



State of Wisconsin  
Department of Financial Institutions  
*Strengthening Wisconsin's Financial Future*

## Investment Adviser Newsletter

Spring 2018

*Our periodic newsletter for investment advisers registered in Wisconsin is published twice per year. Past editions can be found at: [Investment Adviser Newsletters](#)*

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### **Our Offices Have Moved!**

Effective May 4<sup>th</sup>, the Division of Securities is now located on Madison's west side at the new Hill Farms State Office Building off of University Avenue (4822 Madison Yards Way, Madison, WI 53705). All DFI phone numbers and post office box numbers will remain unchanged (PO Box 1768, Madison WI 53701-1768). If you have any questions regarding our new location, please feel free to contact our Examiner of the Day at (608) 266-2139.

### **SEC Outreach Event in Milwaukee**

On Monday, May 21<sup>st</sup>, the SEC's Chicago Regional Office will be holding a free compliance outreach seminar for investment advisers at Marquette University from 1:00 to 4:30 pm. Division of Securities examiners and other staff will be in attendance. The agenda includes panels on the SEC's exam program and hot topics such as cybersecurity, fees and expenses, and cryptocurrency. There will also be a Q&A session. If your assets under management are at a level where you anticipate future SEC registration, this may be a good opportunity to meet some of the local SEC staff.

If you are interested in attending, please send an email to [deborah.fabritz@wisconsin.gov](mailto:deborah.fabritz@wisconsin.gov) no later than May 15<sup>th</sup>. We will then forward a list to the SEC which is restricting attendance to confirmed attendees.

### **New AARP Tool to Select an Advisor**

If you are being interviewed by a prospective client, that person may be using a free online tool, "AARP Interview an Advisor," which was launched in early 2018 by AARP and NASAA (the

North American Securities Administrators Association). The tool provides users with a list of suggested questions to ask when selecting a financial advisor. Included are questions regarding the advisor's qualifications, compensation, and whether the advisor acts as a fiduciary.

The tool reinforces the fiduciary concept that a financial advisor should be selecting investments in the client's best interest while not generating higher fees for the advisor. Some of the other topics the tool covers are: 1) licenses or professional designations the advisor holds, 2) whether the advisor breaks out all their fees and commissions, 3) the existence of any disciplinary action by a regulator, and 4) whether the advisor is limited to investment products only offered by the advisor's firm. There is also a four question pre-meeting quiz for users to take. The website for this free tool is available to anyone at <https://www.aarp.org/benefits-discounts/all/interview-an-advisor/>.

### **Current and Emerging Investor Threats**

The Wisconsin Department of Financial Institutions (DFI) released its annual list of top investor threats in December 2017. As a member of the North American Securities Administrators Association (NASAA), DFI participated in the survey conducted by NASAA to identify the most frequently identified source of current investor complaints or investigations. Securities regulators from 50 U.S. jurisdictions responded to the survey conducted in 2017. (The survey was based on 2016 calendar year data.)

According to the results of the survey, 74 percent of state regulators identified promissory notes as among their leading sources of complaints or investigations. Both real estate investments and Ponzi/pyramid schemes were identified as the second-most frequent source of current complaints or investigations by 54 percent of regulators. The third most cited source was oil and gas-related investments or interests, as identified by 50 percent of regulators. This was followed by affinity fraud (28 percent) and variable annuity sales practices (26 percent). In addition, DFI also included binary options in its list of investor threats due to complaints received by the Division of Securities.

NASAA's Enforcement Section also identified three emerging threats that investors should watch for in 2018. They include initial coin offerings (ICOs), cryptocurrency contracts for difference (CFD), and identify theft for purposes of depleting investment accounts, especially among seniors.

As investment advisers, you can assist state regulators in getting the word out to your clients and educating them on the various types of threats they may encounter. As the old

saying goes, “if it is too good to be true, it probably is”. To view DFI’s annual list and a description of each type of threat go to 2017 Top Investor Threats.

For more information on NASAA’s survey and emerging threats, go to their announcement at [NASAA Announces Current and Emerging Investor Threats](#). For more details of the top investor threats including case examples from state regulators, go to [Top Investor Threat Details](#).

If you have a client that encountered or has been a target of one of the threats above, you or the investor may report it to the Division of Securities by calling the Examiner of the Day Line at (608)266-2139.

### **Old Scams, New Masks**

Earlier this month, the Texas Securities Board released the results of a four week sweep of cryptocurrency investment opportunities being solicited to Texas investors. The results were striking:

- 32 investigations opened
- Not a single promoter was registered to sell securities in Texas
- 5 offers guaranteed returns – some up to 40% per month
- Nearly all broadly advertised via social media

In the past five months, the Texas Securities Board has taken enforcement action on seven different crypto companies. These actions, coupled with recent steps taken by the SEC, CFTC, FBI, and a host of state regulatory authorities point to a growing front in investment scams.

For every traditional scam – pump and dump, pyramid, or Ponzi - there is a cryptocurrency variant. Everyone knows someone who made it rich with one cryptocurrency or another. This gold rush mentality creates an environment where investors let their guard down and are susceptible to investing in common scams coated with a shiny veneer of false crypto promises.

Now more than ever, it’s critical that investors are able to get unbiased advice from their investment adviser plainly describing the risks of investing with the current crypto asset dominating the news cycle. To educate yourself on the potential dangers, you may wish to review resources such as the following:

- [NASAA – Informed Investor Advisory: Cryptocurrencies](#)
- [Investor.gov – Thinking About Buying The Latest New Cryptocurrency or Token?](#)
- [SEC.gov – Initial Coin Offerings](#)
- [Texas Securities Board – Widespread Fraud Found in Cryptocurrency Offerings](#)

## Form ADV Amendment FAQs

In our Fall 2017 newsletter, we wrote about the recent Form ADV amendments that went into effect in October. Following up, here are the answers to some frequently asked questions:

Q: When must I file Form ADV annual amendments?

A: Pursuant to DFI-Sec 5.04(3)(b), each investment adviser shall file a complete, updated Form ADV with the investment adviser registration depository within 90 days of the end of its fiscal year. Many investment advisers use a calendar year as their fiscal year. In those cases, we would expect to see annual amendments filed by March 31.

Q: When must I file Form ADV other-than-annual amendments?

A: Pursuant to DFI-Sec 5.04(3)(a), each investment adviser shall file with the division any notice of change of control or change of name, as well as any material change in the information included in the investment adviser's most recent application for registration, in an amendment to Form ADV filed with the division within 30 days of the date of the change.

Q: Do I have to file an annual Form ADV amendment even if not much has changed in my business over the past year?

A: Yes. You should review your Form ADV Part 1 and Part 2 and make any changes as necessary. Pay close attention to the recent changes to Form ADV, especially the number and types of clients (Part 1 - Item 5.C. and 5.D.) as well as separately managed account clients (Part 1 – Item 5.K. and Schedule D Section 5.K.). You should also update the date on the cover page of your ADV Part 2 (i.e. brochure) and amend the amount of assets under management (if applicable).

Q: The new changes to Form ADV regarding separately managed accounts are confusing. What guidance can you give me on this topic?

A: With regards to Form ADV, separately managed accounts (“SMAs”) are advisory accounts other than pooled investment vehicles (i.e., registered investment companies, business development companies, and non-registered pooled investment vehicles, such as private funds). Investment advisers that sub-advise pooled investment vehicles should not treat those accounts as SMAs on Form ADV Part 1A, even if the adviser considers such accounts to be SMAs for internal reporting purposes.

For investment advisers with SMAs, section 5.K.(1) requires the approximate percentage of SMA regulatory assets under management that are invested under 12 broad asset categories. Advisers may use internal methods to determine how to categorize the assets. If some assets

may reasonably be included under multiple categories, advisers must not double count assets when reporting and shall make a good-faith determination as to which category is best.

Q: I have additional questions about Form ADV amendments. Where can I turn for answers?

A: The SEC's Frequently Asked Questions on Form ADV and IARD

<https://www.sec.gov/divisions/investment/iard/iardfaq.shtml> is a good place to start. Our Examiner of the Day phone line is another resource: 608-266-2139.

## Financial Exploitation of Seniors Rule

With an aging population, there are more instances when seniors may be vulnerable to financial exploitation. FINRA implemented [Rule 2165 Financial Exploitation of Specified Adults](#) and amended Rule 4512 to assist broker-dealers and their representatives who suspect financial abuse by permitting them to place a temporary hold on a disbursement of funds or securities and to notify a trusted contact person (in addition to the account owner). The rule became effective on February 5, 2018, and will impact you if manage assets held at a broker-dealer custodian or are dually registered as a broker-dealer agent.

Two of the key definitions under FINRA Rule 2165 include the following:

- “Trusted Contact Person” shall mean the person who may be contacted about the Specified Adults Account in accordance with [Rule 4512](#) (Customer Account Information), which requires that the custodian make a reasonable effort to obtain the name and number of a trusted contact person. If the client refuses, the custodian may still open or maintain the account. Also, the custodian is not required to notify the trusted contact of their appointment.
- A “Specified Adult” is:
  - A natural person age 65 or older; or
  - A natural person age 18 who the representative reasonably believes has a mental or physical impairment that renders the person unable to protect his or her own interests.

Under the rule, a custodian who reasonably suspects financial exploitation may delay or “freeze” disbursements from the account of a Specified Adult for up to 15 days with an optional 10 day extension. The rule also allows the courts and other regulatory agencies to extend the freeze beyond 25 days. These courts and other regulatory agencies can also overrule a custodial freeze by terminating it.

The custodial freeze does not target the client's entire account but rather specific withdrawal transactions involving money or securities that are suspect of being fraudulent. The rule also does not grant the custodian the power to suspend trading in the account. If a disbursement is delayed, the rule requires the custodian to document the following five items: 1) the suspected fraudulent request for the withdrawal of funds or securities, 2) "the finding of a reasonable belief the financial exploitation has occurred, is occurring, has been attempted, or will be attempted", 3) the name and title of the custodial employee that authorized the freeze, 4) the notifications sent to the relevant parties like the trusted contact, and 5) "the internal review of the facts and findings that supported the custodians belief that the exploitation has occurred, is occurring, may have been attempted, or will be attempted."

The rule requires the custodian to notify the trusted contact of suspected fraud or exploitation unless the custodian believes the trusted contact is involved with the fraud or is unavailable. The custodian may discuss the following with the trusted contact: 1) details about the client's account in regards to financial fraud or exploitation, 2) confirm the client's contact information, 3) discuss the client's health status, and 4) ask for "the identity of any legal guardian, trustee, or power of attorney", etc. that may also be involved with the client.

Prior to FINRA Rule 2165, there was no standard or definitive process to delay disbursements other than a firm's own internal procedure, so this is a positive step toward greater protection of the vulnerable adult population. For more information, feel free to review FINRA's FAQs regarding "FINRA Rules Relating to Financial Exploitation of Seniors": <http://www.finra.org/industry/frequently-asked-questions-regarding-finra-rules-relating-financial-exploitation-seniors>

### **Use of Client Password as an Unethical Business Practice**

In our Fall 2016 newsletter, we wrote about some of the issues and problems that arise when an adviser makes use of a client's username and password to access the client's account. Last November, the membership of the North American Securities Administrators Association adopted an amendment to NASAA's Unethical Business Practices of Investment Advisers Model Rule to prohibit investment advisers from accessing clients' electronic accounts through the clients' own unique identifying information (the "Account Access Model Rule."). The amendment makes it an unethical business practice in violation of the model rule for advisers to access clients' accounts with the client's own log-in information rather than the adviser's own, unique log-in credentials. NASAA has published on its website a set of Q&As regarding the Account Access Model Rule which can be found here: <http://www.nasaa.org/industry-resources/investment-advisers/>

Please let us know if you have any questions regarding the Account Access Model Rule which is not yet formally adopted within our administrative code but prior to adoption, will be enforced by our Division as a best practice.

### **Questions? Contact the Examiner of the Day**

Our securities examiner staff includes: Mark Eisenmann, Charlie Benson, Joe Friesen, Jenny Acker, and Rob Monroe. You can expect one or more of our examiners to visit your office when you are next due for an examination by our Division of your business practices and your books and records. In the meantime, questions regarding compliance with Wisconsin Uniform Securities Law, including the administrative code, may be directed to the Examiner of the Day at (608) 266-2139.

### **More Ways to Connect with DFI**

The Wisconsin Department of Financial Institutions (DFI) Facebook page provides information on DFI activities, financial literacy, investor education, scam warnings and other timely news to help protect investors. Please check out DFI's Facebook page – [www.facebook.com/WIDFI](http://www.facebook.com/WIDFI) and share any content that you find useful. Feel free to “Like” our page so that you receive future posts in your Facebook newsfeed. In addition, to keep up with the latest from DFI - follow us on Twitter at: [@WIS\\_DFI](https://twitter.com/WIS_DFI)

