

Investment Adviser Newsletter

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Contact Us

If you have questions, send us an email or give us a call.

(608) 266-2139

DFISecurities@dfi.Wisconsin.gov

Connect with DFI on Social Media

Visit the DFI's Social media profiles on [Facebook](#), [X, formally Twitter](#) and [LinkedIn](#) for information on the agency's activities, personal finance tips, investor education, scam warnings, and other timely news to help protect investors. Please feel free to share any content that you find useful, and "like" or "follow" our social media profiles so that you can receive future posts in your social media newsfeeds.



Have you Completed Your Continuing Education for 2023?

The year-end deadline for completing the new annual continuing education (CE) requirement is quickly approaching. Under Chapter 11 of the DFI securities administrative code, which sets out annual continuing education requirements for the investment adviser representatives (IARs) of both state-registered and SEC-registered investment advisers, IARs have until December 31st to complete their CE for 2023.

However, it's best not to wait until the last minute so that sufficient time is allowed for CE providers to report your

credits to the tracking management system hosted by FINRA. And if you haven't done so already, you'll want to create an account on FINRA's Financial Professional Gateway (FinPro) to monitor your CE status and course completion.

The new CE rule requires that every IAR complete 12 continuing education credits annually to maintain their IAR registration. A "credit" is a unit designated by NASAA to be at least 50 minutes of educational instruction. Some courses offer more than one credit depending on the length of the course. Generally, the provider's course description will identify the number of credits available for completing the course.

The 12 credits must include 6 credits of Products and Practices courses and 6 credits of Ethics and Professional Responsibility courses. IARs dually registered as broker-dealer agents may apply their FINRA Regulatory Element training to receive 6 credits of Products and Practices training (by paying the \$3 per credit reporting fee).

IARs are free to select and complete CE courses that fit their interests and business models. The list of approved CE providers is maintained on NASAA's website with links to the providers' websites and course offerings. The list now includes an indication of whether the provider offers courses approved for both IAR CE and a professional designation such as CFP.

Continuing Education Continued...

The Wisconsin Division of Securities is an approved CE provider and has released its first course regarding Wisconsin DFI-Sec 5.06: Prohibited Conduct, which is accessed through the NASAA website.

Our next course, Protecting Senior Clients From Financial Exploitation, will soon be posted. Both courses are free of charge except for the \$3 per credit reporting fee.

If an IAR does not complete the CE requirement by the annual deadline,

CRD will set his or her IAR CE status to “CE Inactive” and the registration status to “Approved – Pending IAR CE.” The IAR will remain “CE Inactive” until complying with the CE requirement. An IAR who is CE Inactive at the close of the next (second) calendar year is not eligible for IAR registration or renewal. The registration status will be set to “Terminated – No IAR CE.”

Note that any IARs registered in 2022 in Maryland, Mississippi or Vermont who did not complete CE for 2022, and therefore already have a status of “CE Inactive,” are not eligible to renew their registration in Wisconsin for 2024 unless they complete their outstanding CE.

Finally, be sure to make the following updates: 1) your written supervisory procedures should reference and require compliance with the annual IAR CE program; and 2) since we send updates and reminders regarding CE via email, any changes to your email address should be promptly communicated to our Division.

Additional guidance regarding IAR CE can be found on the Division of Securities website and the NASAA website, including a list of Frequently Asked Questions. If you have other specific questions, please feel free to call the Examiner of the Day phone line at (608) 266-2139 or contact Deb Fabritz at deborah.fabritz@dfi.wisconsin.gov.





Watch For 2024 Registration Renewals

As you do each year, you will need to renew your firm and individual registrations through IARD (Investment Adviser Registration Depository) during the annual registration renewal process. Your renewal statement will be available on IARD beginning November 6th. Renewal payments for 2024 are due no later than December 11th for firm, individual, and any branch registrations for state-registered investment advisers. Be sure to submit your timely renewal payment to avoid a lapse in your firm's ability to conduct business next year.

If you are based in Wisconsin and your future plans do not include renewing for 2024, please take a minute to send an email to jennifer.acker@dfi.wisconsin.gov to confirm that you will not be renewing for next year. (That way, we'll stop directing any reminder emails or phone calls to you.) You should also file an ADV-W regarding your firm's planned withdrawal. Beginning November 1st, you may submit ADV-W forms that are post-dated for 12/31/23.

“Be sure to submit your timely renewal payment to avoid a lapse in your firm's ability to conduct business next year.”

For questions regarding the renewal process or your firm's status, you may contact either the IARD Call Center at (240) 386-4848 or our Examiner of the Day at (608) 266-2139. Additional information is also available on the [IARD.com website](http://IARD.com).

Following your renewal for 2024, don't forget to file your ADV annual amendment. To comply with [Wis. Admin. Code s. DFI-Sec 5.04\(3\)\(b\)](#), each investment adviser must file a completed, updated Form ADV with IARD within 90 days of the end of its fiscal year. This means that if your firm's fiscal year end is December 31, your next ADV annual amendment should be filed after January 1, 2024, and no later than March 31, 2024.

Division Adds Outreach to New IAs

There are a number of ways and times that the Division of Securities stays in contact with our state registered investment advisory firms. Sometimes it's when we are following up because you haven't timely updated your ADV, or you appear on the list of firms that haven't renewed for the next year. You'll also likely hear from us later this year if you are missing continuing education credits.



Our most thorough type of outreach is the firm examination process. If you've been through an exam recently, hopefully it was a worthwhile experience where you had an opportunity to improve your firm's practices after learning more about the nuances of invoices, fee structures, or suitability documentation. It occurred to us that newer examiners may be interested in learning more about the exam process in advance of it taking place, and have other questions about compliance with our regulations.

Enter our newest outreach opportunity – the New Adviser Roundtable.

Starting this past July and again in

October, the Division invited recently registered investment advisers to attend an informal, voluntary video Teams call with Division staff. The Roundtable is a chance to get more insight on the process for routine exams and to engage in an interactive discussion. By getting to know the Division, these recurring roundtables will facilitate future communications with our examination staff.

The roundtables are also an opportunity for advisers to network with peer firms. Being a newly registered investment adviser can be a challenging proposition with the compliance requirements and business issues involved in starting a firm. Therefore, it can be helpful to meet other advisory firms going through the same process at about the same time. If you're a newer adviser and would like to be invited to the next roundtable, please contact joseph.friesen@dfi.wisconsin.gov.



DFI Joined National Regulation Best Interest Examination Initiative

The Wisconsin Division of Securities participated along with other states initiatives to review firm compliance with Reg BI.

These exams focused on compliance with disclosure and conflict of interest obligations, as well as duty of care obligations encompassing complex products. The complex products that were reviewed included private placements, non-traded REITS,

leveraged and inverse ETFs, and variable annuities. (These complex, costly and risky products are referred to as CCRs.)

Recently, the United States Securities and Exchange Commission (SEC) reached a settlement with a small Wisconsin-based investment advisory firm, that is also registered as a broker-dealer, over a lack of written supervisory procedures related to Reg BI compliance.

Despite investment advisers already having a fiduciary duty to their clients, the Division believes Reg BI is still an instructive topic for investment advisers, especially with regards to the conflict of interest obligation.

The National Reg BI Examination Initiative made the following key observations:

- Firms have been updating their investor profile forms and enhancing their policies and procedures to focus more directly on Reg BI obligations, though more specific instruction is needed with respect to considerations of reasonably available alternatives and conflict mitigation;
- Firms recommending complex products are imposing product-specific restrictions based on age, net income/worth, and risk profiles and are using exception reports to monitor compliance with those restrictions;
- Firms are using helpful cost-comparison tools to better consider reasonably available alternatives, but are still ignoring common lower-cost and lower-risk products when recommending complex products;



Regulation Best Interest Continued...

- Firms are still relying on financial incentives to sell CCR products and there is little uniformity in implementing effective firm mitigation strategies; and
- Firms have not enhanced point-of-sale disclosure, but they have devoted significant time, energy, and effort to compliance with Reg BI's Disclosure Obligation by crafting the Form CRS and detailed Supplemental

Reg BI disclosures, along with disclosure information available via link to the firm's website.

Examination findings related to the Conflict of Interest obligation included the following:

- Certain firms had procedures that generally acknowledged the Conflict of Interest Obligation and the requirement to establish, maintain, and enforce written policies and procedures reasonably designed to identify conflicts of interest, but the procedures did not contain information on how the firm identifies conflicts, nor did the firm have a list of conflicts, such as a conflict register or matrix;
- Other firms that generally acknowledged the Conflict of Interest Obligation had no procedures to mitigate conflicts of interest of an associated person potentially recommending a higher commission product and placing their own interest ahead of the customer's interest;
- The only mitigation step in place for a vast majority of firms was limiting the types of customers to whom a product may be recommended. Many firms limited the types of customers eligible to purchase alternative investments by having concentration limits, but these firms did not create any policies and procedures addressing the obligation to mitigate. In fact, the concentration limits were in place prior to Reg BI or otherwise appeared coincidental to mitigating the conflict of interest.

More information about the Coordinated National Regulation Best Interest Examination Initiative, including a copy of the report, can be found [here](#).

Conduct Due Diligence for Alternative Investments

The label “alternative investments” can include many types of investments, including but not limited to commodities, real estate, cryptocurrencies, collectibles, venture capital, private equity, hedge funds, and private placements. While these investments can offer unique opportunities to a suitable investor, they also come with heightened risks due to their limited oversight and complexity. As your clients’ fiduciary, it is your duty to conduct (and document) your due diligence on any product you recommend to your clients, including alternative investments.

One significant red flag in alternative investments is a lack of transparency. If the issuer or sponsor of the product or fund is unwilling to provide comprehensive information to you about the investment strategy, its underlying assets, fee structure, how returns are generated, and how investors are ultimately paid, you should consider other opportunities. Be especially wary if the issuer or sponsor is claiming “secret” or “proprietary” methods to generate investor returns. Or, if the investment is too complex for you or your clients to understand, you should consider walking away.

You should be able to monitor the reporting practices of the alternative investment. For example, you can ask the issuer for financial statements and assess the completeness of the reports and whether they are audited. Are the statements issued regularly or are they delayed? Are there any relevant industry benchmarks to compare with your investment? Reliable and timely reporting audited by a third party is essential for evaluating any potential investment. You should not simply rely on the issuer’s or manager’s word regarding their own track record.

Fees are another area that can erode an investor’s returns. Are commissions and management fees disclosed in the subscription agreement? Are the fees reasonable as compared to industry benchmarks? Be wary of investments that promise to never charge a fee or commission. If it sounds too good to be true, it probably is.



Due Diligence Continued...

You should conduct background research on the investment itself and the issuers or managers behind the investment. Is the alternative investment registered with the appropriate regulators or exempt from registration? If it is exempt from registration, is there a notice filing with the Division of Securities? Are the issuers or managers registered? What is their professional background and experience? Do they have any public court records that might be relevant? Again, don't just take someone's word for it that they are "registered"; go online and check them out through [FINRA BrokerCheck](#) and other resources.



Alternative investments often have limited liquidity compared to traditional assets. Make sure you and your clients understand lock-up periods and redemption restrictions. Watch out for excessive restrictions or unclear redemption terms. Many investors overlook liquidity restrictions when investing in alternatives because they are focused on the potential for higher returns. It is important to emphasize any liquidity restrictions on the investment while making a recommendation to your clients.

“Alternative investments come with a unique set of risks that require financial advisors to conduct thorough due diligence.”

Also, watch out for claims that the prospective investment is not a “security”; this is often untrue when compared to the broad definition of a [“security”](#) under the Wisconsin Uniform Securities Law. There are former investment advisers who had their registration revoked after selling an unsuitable product that was touted as “not a security.”

Alternative investments come with a unique set of risks that require financial advisors to conduct thorough due diligence. Speaking with the issuers or managers over the telephone and taking their word for their track record, qualifications, or proprietary processes does not satisfy the fiduciary duty owed to your clients. Recognizing red flags while conducting due diligence is an expectation that the Division has of its registrants, because this can help investors avoid costly scams and schemes that are packaged as “safe and secure” investments. Due diligence is also an ongoing process, and your duty to your clients continues throughout the life of the investment.

IA Meet AI

What is artificial intelligence?

Artificial intelligence (AI) is the intelligence of machines or software. It is the ability of a machine to learn and problem solve (like a toaster that automatically adjusts cooking time according to the moisture content of the bread), rather than just automate a simple task (like a \$10 toaster that effortlessly burns your toast with glee every time). If you've used a search engine or a website chatbot, then you've already encountered AI. More complex AI learning, like those using large language models, has resulted in ChatGPT and other programs that can use large amounts of data to produce human-like responses to queries.



How is AI being adopted?

Investment advisers may find AI useful in streamlining workflow and reducing repetitive administrative operations. For example, online chatbots or virtual assistants can help respond to routine customer inquiries, screen your emails, and operate 24/7. Fraud detection AI can monitor accounts for patterns or anomalies that might indicate suspicious activity. AI tasked with automated portfolio management can construct, rebalance, and continuously monitor client portfolios based on the client's objectives and risk tolerance.



IA Meet AI Continued...

What issues should investment advisers consider?

If you decide to adopt any AI processes into your business practices, be sure to consider and comply with the following fiduciary duties:

Duty of care

- Providing advice in the best interest of the client
 - Create policies and procedures for your firm regarding the use of AI and its supervision. Specify the frequency of evaluations for AI programs, and how the firm is verifying their efficacy and accuracy. Make it clear which personnel are permitted to access and modify the AI program, and who is responsible for oversight.
 - Even if you are not using an AI program for investment advice or portfolio management, it's imperative to be aware of how AI might influence communications and advice to your clients. If AI is being used to rebalance client portfolios based on economic data, how is the program being supervised and verified? Are clients basing their investment decisions on information they received from your website chatbot?

Duty of loyalty

- Full and fair disclosure of material facts
 - Disclose to clients the specific uses of AI in your business practice, especially if AI is used to guide portfolio management decisions or respond to client texts or emails.
 - Disclose to clients the risks associated with the use of AI for portfolio management or investment advice.
 - Disclose to clients the degree of human involvement and oversight involved; i.e. when AI operations might be overridden and to what degree they are monitored by a human.
- Privacy concerns
 - Before adopting an AI product or application, determine what client information would be shared with the AI and whether the application would in turn share that information with other 3rd parties.

Although AI may be programmed to maximize efficiency or cost savings, it is not usually programmed to prioritize fiduciary duty and the investment adviser is the one responsible for their own advice and actions. This fiduciary duty requires that advisers serve the best interest of their clients, and it applies to the entire adviser-client relationship. AI cannot replace significant duties and obligations to the client.

Stay tuned for future newsletter articles regarding this developing topic.



Investment Adviser Resources

Do you have questions about what records you are required to maintain or other investment adviser related matters? You could likely find the answer in the Division of Securities [Investment Adviser Guide](#) on DFI's website. The guide contains resources with information on recordkeeping, our examination process, advertising, contract requirements, and more. Past editions of this newsletter can also be found on our [website](#).

The North American Securities Administrators Association (NASAA) also has investment adviser resources on its [website](#). Check out NASAA's [IA Guide](#) and [IAR CE Resources](#) links for more information. NASAA's [Serve Our Seniors](#) website contains helpful resources for advisers if you suspect financial exploitation of a client or a client's diminished capacity.

If you're not able to find the answer to your question, you should feel free to call our Examiner of the Day Line at (608) 266-2139 for assistance.



Enforcement News

Wisconsin Joins \$10.2 Million Settlement With Robinhood

The Wisconsin Department of Financial Institutions (DFI) and several other states, with the Alabama Securities Commission as the lead, reached a settlement agreement with Robinhood Financial LLC (Robinhood) regarding operational and technical failures that harmed investors in March of 2020. There were platform outages, deficiencies in its review and approval process for options and margin accounts, weaknesses in the firm's monitoring and reporting tools, and insufficient customer service and escalation protocols that in some cases left Robinhood users unable to process trades during volatile periods.

The total settlement amount is \$10.2 million, with Wisconsin and other states each receiving \$200,000. Robinhood has one year to comply with the FINRA-ordered independent compliance consultant's recommendations or create measures that are more effective at addressing the recommendations.

The administrative order is available [here](#).

The NASAA press release is available [here](#).

Wisconsin Takes Action Against Coinbase

The Wisconsin DFI issued an administrative enforcement action against Coinbase Global, Inc. and Coinbase, Inc. for violating securities laws in connection with Coinbase's staking rewards program. DFI determined that Coinbase didn't obtain the appropriate registration to offer or sell these securities. Nine other states were part of the task force that investigated. DFI assessed Coinbase a \$500,000 civil penalty.

So what is staking? Staking occurs when investors lock their crypto assets for a set period to help support the operation of a blockchain. In return, the investor is promised more crypto assets. Under Coinbase's staking rewards program, investors deposited crypto assets with Coinbase, which then facilitates the staking of these assets on the blockchain. The program was offered to the general public and advertised an annual return of up to 6% on investments. Coinbase pooled investors' crypto assets and employed a team to operate staking validator nodes to generate staking rewards. Coinbase took a cut of those profits before sharing them with investors.

The full news release is available [here](#).

The administrative order is available [here](#).