

Due Diligence Works, Inc.

Insource - Outsource

Why Insource?

- Strategically Important
- Have built-in Economies Scale
- Customize to your organization
- Manage by Direct Staff

Why Outsource?

- Focus staff on strategically important activities
- Reduce Cost / Gain Economies of Scale / High Fixed Cost
- Stay Current with Best Practices
- Manage by Contract

What is Required – FINRA 2018 Annual Regulatory and Examination Priorities Letter (Excerpt)



- FINRA will focus on:
 - Examination of the controls Firms have in place to meet suitability obligations.
 - **How firms identify products that are subject to new product vetting.**
 - The vetting process itself.
 - How controls are put in place to ensure personnel are appropriately educated & trained on the sale and supervision of the product.
 - FINRA provided the following guidance on the vetting process:
 - **Firms should identify the risks associated with the product and include those risks in product training.**
 - Particular attention should be paid to situations where registered representatives recommend complex products to unsophisticated, vulnerable investors.
 - Firms' handling of products where FINRA has observed firms experiencing problems implementing effective controls:
 - UITs
 - **Multi-share-class products**
 - **High-risk or complex products**
 - **Accounts being transferred from front-end sales charge products in brokerage accounts to fee based accounts.**

What is Required – SEC 2018 National Exam Program Examination Priorities (Excerpt)



- SEC will focus on:
 - Services & products sold to Senior Investors with retirement accounts.
 - Investment recommendations
 - ***Sales of Variable Insurance Products***
 - Sales of Trade Date funds
 - Sales of Mutual Funds & ETFs to Retail customers. Focus on:
 - Mutual Funds that have experienced poor performance or liquidity (***subscriptions & redemptions***) relative to peer group.
 - Mutual funds and ETFs that track custom-built indexes and ***any conflicts*** with the advisor and the index
 - ETFs with little or no secondary market trading volume or at risk of being delisted.

What is Required – OCC – NDIP (Excerpt) (Retail Non-deposit Investment Products)



- Product Selection governance based on OCC requirements are stringent and onerous.
- PRODUCTS & SERVICES:
 - **Identify products and services that meet clients' investment needs, be easily understood, and be appropriate for the distribution channel.**
 - Adopt appropriate policies and procedures that state the criteria used to review each type of investment product sold or recommended.
 - **DD processes should include well-documented, disciplined product selection, retention, termination, and monitoring process that applies consistent criteria to all products and providers.**
 - Perform DD before introducing a product.
- THIRD PARTY PROVIDERS OF PRODUCTS & SERVICES:
 - Implement an effective third-party risk management process (DD on carriers, providers) to identify risks, conflicts of interest, appropriateness of the services for the Banks' unique market, personnel, customers, or operating environment.
 - **Conduct adequate DD of each third party, including assessing the third party's reputation, products, and financial condition.**
 - **Perform own analysis of third party's assertions, representations, or warranties to ensure the third party and its products are a good fit for the bank's customers.**

Question: How Big Should a Product Team Be?

Answer: 5 people (minimum)

1

Product Director

2

**Managed
Money
Product
Manager**

+

3

**Annuities
& Life
Insurance
Product
Manager**

+

4

**Mutual
Funds &
Structured
Products
Product
Manager**

+

5

**Secondary
Products
(i.e. UITs) &
Research
Support
Product
Specialist**

How much should you pay for a Product Analyst?



Definitions

(In order of seniority, starting with the most senior role.)

Product Director	Directs a group of people (runs the department)
Product Manager	Manages a product line (and maybe a Product Specialist)
Product Specialist	Specializes in specific products or companies (does not manage people) (sometimes acts as a Super Administrative Assistant)

Why A Partner Can Help in Due Diligence



Because the regulators are demanding more

Managing Risk

Expertise	Focus	Continuity	Independence	Cost
Our expertise is over 100 years of industry knowledge, and over 60 years of due diligence experience and growing.	This is what we do. It's a mind set that needs focus. Due Diligence is hard to do with limited or over committed resources. With our focus, we review each product and take the time to understand it, and see how it fits into your firm.	When a regulator walks in and asks for your file and records, now it's one phone call away. You don't have to worry about training new hires, attrition, and rehires (this is how knowledge gets lost).	An independent firm is not beholden to product providers or internal affiliates, you keep the relationship, let the due diligence firm do the leg work and sometimes be the bad guy.	There are economies of scale that can be gained in the industry. 100% of due diligence internal costs are driven by number of products not the size of your sales force. We can bring higher quality at a better cost.

Product Level Due Diligence is no longer optional, best interest advice starts with robust full time due diligence.

Headline Risk – To Name a Few



"[REDACTED] pushes customers into products that do not add value and may not be suitable but that generate higher fees." - whistle-blower complaint -

[REDACTED] Has knowingly violated ... the Fiduciary Rule
..... – Commonwealth of MA (Securities Division)

"\$30M [REDACTED] Fine Highlights Risk of Teams Stretched Thin"

Regulator investigates volatility fund due diligence
– FINRA

Finra cracks down on faulty variable annuity exchanges

The Securities and Exchange Commission (SEC) has charged the investment services division of [REDACTED] Banks with collecting more than \$1.1 million in avoidable charges from clients by recommending higher-fee mutual funds.