Wisconsin Department of
Financial Institutions

Spring 2019
Division of Securities

Investment Adviser Newsletter

MEET DFI'S NEW SECRETARY

In January, Kathy Blumenfeld was appointed by Gov. Tony Evers to her new role as DFI's Secretary. She previously served as Executive Vice President of Special Operations at TASC (Total Administrative Services Corporation) where she led a federal contract modernizing the workplace charitable giving program for all federal employees and retirees. Prior to her work at TASC, Secretary Blumenfeld was Vice President of Lending & Payment Security for CUNA Mutual Group, where she worked for 26 years. She began her career as a CPA and has been active in her community serving on non-profit boards.

As Secretary, she is committed to developing caring and diverse teams that are passionate about their jobs and providing great customer service. A few of her top interests at DFI include elder financial abuse, consumer/investor protection, financial literacy at all life stages, and college affordability.

INSIDE THIS ISSUE

SPECIAL POINTS OF INTEREST

Our periodic newsletter for investment advisers registered in Wisconsin is published twice per year. Past editions can be found here.

SUITABILITY DOCUMENTATION…HOW MUCH IS ENOUGH?

The Division regularly finds that maintaining documentation of client suitability, as required by DFI-Sec 5.03(2)(c), is a struggle for advisers. Why is this? During exams, advisers can usually describe a client's financial circumstances in detail and clearly know their client; however, at times the corresponding documentation is missing. To demonstrate that you are meeting the requirements of the Wisconsin administrative code, you should collect, maintain, and update the right kind of customer suitability information.

Your documentation can be in any format, so long as you can produce it upon request. Advisers are not required to use customer relationship management software (CRM), which can be costly. However, if you are using CRM software, it will enhance your ability to record client information. CRM packages are typically robust and track all kinds of information, including the client information that meets DFI's rule.

Below is the Wisconsin investment adviser's documentation of suitability rule divided into three parts to help you assess your compliance with the rule. The bold-faced text is quoted from DFI-Sec 5.03(2)(c).

The first part of 5.03(2)(c) states … ***Each registered investment adviser who renders investment supervisory or management service to any client shall, with respect to the portfolio being supervised or managed and to the extent that the information is reasonably available to or obtainable by the investment adviser, maintain and keep current*** ….

An adviser needs to make a reasonable effort (by phone or in person) to obtain client suitability information and keep it current. At a minimum, you should interact with clients on an annual basis to review and update their suitability data.

Suitability cont…

Client circumstances will likely dictate more frequent interaction but don't let a year pass without checking and updating your suitability records for each client. At times when asked, busy clients may decline to meet, which you should document. However, using a client declination as your documentation is not optimal. A pattern of documenting that clients declined to meet to review their suitability circumstances suggests a lack of effort on the part of the adviser since clients will likely want to meet at least annually.

"…don't let a year pass without checking and updating your suitability records for each client."

The second part of 5.03(2)(c) refers to the new account form (NAF) information you collect: ***written information concerning a client's net worth, annual income and other financial information, investment experience and such other information necessary and relied upon by the investment adviser to determine the suitability of any investment recommendation or investment advice to the client.***

If you are not using a retail broker-dealer's NAF, and are instead using an institutional application such as Schwab or TD Ameritrade, you may not be capturing a client's net worth, annual income and other financial information, investment objectives and experience. Institutional applications generally do not capture net worth, annual income, and other financial information typically found on new account forms. This necessitates that the adviser create their own form to supplement the institutional application for opening client accounts.

The third part of 5.03(2)(c) requires that: ***The written information shall be updated when the investment adviser receives information from the client that results in material changes to the client's annual income, net worth, investment objectives or other changes to information affecting the investment adviser's ability to make suitable recommendations for the client ….***

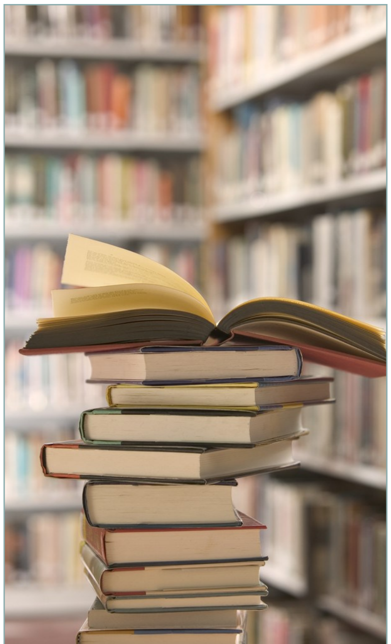
SUITABILITY CONT…

Advisers generally have contract language providing that the client will inform the adviser of any material change in their financial circumstances. The material event language appears to put the burden on the client to keep the adviser informed. However, if there is information reasonably available and obtainable by the adviser each year, the adviser should probe and actively listen for any changes in client circumstances. Write material events down. If there are no material changes – write that down.

Clients will not always consciously connect a material change in their life (e.g. health or college related expenses) with a need to update their adviser, even though the event could affect the investment advice and management provided by the adviser. The fact the client does not meet their contractual obligation to inform you of a material event does not relieve you of your fiduciary duties. The rule requires advisers to seek reasonably available information and keep it current – which means creating a record of relevant suitability information.

Plan your client interactions with a consistent process, actively listen for any material changes, and record your notes with the date you received the new information or confirmed the lack of any material changes.

Good suitability documentation will add value to your client relationships by helping to ensure that your advice is always appropriate for the client's circumstances. If, unfortunately, there is ever a concern or complaint regarding a recommendation to a client, your suitability documentation should fully support the recommendation, which will help minimize your firm's litigation risk. This can be especially important when elderly clients are no longer handling their own investments or have passed, resulting in a review of the client's portfolio by a family member or other third party. Of course, the primary purpose of good documentation is to assist you in reviewing the client's circumstances prospectively, so your advice is relevant and your ongoing fiduciary duty is met.



RECOGNIZING SIGNS OF DEMENTIA

What is Dementia?

Investment advisers may be one of the first to notice signs of dementia in a client as they age, because difficulty managing finances can be an early sign. Dementia is a general term that describes a group of symptoms associated with a decline in memory or other thinking skills severe enough to interfere with a person's everyday life. Alzheimer's is the most common disease that causes dementia. It can also be caused by strokes, Parkinson's disease, Lewy Body disease, frontotemporal disease and other conditions. Dementia mainly affects people over the age of 65, but it can affect people as young as their 30's, 40's or 50's.

Alzheimer's and Dementia Facts & Figures:

DEMENTIA SYMPTOMS CAN INCLUDE CHANGES IN A PERSON'S:

- Memory and thinking
- Understanding and deciding
- Movement and balance
- Behavior and personality
- Reading, writing, and speaking
- Planning and organizing

- Approximately 5.8 million Americans are living with Alzheimer's disease. By 2050, this number is projected to rise to nearly 14 million.
- 1 in 3 seniors dies with Alzheimer's or another dementia. It kills more than breast cancer and prostate cancer combined.
- Every 65 seconds, someone in the United States develops Alzheimer's.
- More than 16 million Americans provide unpaid care for people with Alzheimer's or other dementias.
- Dementia affects one in two people over the age of 80.
- Currently there are 116,000 people affected by dementia in Wisconsin and this number is expected to be 242,000 by the year 2040.

Source: Alzheimer's Association

SIX WARNING SIGNS SPECIFIC TO MONEY MANAGEMENT:

- Lapses in memory that cause people to miss appointments, confuse payments of documents, or repeat orders or questions
- Disorganization with documents or record keeping
- Worsening money management skills; forgetting to record transactions in checkbook, or incorrectly filling out registers or checks
- Decline in ability to do basic math computations
- Difficulty grasping financial concepts that were previously understood
- Poor judgement with finances such as drastic changes in investment strategy or interest in get-rich-quick schemes

Source: Dementia Friendly America

USE DEMENTIA FRIENDLY COMMUNICATION SKILLS TO HELP YOU INTERACT SUCCESSFULLY WITH INDIVIDUALS WHO HAVE DEMENTIA:

- Approach from the front within the line of vision and make eye contact
- Smile and use friendly facial expressions
- Use open and friendly body language
- Use a kind tone of voice and speak clearly
- Simplify and slow down, use one or two choices
- Use short sentences or pause between sentences
- Tell or ask one thing at a time and give the individual time to respond
- Repeat as needed or re-phrase the question if they don't understand
- Use gestures
- Reduce distractions and noise, if possible

You may find that you are now working with the adult child or caregiver of an elderly client with dementia, but continue to include that client in meetings.

WHAT ARE THE SIGNS A PERSON MAY HAVE DEMENTIA?

- Looking confused or lost
- Searching for something
- Difficulty communicating
- Difficulty comprehending
- May say or do unusual things
- Difficulty handling money.....may forget to pay

OTHER RESOURCES FOR DEMENTIA FRIENDLY INFORMATION AND INITIATIVES

- WI Aging and Disability Resource Centers to find a center in your area
- WI Department of Health Services Alzheimer's Disease and Dementia Resources
- WI Adult Protective Services to find an agency serving your county
- Alzheimer's Association
- Dementia Friendly America
- The Purple Angel

WISCONSIN'S INITIATIVE IN CREATING DEMENTIA FRIENDLY COMMUNITIES

A dementia friendly community is one in which local businesses, organizations, churches and community groups make simple changes that help a person with dementia feel welcome and safe. In Wisconsin, the Aging and Disability Resource Centers and other organizations have incorporated the use of "The Purple Angel Dementia Awareness Campaign" symbol in their work to help raise awareness about how communities can become more dementia friendly. A purple "dementia-friendly" symbol on a business's window indicates that their employees have received training on how they can help better serve customers with dementia. For more information on Wisconsin's initiative to create dementia friendly communities or to get involved in making a community more dementia friendly, visit the Wisconsin Department of Health Services website here.

BEWARE LEVERAGED AND INVERSE ETFS

Exchange-traded funds (ETFs) have become popular investment vehicles for investors who want liquidity and investment costs that are generally lower than mutual funds. Traditional ETFs are typically structured such that their performance will closely approximate the performance of their underlying reference assets over an extended period of time. Non-traditional ETFs, such as those that are leveraged and/or inverse[1], however, perform differently than traditional ETFs.

Leveraged and/or inverse ETFs are typically designed to achieve their performance objectives on a daily basis. Therefore, the performance of these ETFs over a period of time longer than one day can differ significantly from their stated daily performance objectives. Investment advisers who recommend these products without fully understanding them pose a potential risk to investors.

For instance, an investment adviser using leveraged and inverse ETFs in client accounts was ordered to pay a civil penalty of $25,000 and restitution in the amount of $94,720 by the Office of Kansas Securities Commissioner. The adviser placed almost all of his 160 retail clients in leveraged and inverse ETFs and held the ETFs for timeframes lasting longer than a day and often over 100 days. The Securities Commissioner found the adviser did not adequately understand the risks associated with the purchase of non-traditional ETFs, and therefore engaged in a dishonest or unethical practice and a breach of fiduciary duty.

The Wisconsin Division of Securities has observed instances of investment advisers inappropriately using leveraged or inverse ETFs in client accounts for extended periods of time, invariably resulting in significant losses for the clients and liability for the adviser.

Leveraged and/or inverse ETFs are complex investment products that require an understanding of how an investor's objective will be met and the impact that market volatility, the ETF's use of leverage, and the customer's intended holding period will have on the performance of the ETF and the customer's investment portfolio. Leveraged and/or inverse ETFs are generally not suitable for retail investors who plan to hold ETFs for more than one trading session, particularly in volatile markets.

In a 2011 Investor Alert on Exchange Traded Funds, NASAA explained that, "Synthetic products like leveraged or inverse ETFs are not appropriate for 'buy and hold' investors because an ETF may reset each day, and its performance may quickly deviate from the underlying index, currency, commodity or basket of assets it is attempting to mirror. In other words, it is possible your ETF could suffer significant loss even if the long-term performance of an index or sector shows a gain."

Investment advisers should exercise extreme caution with respect to leveraged and inverse ETFs which should not be used unless the adviser fully understands the terms and features of the funds, including how they are designed to perform, how they achieve that objective, and the impact that market volatility will have on their performance.

[1]Leveraged ETFs seek to deliver multiples of the performance of the index or benchmark they track. Inverse ETFs seek to deliver the opposite of the performance of the index or benchmark they track. Leveraged inverse funds seek to achieve a return that is a multiple of the inverse performance of the underlying index.

DFI Secretary Kathy Blumenfeld joined Lieutenant Governor Mandela Barnes at Homestead High School in Mequon. The high school hosts a branch of Kohler Credit Union where junior Morgan Klug works.

DFI Secretary Blumenfeld is joined by WI HEAB Executive Secretary Connie Hutchison and WI Treasurer Sarah Godlewski to discuss the impact of student loan debt. Governor Evers has tasked them with studying the feasibility of creating a refinancing authority for student loan debt in the future.

For Money Smart Week's Big Read, DFI Secretary Blumenfeld narrates "Count on Pablo" for Belleville Elementary students.

DFI College Affordability Specialist Cheryl Rapp answered many questions about affording college from students and families at Spring Harbor Middle School.

FINANCIAL LITERACY AWARDS

On March 21st, Governor Tony Evers presented the 2018 Financial Literacy Awards to 13 worthy recipients from across Wisconsin. The awards are an annual event where individuals and organizations are recognized for their efforts to increase the financial knowledge in our schools and communities.

“Financial literacy skill training is something we all need throughout our lives from elementary school to the workplace to retirement,” Governor Evers said.

This year’s winners included teachers, schools, credit unions, volunteers, and more who went above and beyond in helping others access the tools and education they need to secure a financially confident retirement.

Click here for more information on all the 2018 award winners.

Further proving her commitment to education, First Lady Kathy Evers as agreed to be an ambassador for the Governor’s Council on Financial Literacy. In that role, she will help promote the work of the Council to measurably improve the financial literacy of all Wisconsin residents.

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 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.

CYBERSECURITY BEST PRACTICES

Due to the nature of the business, investment advisers are in possession of sensitive client information that could be exploited by malicious hackers. Even small firms are susceptible to the ever-changing cyber threats. The following best practices are not all-encompassing, but can help investment advisers improve their risk management and help protect their IT systems from unwanted intrusion.

1. Use two-factor authentication to protect as many systems as possible, especially those systems containing personally identifiable client information.
2. Do not open suspicious emails or click on suspicious links and attachments sent by unknown senders. Even known senders can have their email account compromised and send emails with dangerous links and/or attachments
3. Install anti-virus software on all devices used to access client information. Allowing your anti-virus software to update automatically is the best way to ensure the software.
4. Require all third-party systems vendors to sign confidentiality agreements in order to protect client information.
5. Use secure email or a secure online portal when providing sensitive information to clients.
6. Include cybersecurity as part of your firm's policies and procedures. Ensure your actual practices align with them, and create a system for enforcing your cybersecurity policies and procedures.
7. Train all personnel, including office support staff, on cybersecurity best practices.