Wisconsin Department of Financial Institutions

Fall 2022
Division of Securities

Investment Adviser Newsletter

Photo Credit: "Go Valley Kids"

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START PLANNING YOUR REGISTRATION RENEWALS FOR 2023

It's time to anticipate and plan for the annual registration renewal process. As you do each year, you will need to renew your firm and individual registrations though IARD (Investment Adviser Registration Depository). Your renewal statement will be available on IARD beginning November 7th. Renewal payments for 2023 are due no later than December 12th for firm, individual, and any branch registrations. Be sure to submit your timely renewal payment to avoid a lapse in your firm's ability to conduct

REGISTRATION RENEWALS CONTINUED…

business next year.

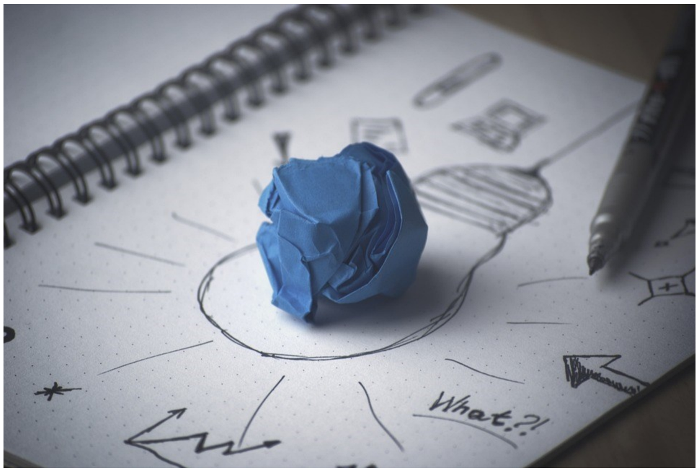
If you are based in Wisconsin and your future plans do not include renewing for 2023, please take a minute to send an email to deborah.fabritz@dfi.wisconsin.gov to confirm that you will not be renewing for next year. You should also file an ADV-W regarding your firm's planned withdrawal. Beginning November 1st, you may submit ADV-W forms that are post-dated for 12/31/22.

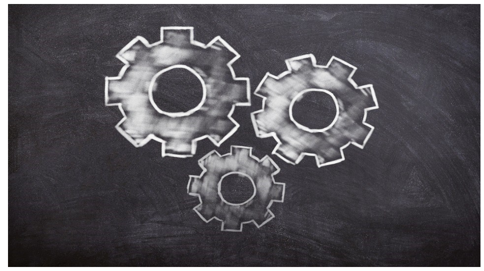
Click here for the 2023 Renewal Program Calendar. For questions regarding the renewal process or your firm's status, you may contact either the IARD Call Center at (240) 386-4848 or our Examiner of the Day at (608) 266-2139.

In addition to the RIA and IAR renewals for 2023, there may be other annual renewals that require your attention. To comply with Wis. Admin. Code s. DFI -Sec 5.04(3)(b), each investment adviser must file a completed, updated Form ADV with the investment adviser registration depository (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, 2023, and no later than March 31, 2023.

Some custodians are requiring investment adviser firms using their platform to maintain errors and omissions insurance coverage. If your custodian requires this coverage, ensure the policy is renewed each year.

If your firm is organized as a corporation or limited liability company, you will have an annual report due with the DFI's Corporation's Division of the WI Department of Financial Institutions. If you are unsure whether the report has been filed for 2022 or want to check the status of your entity, you can search DFI's website at Search Corporate Records or contact the Corporations Division at (608) 261-7577.





CONTINUING EDUCATION REQUIREMENTS LAUNCH IN JANUARY 2023

In July, the Division of Securities delivered two in-person presentations, first in Madison and then in Brookfield, regarding the new annual continuing education requirements for investment adviser representatives that go into effect on January 1, 2023. If you were unable to attend one of those events, we posted a 28 minute seminar recording on the Wisconsin DFI Facebook page.

Other useful website links for information regarding the continuing education program include the following:

WI Division of Securities IAR CE

NASAA IAR CE Resources

The NASAA website includes an updated page regarding the status of state adoptions of the CE model rule. Currently, Wisconsin and at least 9 other states will require continuing education in 2023.

Note that CE course providers are accessed through NASAA's website and all investment adviser representatives will open a FinPro account through FINRA to track their CE status. There are many approved CE providers and their websites are hyperlinked from the NASAA website.

The Division has been approved as a CE provider and is actively developing several continuing education courses that will be available next year through NASAA's learning platform. To help investment adviser representatives get a start on meeting their continuing education requirements, the Division's on-demand courses will be offered at no cost except for the $3 per credit roster reporting fee .

If you have any questions regarding the new CE program, please send an email to deborah.fabritz@dfi.wisconsin.gov or call the Examiner of the Day phone line at (608) 266-2139.

SINGLE-STOCK ETFS MAY NOT BE SUITABLE

A single-stock ETF is an ETF that provides leveraged or inverse exposure to a single security rather than a diversified portfolio of multiple securities. A bullish ETF may seek to provide 1.5x to 2.0x the daily return of the stock, while a bearish ETF may seek to provide the inverse return of the daily performance of the stock.

The ability to gain exposure to leverage and inverse returns comes at the cost of increased risks.

In July of this year, SEC Commissioner Crenshaw released a statement discussing some of the risks associated with single-stock ETFs. Like other leveraged or inverse ETFs, single-stock ETFs rebalance daily. The compounding effects of daily rebalancing cause the long-term returns of the single-stock ETF to differ significantly from the long-term returns of the underlying security.

For example, the underlying stock may be up 10% over several weeks or months of trading, but that does not mean that the respective 2x single-stock ETF will be up 20% (2x) over that same time period. In some cases, the return could even be lower than the underlying stock's return. This is because the ETF seeks to match the stock's returns on a daily basis and not a long-term basis. For the same reason, an inverse ETF tracking the same stock may be down more than 1x the return of the underlying stock.

Although it may be tempting to gain exposure to leverage without the complexities of trading options or shorting stocks, it would be difficult for an investment adviser in Wisconsin to justify holding a single-stock ETF in a client's account. Ultimately, these types of complex products are best suited to clients that understand their features and associated risks, can tolerate the volatility and potential losses, and have a short-term trading objective.

It is the adviser's responsibility to document their client's suitability for such products. Upon examination, examiners will check for complex products in client portfolios and verify associated suitability documentation. Client objectives, risk tolerance, and financial information should be documented and kept up to date. It is not sufficient to simply "know" your client's suitability for a product without having documentation to back up your knowledge. A lack of documentation to demonstrate your client's suitability for a complex product can leave you or your firm liable if losses occur in the account from the complex product.

CRYPTO SCAMS ARE ON THE RISE

Recent headlines are packed with cautionary tales regarding cryptocurrencies – Kardashians improperly endorsing an obscure alt coin, 300 million dollar Ponzi schemes, 2.2 billion dollars stolen in 2022 so far, crypto lending firm goes bankrupt owing clients 4.7 billion dollars, etc. As the headlines stack up, so do complaints and open investigations. To discuss the current state of the Division's ongoing crypto actions, we're joined by the Supervisory Attorney of our Enforcement Bureau, Robin Jacobs.

WHAT ARE SOME COMMON THEMES BEHIND THESE SCAMS?

Scam artists are skilled at using the latest trend or headline to fleece unwary investors and crypto-related businesses are rich fodder for scam artists who exploit the public's fascination with digital assets/blockchain technology. However, investors often do not understand the risks involved when dealing with people and products who operate outside of the regulated marketplace (even though in many instances, they are engaged in conduct that falls within a regulator's jurisdiction).

For example, crypto deposits do not have the FDIC protection for bank deposits or the Securities Investor Protection Corporation (SIPC) protection available to brokerage accounts. Consequently, state securities regulators are devoting substantial resources to investigate illegal and fraudulent schemes tied to cryptocurrencies.

WHAT DO YOU OWE TO THE CURRENT RISE IN THESE CASES?

Crypto cases are on the rise due to the increasing use of the internet and social media to illegally market products and the leveraging of widespread interest in digital assets to harm the public. Financial fraudsters no longer need to rely on print media, radio promotions and cold calls to fraudulently market securities. Instead, they are capitalizing on the rapid growth in technology, including expanded access to the internet, development of smartphones, proliferation of social media, and availability of inexpensive voice and text messaging platforms.

According to the NASAA 2022 Enforcement Report, in the most recent

CRYPTO SCAMS CONTINUED…

reporting year, state regulators opened 215 investigations of parties suspected of illegally or fraudulently offering securities relating to digital assets, an increase of about 70% from the previous reporting year. They also filed 89 enforcement actions against firms accused of misconduct involving products incorporating digital assets, an increase of 43% over the past year and 100% over the past two years.

CAN YOU SPEAK TO THE COLLABORATION THAT IS OCCURRING BETWEEN STATE SECURITIES REGULATORS ON THESE CASES?

In 2018, NASAA launched Operation CryptoSweep, resulting in more than 330 inquiries and investigations that led to the filing of more than 85 enforcement actions.

In 2020, a coordinated team of state regulators began investigating BlockFi Lending LLC. The investigation revealed that BlockFi was promoting unregistered digital asset interest accounts. It also revealed that as many as 570,000 investors – including nearly 400,000 investors from the United States – may have invested more than $10 billion in the firm's cryptocurrency depository accounts.

In 2022, BlockFi settled with the state agencies and SEC by agreeing to stop offering unregistered depository accounts to the public, agreeing to comply with state and federal regulations, and to pay a fine of $50 million to state agencies. Other crypto banks which have been the subject of coordinated state enforcement actions include Celsius Network, Inc., Voyager Digital LTD, and Nexo Capital, Inc.

WHAT WARNING SIGNS SHOULD ADVISORS LOOK OUT FOR IN CLIENT ACCOUNTS THAT MIGHT INDICATE CRYPTO FRAUD?

The same rules that apply to investments in the physical world continue to apply to investments in virtual worlds. Screen names are not a substitute for real names. Qualifications and experience matter. There are no virtual risks, just real risks of losing real money in a real scam.

> ***The best defense isn't rooted in technical knowledge but traditional due diligence.***

Investors should put aside emotion, investigate red flags of fraud and objectively consider all material information before purchasing securities.

CRYPTO SCAMS CONTINUED…

Unfortunately, the nature of crypto fraud creates significant challenges to recovering lost funds.

ARE THESE CRYPTO SCAMS NOVEL OR ARE THEY REINTERPRETATIONS OF OLDER SCAMS?

The crypto complaints that our Bureau is seeing run the gamut from using new technology to run old style schemes, like a pump and dump or romance scam, to the strange new world of the metaverse. Bad actors are using new technology such as blockchain and cryptocurrencies to more effectively conceal their identities, launder money, market and sell illegal goods and impersonate trustworthy parties.

WHAT SHOULD AN ADVISOR DO IF THEY SUSPECT A CLIENT HAS FALLEN VICTIM TO A CRYPTO FRAUD?

Reporting a matter may depend on whether the fraud involved securities and/or some other issue, such as identity theft.

To report concerns about an incident:

DFI Division of Securities: dfi.wi.gov or 608-266-2139 (investments)

Office of the Commissioner of Insurance: oci.wi.gov or 608-266-3585 (insurance and annuities)

Dep't of Trade, Ag and Consumer Protection: datcp.wi.gov or 608-224-5163 (identity theft)

Consumer Financial Protection Bureau: consumerfinance.gov (financial products and services)

Adult Protective Services: danecountyhumanservices.org or 608-261-9933 (elder financial abuse)

WHAT RESOURCES ARE AVAILABLE TO EDUCATE INVESTORS ON CRYPTO SCAMS?

For crypto investor education, check out the following websites:

NASAA: Informed Investor Advisory: Cryptocurrencies

SEC: Crypto Assets

FINRA: Cryptocurrency

BE CAUTIOUS OF FINFLUENCERS!

The Division of Securities has observed an increase in financial content on various social media websites. These videos are produced by financial influencers or "finfluencers" -- persons with large amounts of followers on social media who promote or make recommendations on financial products. These posts or videos are often stylized to be entertaining and shared with other potential investors.

While there is nothing new about marketers paying celebrities to endorse products, some finfluencers may not be disclosing they are receiving compensation for their endorsements. Many finfluencers do not work in the financial services industry, are not qualified to provide investment advice, and do not disclose that their social media content is not intended as a replacement for individualized financial advice.

Furthermore, some finfluencers peddle inappropriate advice that is notable for sounding too good to be true.

These endorsements should be treated with skepticism and subjected to the same scrutiny given to any other financial decision.

These social media posts or videos might be flashy and cater to the viewer's emotions, rather than offer any data or other rational basis to the claim.

Please feel free to refer your clients to the investor alerts on this and other topics on our Investor Education website.

INVESTMENT SCAMS EXIST IN THE METAVERSE

New technologies can generate hype and excitement but can also be prone to fraudsters operating investment scams. One such technology is the Metaverse, a term used to describe online virtual worlds that stand alone or are interconnected. Using avatars, these virtual worlds can allow users to experience many of the same things as people do in the physical world.

State regulators are coordinating efforts to stop financial misconduct tied to the metaverse. In May 2022, five state securities regulators, including Wisconsin, filed enforcement actions against an organization with possible ties to Russia for allegedly promoting fraudulent metaverse investments to US residents. The scheme involved offering NFTs (non-fungible tokens) to investors that claimed to convey ownership interest in a metaverse casino and the rights to share profits in the casino. Investors would purportedly profit when patrons, acting through avatars, paid to play virtual craps, blackjack and other games. Regulators further alleged the club lied when claiming a partnership with the physical Flamingo Casino in Las Vegas and failed to back claims that it was buying digital land from rapper and TV personality, Snoop Dogg. Since the state actions, Flamingo Casino Club was effectively shut down from continuing to sell NFTs.

The following tips could help protect you and your clients from metaverse scams and frauds: 1) Make sure to carefully guard personal information, passwords, and other financial information. 2) Be cautious of any metaverse crypto or NFT investment offers as they can be prone to rug pulls, also known as "pump and dump" schemes.

3) Look beyond the flashy marketing and don't fall for the hype.

4) Verify information by making real-world contact.

Most investment offerings are regulated and our Division's Examiner of the Day phone line at 608-266-2139 can help answer questions about securities registrations and exemptions.

DON'T MISS THE NASAA SENIORS PRESENTATION

The North American Securities Administrators Association (NASAA) Senior Issues and Diminished Capacity Committee develops tools, resources, and educational materials to address seniors and individuals with diminished capacity and to assist firms in monitoring for cognitive issues, spotting financial exploitation, and supervising advisors who may have cognitive impairment. In addition, the committee keeps informed on emerging research relating to financial exploitation and issues impacting senior and vulnerable adult investors.

On Thursday, November 3, 2022, at 1:30 pm CT, the committee will present the third episode of NASAA's Senior Issues and Diminished Capacity Committee webinars called "Securities Regulators and Adult Protective Services Agents Speak." This webinar will provide a great opportunity to hear directly from knowledgeable securities regulators and adult protective services professionals who work to combat at-risk investor abuses. They will discuss issues they confront and the methods they use to mitigate exploitation.

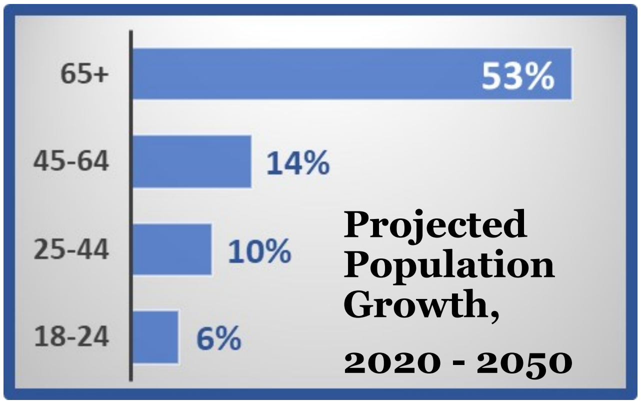
The panel will discuss the new trends they are seeing, enforcement work to stop fraudulent activity, multidisciplinary teams working at the local, state and federal level, training and education initiatives and more. Their discussion will include how the SEC, FINRA, the states and Adult Protective Services agencies work together against financial exploitation.

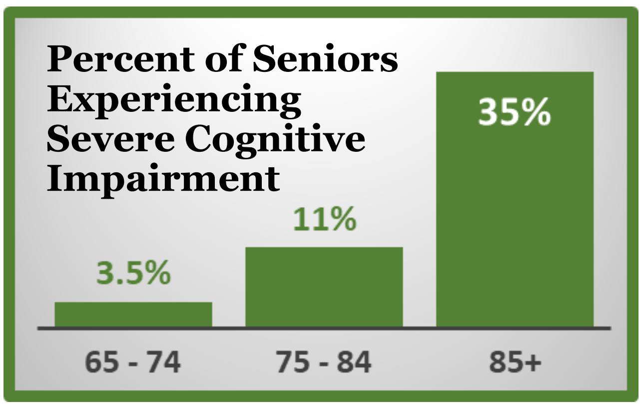
The complimentary, 90-minute webinar is open to the public and will provide benefits to anyone interested in learning about vulnerable/retirement-stage investor protection issues. To meet the speakers and register for the webinar, go to NASAA's website.

The committee's first two episodes of their series of webinars regarding senior issues are available on NASAA's website. Episode one, titled "NASAA's Senior Issues and Diminished Capacity Committee Presents," launched the webcast series, which was created to address issues relevant to those dealing with at-risk investors. In the second episode, "Financial Service Industry Speaks," speakers from the financial services industry discuss how they work within their firms and with other stakeholders to mitigate vulnerable investor harm.

We encourage you to register for the November webinar and consider viewing the prior episodes to learn more about issues impacting senior and vulnerable adult investors.

ARE YOU COLLECTING TRUSTED CONTACT INFORMATION?





In our Fall 2021 newsletter, we discussed FINRA Rule 4512, which requires broker-dealer agents to ask clients to identify a trusted contact. Since that time, we've received questions from investment advisers about the use of trusted contact forms and other steps advisers can take to help protect seniors and other vulnerable investors against potential financial exploitation.

With financial fraud and scams continuing to increase, and the projections for a much larger population of older adults over the next few decades, it is more important than ever for investment advisers to be aware of the myriad of financial threats faced by their clients, regardless of age and cognitive ability.

One crucial step advisers can take to protect their clients is to encourage them to designate a trusted contact. A trusted contact designation provides a secondary contact person that you can reach out to if you notice suspicious activity concerning a client's account or have concerns about a client's wellbeing.

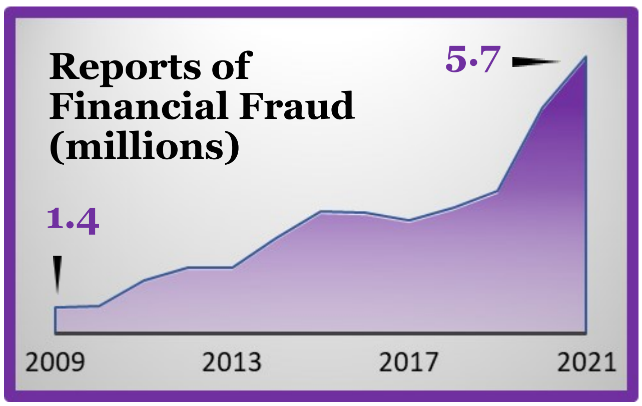
In addition to asking your clients to designate a trusted contact, it is also important to make sure they understand what a trusted contact is and is not - for instance, a trusted contact does not have the authority to direct transactions in an account. FINRA and NASAA have some talking points available that may be helpful to you when discussing trusted contacts with clients. To present the option of a trusted contact in a manner that helps clients realize its importance,

TRUSTED CONTACT INFORMATION CONTINUED...

you can:

- Simplify the information you provide them
- Inform them of the prevalence of financial exploitation and fraud
- Point out that other investors regularly identify a trusted contact person
- Present the option to designate a trusted contact as an active choice (for example, they should check "yes" or "no") *

  * Sourced from https://www.osc.ca/sites/default/files/2020-11/rule_20201109_11-790_protecting-aging-investors-through-behavioural-insights.pdf



If you would like help getting started drafting a trusted contact form, please contact Securities Examiner Lily Castonguay at (608) 440-0541 or lily.castonguay@dfi.wi.gov.

Chart References

Chart: "Projected Population Growth, 2020 – 2050" sourced from U.S. Census Bureau,

https://www.census.gov/data/tables/2017/demo/popproj/2017-summary-tables.html

Chart: "Percent of Seniors Experiencing Severe Cognitive Impairment" sourced from U.S. Dept of Health and Human Services,

https://aspe.hhs.gov/reports/risk-costs-severe-cognitive-impairment-older-ages-literature-review-projection-analyses-0#results

Chart: "Reports of Financial Fraud" sourced from Federal Trade Commission,

https://www.ftc.gov/system/files/ftc_gov/pdf/CSN%20Annual%20Data%20Book%202021%20Final%20PDF.pdf

ENFORCEMENT UPDATES

The North American Securities Administrators Association (NASAA) recently released its annual Enforcement Report based on 2021 data collected from all states, including Wisconsin.

The Enforcement Report highlights investigations and actions taken by state regulators (enforcement, criminal, civil and administrative), and penalties imposed (e.g., restitution and fines). The report identifies the most common types of fraud schemes and securities related problems such as promissory notes, energy, internet and social media, digital assets, precious metals and the metaverse. One of the main goals of the states is to proactively protect older investors.

The report also contains a breakdown of licensing activity. As usual, states were successful as gatekeepers to prevent "bad actors" from entering or remaining in the securities industry. State securities regulators continue to promote compliance by taking appropriate steps to identify, investigate and address violations by registered firms.

Here are some updates regarding Division cases against former registrants:

Last year, the Division issued an order against **Michael Shillin and Shillin Wealth Management** barring them from future registration. On August 25, 2022, following a plea agreement, Shillin was sentenced in federal court four to seven years in federal prison and five years of supervised release.

The charges against Shillin alleged he 1) misrepresented to certain clients that they had successfully subscribed for IPO or pre-IPO shares in high-profile companies when they had not, and lied to clients about the true value of their investment portfolios; 2) provided certain clients with fabricated account statements and fraudulent tax documents; 3) encouraged advisory clients to purchase insurance policies that were non-existent or had fewer benefits than Shillin claimed, and 4) received hundreds of thousands of dollars (through commissions and advisory fees) as a result of his fraudulent conduct. He also used fraudulent collateral to obtain bank loans that totaled over $450,000.

The full press release from the U.S. Attorney's Office Western District of Wisconsin is available here.

On August 4, 2022, the Division issued a final order by consent to cease and desist, revoking exemptions, barring registrations, and imposing restitution and penalties against **Anthony Liddle and Prosper Wealth Management**. The final order by consent includes restitution to 12 investors

ENFORCEMENT UPDATES CONTINUED…

in the amount of $1,683,727 and $25,000 in penalties.

Liddle had coaxed investors to write checks to his "doing business as" (DBA) investment advisory firm for investments that were never made because Liddle used the funds for personal and business expenses, purchasing a house, to pay down debt and to make monthly payments to certain investors so they believed their investment had been made. His victims were mostly older investors.

The full order is available here.

Images courtesy of various creators at Pixabay.com

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.