Wisconsin Department of Financial institutions

Spring 2021
Division of Securities

DOS Investment Adviser Newsletter

SPACs - RISKS & COMPLIANCE FOR INVESTMENT ADVISERS

You may have noticed an increase in news articles regarding the boom in Special Purpose Acquisition Companies ("SPACs") but have limited knowledge regarding this particular type of security. Here is a summary of some of the basics:

What is a SPAC?

A SPAC is a shell company that is listed on a stock exchange. The SPAC's purpose is to pool investor funds to purchase an undetermined private company, thus bringing the private company public. Proceeds raised in the SPAC's IPO are held in a trust, and those assets are used to acquire the target company. Typically, SPAC's must acquire a target company within two years, or it must return the assets to the shareholders and delist. The management team ("Sponsors") that operates the SPAC will receive its compensation by claiming 20% of the newly combined company's equity.

What are the risks of buying shares in a SPAC?

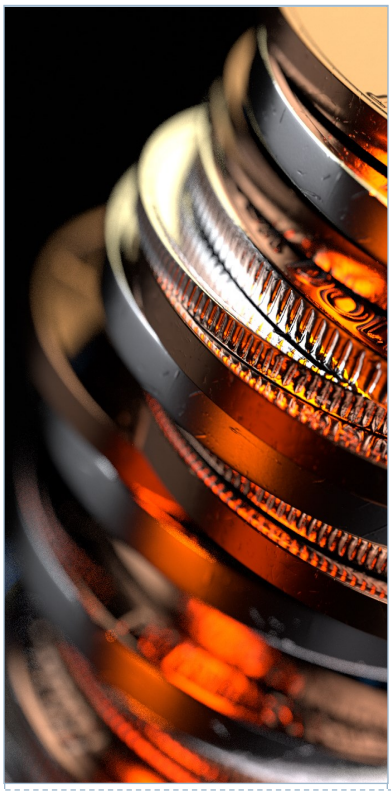
Investors may think that buying a SPAC is a risk-free strategy because if there is no target, they get their money back. This line of thinking ignores several risks that may generate losses for investors.

Not only is there the risk of a SPAC failing to acquire a company, but if the SPAC does acquire a company, investors may face significant losses through equity dilution. Aside from the equity that the sponsors claim, the target company may also negotiate additional equity in the newly formed company, diluting the original investors even further. The research linked above used a sample of 47 SPACs that merged between

INSIDE THIS ISSUE

PAST NEWSLETTERS

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



SPACS CONTINUED…

January 2019 and June of 2020 and notes that the median losses through dilution reached up to 50.4% in the sample.

Investors should evaluate the quality of the management team behind the SPAC. For example, a management team with experience and a track record of making quality acquisitions may reduce the risk of making a poor acquisition. The same paper linked above notes that even a high-quality management team is not a guarantee of positive returns in a SPAC. Some SPACs may feel tempted to utilize celebrities to promote their shares, which should be seen as a red flag to investors and their advisers.

Are my clients suitable for SPACs?

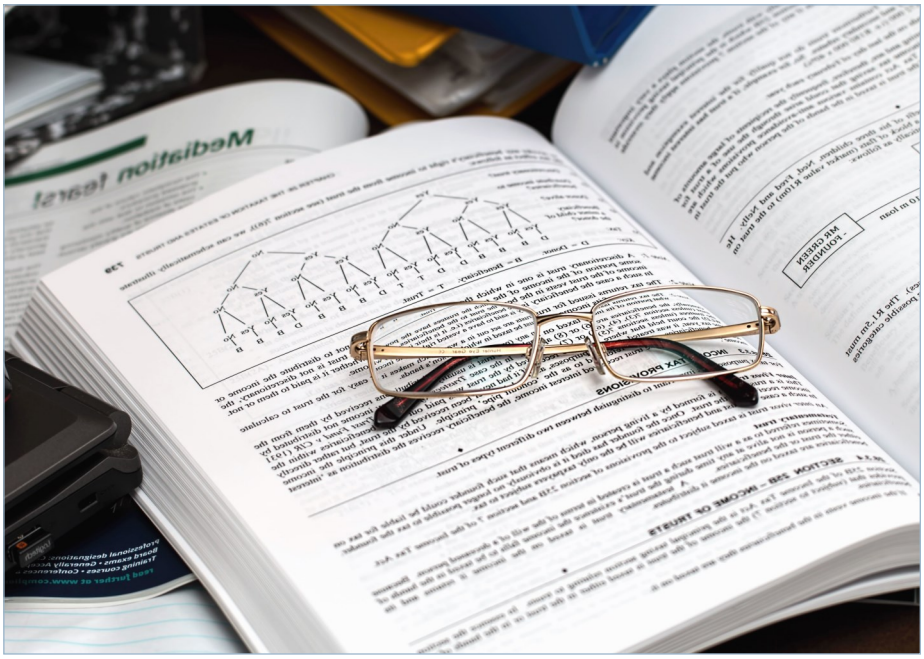
Given the costs and "blank check" nature of SPACs, the Division considers SPACs to be at least as risky ***or riskier*** than purchasing shares in a newly minted IPO. If your client's risk tolerance is not high enough to tolerate the uncertainty of an IPO, they are likely not suitable investors in SPACs, either.

*"Given the costs and 'blank check' nature of SPACs, the Division considers SPACs to be at least as risky **or riskier** than purchasing shares in a newly minted IPO."*

Advisers that have clients with riskier assets in their portfolios should always take extra caution to ensure compliance with the Division's suitability records requirements. Per DFI-Sec. 5.03(2)(c), advisers shall keep current records pertaining to:

> Written information concerning a client's net worth, annual income and other financial information, investment objectives and 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. 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 as required under s. DFI-Sec 5.06 (4).

Under DFI-Sec. 5.06, the following is considered a "dishonest or unethical business practice" or "taking unfair advantage of a client" by an investment adviser or an investment adviser representative under s. 551.412 (4) (m), Wis. Stats.:



SPACS CONTINUED…

(4) Recommending to a client the purchase, sale or exchange of any security without reasonable grounds to believe that the recommendation is suitable for the client on the basis of information furnished by the client after reasonable inquiry concerning the client's investment objectives, financial situation and needs, and any other information known by the investment adviser.

Advisers who update the written suitability documentation during or following regular portfolio reviews with their clients will have an easier time complying with 5.03(2)(c) and will be able to stand firmly against liability claims when riskier investment products fail to perform.

Resources:

A Sober Look at SPACs: https://corpgov.law.harvard.edu/2020/11/19/a-sober-look-at-spacs/

Celebrity Involvement with SPACs – Investor Alert: https://www.investor.gov/introduction-investing/general-resources/news-alerts/alerts-bulletins/investor-alerts/celebrity

DFI-Sec 5.03(2)(c): https://docs.legis.wisconsin.gov/code/admin_code/dfi/dfi_sec/5/03/2/c

DFI-Sec 5.06(4): https://docs.legis.wisconsin.gov/code/admin_code/dfi/dfi_sec/5/06/4

STATE AND FEDERAL REGULATORS SUE GPB CAPITAL HOLDINGS

Earlier this year, the Securities and Exchange Commission charged registered investment adviser GPB Capital Holdings LLC ("GPB Capital") and three individuals with fraud and running a Ponzi-like scheme. They raised over $1.7 billion and defrauded over 17,000 investors from 2013 through 2018.

The alleged scheme revolved around the sale of unregistered, high commission limited partnership interests in a series of alternative-asset investment funds managed by GPB Capital and targeted exclusively to accredited investors. In November of 2018, GPB Capital disclosed that their auditor (Crowe LLP) had resigned and GPB Capital never delivered any audited financials to investors.

In addition to the SEC case, the North American Securities Administrators Association ("NASAA") announced last February that seven state securities agencies had filed regulatory actions against GPB Capital.

The three individuals named in the SEC and state complaints are David Gentile, the owner and CEO of GPB Capital, Jeffrey Lash, a former managing partner at GPB Capital and Jeffry Schneider, the owner of GPB Capital's placement agent Ascendant Capital. The complaints allege that all three lied to investors about the money used to make 8% annualized distribution payments and revenues generated by two of GPB's investment funds. Instead, GPB Capital was using new investor funds to pay monthly distributions to prior investors. The complaints further allege that GPB Capital manipulated the financial statements of certain limited partnership funds that were managed by GPB Capital.

The states are seeking court-ordered monetary penalties, investor restitution, disgorgement, and permanent injunctive relief barring the defendants from violating securities laws or participating in the sale or issuance of securities in the future.

If you know of anyone in Wisconsin who invested in a GPB Capital fund, please contact Examiner Lang Lor at lang.lor@dfi.wisconsin.gov.

DFI RULES:

DFI-SEC 5.04(4):

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.

DFI-SEC 5.04(3)(a):

EXCEPT AS PROVIDED IN SUBS. (2) AND (4), 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.

DFI-SEC 5.05(1):

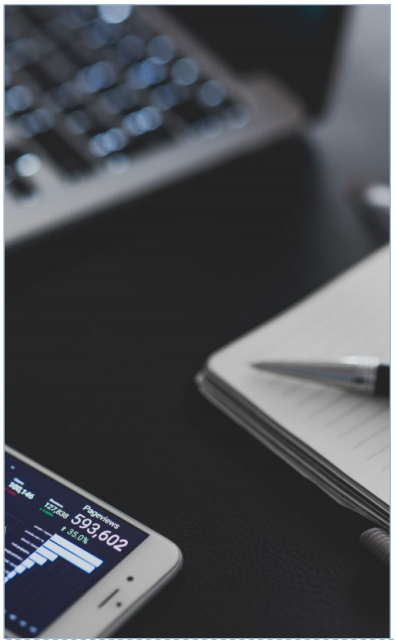
EACH INVESTMENT ADVISER SHALL ESTABLISH WRITTEN SUPERVISORY PROCEDURES AND A SYSTEM FOR APPLYING THE PROCEDURES, WHICH MAY REASONABLY BE EXPECTED TO PREVENT AND DETECT ANY VIOLATIONS OF CH. 551, STATS., AND RULES AND ORDERS THEREUNDER. THE PROCEDURES SHALL INCLUDE THE DESIGNATION AND REGISTRATION OF A NUMBER OF SUPERVISORY EMPLOYEES REASONABLE IN RELATION TO THE NUMBER OF ITS REGISTERED INVESTMENT ADVISER REPRESENTATIVES, OFFICES AND ACTIVITIES IN THIS STATE.

DID YOU FILE YOUR ANNUAL ADV UPDATE?

It is the time of the year for many investment advisers to complete their annual Form ADV update. DFI's administrative codes requires investment advisers to file an updated Form ADV through IARD within 90 days of the end of its fiscal year. Since many investment advisers have a fiscal year ending on December 31, the deadline is March 31. If you haven't filed your annual Form ADV amendment, please do so as soon as possible.

In addition to the annual amendment, Form ADV shall be updated within 30 days of a material change, change of control, or name change. Material changes are any items that could affect a client's decision to hire an adviser or materially impact an adviser's business, which in turn could impact a client. Examples of material changes include, but are not limited to, offering a new service, making changes to the firm's fees, identifying a new conflict of interest, buying a new type of investment with different risks, obtaining custody of client's funds or securities, changing custodians, or gaining a new affiliate.

As you are making your annual Form ADV amendments, it may also be a good time to review your written supervisory procedures and make any updates as needed. While there is no rule specifying when the firm's written supervisory procedures shall be reviewed and updated, Division staff expects investment advisers to review their written supervisory procedures within a reasonable period of time in order to prevent these procedures from becoming outdated. The Division considers an annual review of procedures to be reasonable. During examinations, some investment advisers have admitted their procedures have not been reviewed and updated for a number of years.



INVESTMENT ADVISERS WITH MULTIPLE OFFICE LOCATIONS

If your investment advisory firm is providing services from multiple locations in Wisconsin, the locations other than the principal place of business may need to file a separate branch office registration through CRD.

In Wisconsin, the term "branch office" has the same meaning as "place of business".

Pursuant to § 551.102(21), Wis. Stats., "Place of business" of a broker-dealer, an investment advisor, or a federal covered investment adviser means any of the following:

A. An office at which the broker-dealer, investment adviser, or federal covered investment adviser regularly provides broker-dealer or investment advice or solicits, meets with, or otherwise communicates with customers or clients.

B. Any other location that is held out to the general public as a location at which the broker-dealer, investment adviser or federal covered investment adviser provides brokerage or investment advice or solicits, meets with, or otherwise communicates with customers or clients.

"Similar to the SEC, the Division Considers any advisory activity to trigger the conduct of business provision of the branch office definition."

Wisconsin defines "branch office" in a similar manner as set forth in the Securities and Exchange Commission's ("SEC") rule § 275.203A-3(b) "place of business" definition: *An office at which the investment adviser regularly provides investment advisory services, solicits, meets with, or otherwise communicates with clients; or Any other location that is held out to the general public as a location at which the investment adviser provides investment advisory services, solicits, meets with, or otherwise communicates with clients*.

If a location is held out as a business location of the adviser, whether by business cards, stationery, website or formal media advertisement, you have met the first test of whether a location is a branch office. The second test is the conduct of business. Similar to the SEC, the Division considers any advisory activity to trigger the conduct of business provision of the branch office definition. DFI's website provides more detailed information on determining whether a location meets the tests described above.

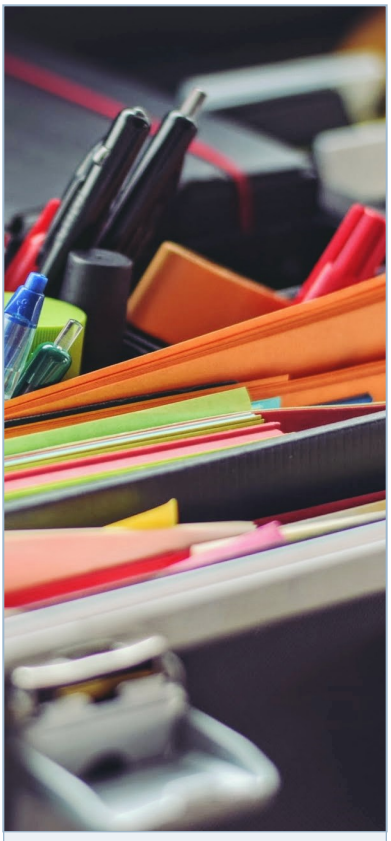
Pursuant to § 551.102(24), Wis. Stats., "Principal place of business" of a broker-dealer or an investment adviser means the executive office of the broker-dealer or investment adviser from

IA BRANCH OFFICES CONTINUED…

which the officers, partners or managers of the broker-dealer or investment adviser direct, control and coordinate the activities of the broker-dealer or investment adviser.

If any location in Wisconsin other than the firm's principal place of business meets the definition of branch office, state registered investment advisers make their branch office filings using Form BR via CRD. The branch office registration fee is $80.00 paid through CRD. The initial opening, any changes and the closing of the branch office must be filed with the Division within 14 days of the event. If any of these events are not filed within the 14 day time period, there will be a $100 delinquent filing fee assessed. The annual renewal of Wisconsin branch offices is accomplished at the same time as the firm's annual renewal application.

Visit DFI's website for more information on branch office definition, late fees and renewals.



U4 UPDATES

Individual Form U4 filings provide information to regulators via the CRD/IARD system and to the general public via the Investment Advisor Public Disclosure website - https://adviserinfo.sec.gov. As such, U4 filings by investment adviser representatives serve an important purpose. However, out of date or inaccurate U4 records are a common deficiency the Division finds when conducting examinations of registrants.

Under DFI-Sec 5.04(3)(c), every registered IA rep must keep their Form U4 up to date with accurate information. Below are three areas of the Form U4 that often need attention.

Professional Designations

Professional designations are identified in Item 8 of the Form U4. Don't forget to check the appropriate box if you hold and currently maintain the status of Certified Financial Planner (CFP), Chartered Financial Analyst (CFA), Chartered Financial Consultant (ChFC), Chartered Investment Counselor (CIC), and/or Personal Financial Specialist (PFS).

Professional designations are not lifetime appointments; you need to stay current on all requirements associated with the designation. Some IA reps will initially be in good standing with the designation but later fail to keep up with continuing education or membership dues. In that case, the U4 should be amended to remove the professional designation. Claiming to have a professional designation that you do not meet the requirements for is identified as, "prohibited conduct" under DFI-Sec 5.06(7).

Other Business

Item 13 of Form U4 requests the details regarding any business you conduct other than the advisory or brokerage registration that is the purpose of the U4 registration filing. However, sometimes IA reps take a limited view on what other business activities need to be disclosed and overlook the following U4 question:

> **Are you currently engaged in any other business either as a proprietor, partner, officer, director, employee, trustee, agent or otherwise?**

The only positions that are carved out from disclosure are those held at tax exempt entities that are also non-investment related. Accordingly, the U4 directions indicate you may exclude any "non *investment-related* activity that is exclusively charitable, civic, religious or fraternal and is recognized as tax exempt."

With respect to other businesses, you should provide the following details: the name of the other business; whether the business is investment-related; the address of the business; the nature of the business; your position, title or relationship with the business; the start date of the relationship; the approximate number of hours/month you devote to the business (including those during securities trading hours); and your duties relating to the business.

These disclosures help make clear to clients and regulators what potential conflicts of interest might be present as a result of other business activities.

Disclosure Questions

The Disclosure Questions in Item 14 of the Form U4 cover a variety of topics: criminal actions (14A and B); regulatory actions (14C-G); civil actions (14H); customer complaints (14I); terminations (14J); and financial disclosures (14K-M). It is important to carefully review the questions in these sections to determine whether they apply to your circumstances. There are also Disclosure Reporting Pages that collect additional detail regarding reportable events. A failure to disclose reportable information may result in administrative action by the Division.

If you have any questions regarding whether information should be reported on your Form U4, please feel free to contact the Division.

IAR CONTINUING EDUCATION UPDATE

The North American Securities Administrators Association ("NASAA") announced last November that its membership had voted to adopt a model rule to set parameters by which NASAA members, including the Wisconsin Division of Securities ("Division"), could implement continuing education ("CE") programs for investment adviser representatives registered in their states. Requiring 12 hours of CE annually, the model rule has a products and practices component and an ethics component, and is intended to be compatible with other CE programs.

"This model rule represents the culmination of years of work by state securities regulators and industry to develop a relevant and responsive continuing education program," said Lisa A. Hopkins, NASAA President and West Virginia Senior Deputy Securities Commissioner, after the NASAA vote. "This successful collaboration will help promote heightened regulatory compliance while also helping investment adviser representatives better serve their clients by remaining knowledgeable of current regulatory requirements and best practices."

Although the CE model rule has not yet been adopted in Wisconsin, the Division initiated the legislative process earlier in the year. Then on February 19, 2021, Governor Evers approved a Statement of Scope relating to CE for investment adviser representatives (Wis. Admin. Code ch. DFI-Sec 11). The Division currently anticipates that the rules may be adopted before the end of the year with the required compliance beginning in 2022.

IAR CE CONTINUED…

This means that IARs will complete and report their required hours of continuing education prior to the end of 2022, and for each calendar year thereafter. The reporting and tracking of CE hours will take place through CRD/IARD.

Please watch for future notices and resources regarding the upcoming CE requirements for all investment adviser representatives, including those registered with federal covered investment advisers.

REGULATORS ALERT INVESTORS REGARDING MARKET VOLATILITY AND OTHER INVESTMENT RISKS

The primary mission of securities regulators is to protect investors. With events such as unusual market volatility, regulators often take action to alert investors of risks that require extra caution.

For instance, at the end of January, the SEC released an Investor Alert regarding the risks of short-term trading based on social media. When the North American Securities Administrators Association ("NASAA") recently announced the Top Investor Threats for 2021, it was not surprising that internet or social media-based frauds were at the top of the list. Tied for second were cryptocurrency-related and precious metals-based investments.

The Wisconsin Department of Financial Institutions ("DFI") recently issued an Investor Advisory providing information to help Wisconsin investors better understand the potential threats to their online financial accounts and how to protect themselves from cybercriminals. The advisory provides an overview of some of the most common threats to online accounts and discusses steps investors can take to better protect themselves and their financial information.

In February, the SEC, FINRA, and NASAA joined together in an Investor Advisory to raise awareness of the risk of investment fraud when senior investors experience greater social isolation, especially during the pandemic.

You may or may not be aware that FINRA has a website page with Investor Insights where it addresses and explains numerous topics such as microcap fraud, options trading, private placements, etc.

In responding to questions from your clients regarding market activity or various investment risks, you may find it helpful to refer clients to the resources and publications from securities regulators such as the SEC, FINRA, NASAA, and DFI.

NASAA PROMOTES INVESTOR PROTECTION AND RESPONSIBLE CAPITAL RAISING

On March 8, the North American Securities Administrators Association ("NASAA") submitted their Legislative Agenda for the 117th Congress. NASAA makes recommendations to Congress on a biannual basis to help strengthen investor protection and assist in the growth of capital formation. The following five key principles were addressed:

PRINCIPLE 1: Congress must place the interests of investors front-and-center and prioritize measures to protect and empower retail investors.

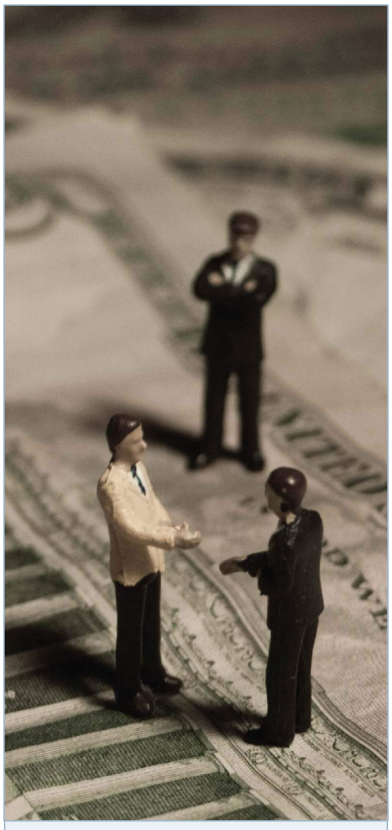
PRINCIPLE 2: Congress should work to restore the preeminence of the U.S. public securities markets and enact reforms to enhance regulatory oversight of the private markets.

PRINCIPLE 3: Congress should promote policies designed to enhance diversity and inclusion in all aspects of the capital markets, take steps to prevent exploitation of elderly investors, and address the unique challenges facing Millennial investors.

PRINCIPLE 4: Congress should vigorously exercise its oversight authority on behalf of the investing public – including, and especially, retail investors.

PRINCIPLE 5: Congress should support small and emerging businesses by helping them raise capital responsibly from investors.

More detailed information as well as the video and slideshow can be found here: https://www.nasaa.org/policy/legislative-policy/legislative-priorities/



ENFORCEMENT NEWS

The Wisconsin Division of Securities is responsible for administering and enforcing the state's securities laws. To read our latest enforcement actions, please visit our website.

- On January 22, 2021, DFI issued a Summary Order to Cease and Desist, Revoking Exemptions and Barring Registration against **Michael F. Shillin and Shillin Wealth Management, LLC.** (DFI Case No. S-242215 (LX). The Summary Order found Shillin was subject to discipline pursuant to Wis. Stat. § 551.412(4) because he was both barred by FINRA and the subject of a cease and desist order issued by the Office of Commissioner of Insurance ("OCI"). The Summary Order also found Shillin violated Wis. Stat. § 551.501(2) when he failed to inform potential investors about the disciplinary actions taken against him by FINRA, OCI and the current investigation by DFI.

- On January 27, 2021, DFI issued a Summary Order to Cease and Desist against **FX-Bittrade** and **Frederick Smith** (DFI Case No. S-242022). FX-Bittrade solicited investors to purchase Bitcoin to invest in foreign currency exchange trading. The Summary Order found the FX-Bittrade transactions were investment contract securities and that Smith and FX-Bittrade violated Wisconsin securities laws by selling unregistered securities and transacting business as an unregistered broker-dealer. Further, Smith and FX-Bittrade violated Wis. Stat. § 551.501(2) when they offered and sold securities while misrepresenting to investors that FX-Bittrade was affiliated with PayPal when, in fact, it had no relationship with PayPal.

- On March 18, 2021, DFI issued a Summary Order to Cease and Desist and Imposing Civil Penalties against **Christopher Soulier** for violating a previous consent order in which he had agreed to disgorge $26,250 in commissions he received

for selling unregistered Woodbridge promissory notes. The Summary Order imposes $10,000 in civil penalties. The respondent has 30 days from the date of service to file a petition for hearing.

- DFI, the Wisconsin Department of Justice and the CFTC filed a joint civil enforcement action against **TMTE, Inc. (aka Metals.com)**, and others for perpetrating a fraudulent precious metals investment scheme. The case involves 1,600 investors and more than $185 million in customer funds, including $2.7 million from 19 Wisconsin investors. Defrauded investors should complete and send their claims forms to the court-appointed receiver by April 30, 2021. More information about the case and the claims process can be found at www.metalsandbarrickcapitalreceivership.com.

A Cautionary Note:

In recent years, the Division has brought several enforcement actions against persons, both registered and unregistered, for offering and selling securities that later turned out to be fraudulent. When asked about the due diligence the IAR performed on the investment prior to recommending it to their clients, the IAR sometimes responded "I relied on what the company had on its website" or "A trusted friend said he invested, so I believed it was a legitimate business operation."

As a reminder, registrants, including investment advisers and

their representatives, must perform due diligence to ensure that any securities recommended to clients are suitable for the client and in the client's best interest. An investment adviser's fiduciary duty includes thoroughly vetting any recommended alternative investments, particularly those with higher risk or longer time

ENFORCEMENT NEWS CONTINUED…

horizons. Registrants should not rely on the representations of the company or issuer offering or selling an "opportunity" that the product is not a security or is exempted from registration without verifying that is, in fact, the case. A registrant's failure to perform due diligence in connection with a fraudulent securities offering may result in disciplinary proceedings.

For example, DFI issued 8 orders against registrants and non-registrants who offered and sold Woodbridge promissory notes to 106 Wisconsin investors. Woodbridge was organized as a Ponzi scheme by Robert Shapiro, who managed to raise over $1 billion dollars from thousands of investors nationwide. Most of the Wisconsin respondents were disciplined for failing to disclose to investors prior state securities orders against Woodbridge for selling unregistered securities. If the Woodbridge agents had performed due diligence on Woodbridge and its principals, they would have learned of the prior orders and could have avoided the financial harm they caused to their customers.

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 and LinkedIn.