

# WHY IS ARBITRATING AN ALTERNATIVE PRODUCT CLAIM LIKE THE WILD, WILD, WEST?

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# INTRODUCTION

- What types of alternative products generate the most claims against BDs/RIAs? What are we seeing today?
- What are the typical allegations asserted against the BD and the reps/advisors?
- What is the most difficult allegation to defend that is asserted against the reps/advisors?
- What is the most important action that a rep/advisor should take when investing a client in alternative products? The question is: Can you defend a transaction that you **recommended** today *possibly* ten years from now?

## WHAT SHOULD A FIRM'S DUE DILIGENCE LOOK LIKE?

- There is a fine line between what is in writing and what can be used against the firm or its Reps/Advisors.
- Is utilizing a checklist a good idea? Maybe yes, maybe no.
- Proactive due diligence and robust documentation
- Analysis of the alternative product, supporting the defense that the firm conducted a careful evaluation of the product before adding it to the approved product list up until the offering closes.

# WHAT ARE THE REGISTERED REPS/ADVISORS DUE DILIGENCE REQUIREMENTS?

- Are Reps/Advisors required to conduct their own due diligence? If yes, what should that due diligence consist of?
- Reps/Advisors must understand the product. If they don't, the case is indefensible.
- Although the firm is obligated to conduct on going due diligence of all the products on its approved product list, a rep/advisor is also responsible to follow up on its own due diligence of products they sell.
- Reps/Advisors need to continue to provide services to the clients that purchased alternative products.
  - A Rep's/Advisor's failure to respond to client inquiries about their alt investments increases the likelihood that the client will pursue an action against that rep/advisor. Transparency and communication are keys to maintaining good relationships with clients.

## MOST DIFFICULT HURDLES DEFENSE ATTORNEYS FACE WHEN ARBITRATING ALTERNATIVE PRODUCT CLAIMS

- Sloppy paperwork
- Inconsistent information when multiple investments in alternatives are made.
- Registered Reps/Advisors lack knowledge of the product.
- Damages calculations.
- Confirmation that the information on the account forms is accurate, consistent, and obtained directly from the clients.



## CHALLENGES IN SELECTING THE ARBITRATION PANELS

- Increasingly more claimant sympathetic.
- Claimant attorneys partnering up and representing multiple but separate clients in order to get two strikes to defense counsel's one when selecting the arbitrators.
- Fewer arbitrators that have the knowledge or expertise to arbitrate complicated financial claims, especially since it is no longer required to have an industry professional on the panel.
- Older arbitrators who demonstrate difficulty hearing and following the information presented at arbitrations.

# CONFLICT OF INTEREST ISSUES TO OVERCOME

- Due Diligence and Marketing Fees
- Fancy Trips
- Representative Agreements
  - Incentives
  - Higher Commission Payouts for Certain Products
  - Firms sharing due diligence fees with the Reps

# WHAT ALL BDS NEED TO DO TO CREATE A DEFENSIBLE ALTERNATIVE PRODUCT SALE

- Well documented due diligence file
- Accurate, comprehensive customer profile information to support the recommendation
- Evidence of Registered Rep/Advisor Product Training
- Well Documented Compliance Review/Approval
- Documentation of Product Monitoring



# WORKING WITH THE PRODUCT SPONSORS TO SUCCESSFULLY DEFEND AN ALTERNATIVE PRODUCT CLAIM

- Product Sponsor Best Practices to include regular updates and distribution of information and documents to the BDs/RIAs that sell their product.
  - Proposed to be incorporated into alternative product selling agreements
- United front and cooperation with BDs/RIAs and their defense counsel when defending an alternative product claim.
- Provide annual client investment statements to the BDs or create a portal so that this information is accessible by the BDs.
- Proactively address red flags noted in third-party reports

# SUPPORT THAT BDS/RIAS WOULD LIKE FROM THE PRODUCT SPONSORS

- Phone support when a client or BD/RIA has questions about a product offered by knowledgeable personnel.
- Transparency of information when the product sponsor is facing a business challenge.
- Responses to requests for client account information.
- Address red flags noted in third-party reports when providing the due diligence package for review.
- Provide requested documentation that is product specific when requested by a BD/RIA or their attorneys.

# Professional Liability Coverage for Alternative Product Related Claims

- Most, if not all, E & O policies issued to BDs/RIAs exclude coverage for claims arising out of the sale/servicing of unregistered investments.
- Coverage is negotiated on a case by case basis for coverage for unregistered investment claims that is then added to the policy by endorsement.
- Typically a sub-limit of liability is imposed for alternative product claims and higher per claim retentions/deductibles apply. Know what your policy's limits are.
- Many carriers are also adding alternative product concentration limits in these endorsements. Make sure that your alternative product sales are in compliance with these concentration limits.
- Make sure that your carrier has your complete and updated list of approved alternative products.

CLE Credit Code

**SUITABILITY**

**THANK YOU!**

# SPEAKER CONTACT INFO

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