

# Client Alert

Current Issues Relevant to Our Clients

June 24, 2013

## FINRA Issues New Investment Alert Regarding Alternative Funds

*On June 11, 2013, the Financial Industry Regulatory Authority (“FINRA”) released the Investor Alert Alternative Funds are not your Typical Mutual Funds as a part of efforts to raise investor awareness regarding registered funds that use investment strategies that differ from the typical buy-and-hold investment strategies. A copy of the Investor Alert is available [here](#).*

The Investor Alert directs investor attention to alternative fund structures and potential risk associated with investments in such funds. The Investor Alert describes alternative funds as investment companies registered under the Investment Company Act of 1940 (“1940 Act”) that accomplish fund objectives through non-traditional investments and trading strategies. Such funds may invest in assets such as global real estate, commodities, leveraged debt, startup companies and unlisted securities offering exposure beyond traditional bonds, stocks and cash. The Investor Alert describes strategies employed by such funds as falling on the complex end of the spectrum including hedging and leveraging through derivatives, short selling and “opportunistic” strategies that change with market conditions. When considering investments in such funds, the Investor Alert encourages investors to consider potential alternative fund investments to take into account: (i) fund structure and diversification; (ii) risk factors unique to sophisticated instruments and strategies; (iii) investment objectives; (iv) increased operating expenses versus traditional mutual funds; (v) fund manager experience; and (vi) limited performance history. The Investor Alert does distinguish alternative funds registered under the 1940 Act from traditional hedge funds, including addressing the limits placed on registered funds in holding illiquid investments and employing leverage, diversity requirements in registered funds, redeemability of alternative fund shares and limitations on fees that registered fund managers may charge.

This Investor Alert is part of an ongoing focus by FINRA on the obligations of broker-dealers to make suitability assessments of investments along with heightened suitability and supervision obligations with respect to “complex products”. In 2012, FINRA released guidance to broker-dealers regarding these suitability obligations and recommended that broker-dealers use heightened scrutiny when conducting a due diligence review on complex

products and implement strict compliance and monitoring procedures in connection with such products. Signaling continued scrutiny of these instruments, in April Richard Ketchum, Chief Executive Officer of FINRA, noted that complex products need “heightened supervision.” It is anticipated that this focus by FINRA on suitability and complex products will continue and alternative fund managers should be prepared to answer investor questions related to this Investor Alert and other recent FINRA pronouncements. In addition, fund managers should continue to watch for future rule changes, guidance and announcements from FINRA relating to alternative funds and other complex investments.

For discussion of certain FINRA rulemaking and guidance regarding broker-dealer suitability determinations and complex products, see the following Client Alerts and publications:

- FINRA Issues Additional Guidance on Suitability Rule (December 17, 2012) available [here](#).
- FINRA Issues Additional Guidance on New Suitability Rule (June 6, 2012) available [here](#).
- Doing Business Under FINRA’s New Suitability and KYC Rules (April 10, 2012) available [here](#).
- FINRA: Complex Products Require Heightened Supervision--Focus on Structured Notes, Inverse/Leverage ETFs, Hedge Funds, Securitized Products, and Similar Products (January 27, 2012) available [here](#).
- FINRA Announces New Know-Your-Customer and Suitability Compliance Date and Interpretive Guidance (May 19, 2011) available [here](#).

- SEC Approves FINRA Know-Your-Customer and Suitability Rules (January 18, 2011) available [here](#).

## For More Information

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*To discuss any of the topics covered in this Client Alert, please contact an attorney in our Investment Management Group or visit us at [chapman.com](http://chapman.com).*

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