because retail investors may not understand that some funds are returning capital to maintain the high distribution rates, causing the closed-end funds to trade at high premiums compared to their net asset value," he said.

The "scarcity of independent financial information and the uncertainty surrounding the private placement securities market and credit-risk exposures associated with many private placements means firms must conduct reasonable due diligence to assess the risk for investors," he added.

According to Ketchum, due diligence "should focus on the issuer's creditworthiness, the validity and integrity of their business model, and the plausibility of expected rates of return as compared to industry benchmarks. Our primary concern is that inadequate due diligence regarding private placements could expose customers to harm and result in insufficient disclosure."

Also of note, Ketchum indicated that FINRA is currently reviewing comments to its controversial conflict of interest rule proposal that would require brokers to disclose compensation when switching firms. As you may recall from our [prior post](#), the proposed rule has elicited strong reactions on the street among recruiters and advisers. The regulator "will soon decide on how to proceed," he stated.

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