

# Investment Adviser Newsletter



## Department of Financial Institutions Launches New website

We are excited to announce the launch of the Department of Financial Institution's (DFI) new website. The website has a fresh new look with easy navigation to securities-related topics. The website address has changed to [dfi.wi.gov](http://dfi.wi.gov). Remember to update your bookmarks!

Click on the Securities tab on the homepage to navigate to information on investment advisers, broker-dealers, securities filings and investor education. Access our [Investment Adviser](#) and [Registered Representative Registration](#) pages for resources specific to investment adviser and investment adviser representative registration. As in the past, archived editions of our [Investment Adviser Newsletters](#) are available on the website. Within the footer of the [website](#), you'll find a link for [A to Z Contact Information](#) searchable by topic to easily find a link to the corresponding page or contact information.

Read the DFI's website launch [news release](#) for more information.

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# Continuing Education For Investment Adviser Representatives In 2023



Last year, Wisconsin published [Chapter 11 of the securities administrative code](#), which sets out annual continuing education (CE) requirements for investment adviser representatives (IARs) of both state-registered and SEC-registered investment advisers. These requirements went into effect January 1, 2023, so IARs are now taking and reporting CE credits in 2023.

The new CE rule requires that every IAR complete 12 continuing education credits annually to maintain their IAR registration. The 12 credits must include 6 credits of Products and Practices courses and 6 credits of Ethics and Professional Responsibility courses.

In addition to Wisconsin, continuing education (CE) is currently required this year by the following states: Arkansas, Kentucky, Maryland, Michigan, Mississippi, Oklahoma, Oregon, South Carolina, Vermont, and Washington DC. However, this is a national program so compliance with the Wisconsin rules will bring you into compliance with any of the listed states where you are registered. Additional states are in the process of adopting CE requirements with an effective date of 2024.

Wisconsin's IAR CE rules provide for the following:

- IARs are free to select and complete CE courses that are the best fit for their interests and business models. The [list of approved CE providers](#) is maintained on the North American Securities Administrators Association's (NASAA's) website with links to the providers' websites and course offerings.
- CE providers report the completion of courses to FINRA for purposes of tracking CE completion. IARs can create an account on [FINRA's Financial Professional Gateway](#) (FinPro) to monitor their CE status and course completion.
- IARs dually registered as broker-dealer agents may apply their FINRA Regulatory Element training to receive 6 credits of Products and Practices training.
- 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."

The Wisconsin Division of Securities is an approved CE provider and will soon post its first course through the NASAA website. Stay tuned – we'll send out an email when the course is available.



## Continuing Education Continued

Additional guidance 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](mailto:Deborah.Fabritz@dfi.wisconsin.gov).

### The Division Observes Common Exam Deficiencies

Certain exam deficiencies tend to occur more than others. Discussed below are some of the deficiencies that Division examiners have frequently found during recent examinations of state-registered investment advisers.

#### **Fee Disclosures**

It is important for your client to have a clear understanding of how they will be paying for your investment advice, and how much they will be paying in total. The client should be able to reconcile the investment adviser's invoice with their account statement from the custodian. The invoice sent by the investment adviser will typically include more detail than what appears in the custodial statement.

In general, the fee schedule disclosed in your ADV 2A should match the fee that appears in the client's written agreement and invoices. Billing practices and calculation methods should also match

across your books and records.

Here are some important fee-related questions and points for investment advisers to consider:

1. Do I bill monthly or quarterly? In advance or in arrears? Remember to include the time period covered by the fee on the invoice.
2. Which value am I using as the basis for the fee? The average assets over the period, or the first/last day of the billing period?
3. Do I include significant contributions/withdrawals made during the billing period in the fee? If so, what is the threshold?
4. Do I provide advice on and charge on assets held away? Does the fee differ from assets under management? From which account(s) are these fees directly deducted? How is this shown in the invoice?

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## Exam Deficiencies Continued

5. If a client relationship is terminated in the middle of a billing period, how is the fee or refund calculated?
6. For hourly fees, include the number of hours billed and the hourly rate. Include a description of the services or deliverables provided.

### **Suitability Documentation**

Examiners are finding that many advisers are missing or have incomplete suitability documentation. This can be a problem for the adviser should the client seek to hold the adviser accountable for a poorly performing investment that may not have been appropriate or suitable for the client.

At a minimum, each investment adviser must keep a record of their clients' net worth, income, experience, investment objectives and other information necessary to make and support investment recommendations to their clients. This

\$100,000 for income or \$500,000 - \$1,000,000 for net worth. If your clients invest in certain exempt securities that are available only to accredited investors, be sure to retain documentation that verifies the investors' accredited status.

If your investment strategy utilizes less traditional, complex investments or private placements, then you should take extra care to document your clients' experience with these complex products and any other information that confirms your client understands how the investment returns are generated and the risks associated with the investment.

### **Missing Client Agreements**

It is important for all of your clients to have an understanding of the scope of services you will be providing to them and that you are both on the same page when they agree to have you manage their assets. The client

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**“Examiners are finding that many advisers are missing or have incomplete suitability documentation”**

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information should be kept current and updated when material changes are made to any of the above items. For example, major life changes such as retirement, marriage/divorce, inheritance, or a promotion can be considered material and should be documented by the adviser.

If clients are not comfortable providing their exact income or net worth, encourage them to instead provide a range. For example, \$0-\$50,000 or \$50,000 -

agreement documents significant aspects of your relationship such as the authorization for discretionary trading and fee charges.

Investment advisers are required to maintain signed written agreements for each client, even if their clients are family members and even if you are not charging them a fee. If your family member client does not pay you a fee, that should be disclosed in the contract.

## Exam Deficiencies Continued

### Social Media Account disclosures

Many investment advisers have social media accounts on websites like Facebook, LinkedIn, Twitter or others. These accounts need to be disclosed on Section 1.I. of Schedule D of your ADV Part 1. If you no longer use these accounts, then you should close down the account and remove it from your ADV Part 1.

### Current Supervisory Procedures

Since each firm registered in this state is required to keep current written supervisory procedures (“compliance manual”), remember to update your compliance manual when you change your billing practices and fees. In your manual, you should also include procedures that describe how you obtain and keep current suitability documentation along with

signed written agreements for all of your clients. It is also a best practice to review your compliance manual annually to verify your procedures are up to date and current with any new rules or rule changes.

### Rule references:

- i. Invoices: [5.035\(1\)\(f\)2b](#) and [5.05\(13\)](#)
- ii. Contracts: [5.05\(2\)\(d\)](#) and [5.05\(5\)](#)
- iii. ADV Part 2A: [5.05\(8\)\(a\)](#) and “General Instructions for Part 2 of Form ADV” ([SEC link](#))
- iv. Suitability documentation: [5.03\(2\)\(c\)](#) and [5.06\(4\)](#)
- v. Supervisory procedures: [5.05\(1\)](#)
- vi. ADV Part 1: “General Instructions for Part 1 of Form ADV” ([SEC Link](#))

If you have any questions about these common exam deficiencies, please send an email to [Carlo.Reiter@dfi.wisconsin.gov](mailto:Carlo.Reiter@dfi.wisconsin.gov).



## Tips for a Successful Exam

At the heart of DFI’s mission is to ensure the safety and soundness of Wisconsin financial institutions while protecting the investing public. One of the ways that the Division of Securities fulfills that mission is by conducting field exams of our state-registered investment advisers to ensure compliance with the Wisconsin Securities Law and administrative code.

The exam process also enables our securities examiners the opportunity to get to know our registrants. The Division understands that exams can be temporarily disruptive to firms because they divert time and attention away from normal operations. Therefore, to ensure that exams go smoothly and are a positive

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## Tips for a Successful Exam Continued

experience for both the firm and the Division, we have compiled the following tips for a successful exam.

### **1. Organize your documents**

During the scheduling process, examiners provide firms with a list of books and records that the examiners plan to review. Admittedly, the list can appear fairly daunting at first glance. We also know that no two firms are exactly the same and some of the items on our request will not be applicable – you’ll be expected to provide only the applicable documents.

During the start of the pandemic, the Division began conducting exams remotely via Microsoft Teams in lieu of in person exams. We also asked advisers to upload the requested documents to ShareFile before the day of the exam. While we have returned to traveling around the state to conduct our exams in person and on-site (weather permitting), we have continued utilizing ShareFile to facilitate the exam process. When firms upload documents prior to the exam, Division staff are able to better prepare and make the day of the exam more efficient.

Regardless of whether the firm is able to upload all of the requested documents to ShareFile, please let the examiner know which files are being provided ahead of time electronically, which will be available in person, and which are not applicable. For documents provided on-site, it’s helpful to identify them with the number of the request from the books and records list.

### **2. Be accurate and forthcoming**

Perhaps the most impactful thing you can do to make an exam go well is to be open and honest with the examiner. Being obtuse or mincing words is likely to increase the time

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**“Perhaps the most impactful thing you can do to make an exam go well is to be open and honest with the examiner”**

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needed to complete the exam. For instance, if an examiner asks if you maintain current, up-to-date client suitability documentation, don’t say, “yes” if you really just keep it in your head based off past discussions. When we then verify the presence – or lack of – client suitability documentation, any misrepresentations will likely impact the duration and/or outcome of the exam.

### **3. Ask questions - don’t assume**

At any stage of the exam process, we welcome your questions, especially if this is the first time your firm is being examined. We might refer to a



## Tips for a Successful Exam Continued

document or record as one thing but you identify it another way. It's much better to clarify a point of confusion right away than to incorrectly assume something that later takes time and energy to untangle.

### **4. Have space for us**

Division examiners often conduct firm exams in dedicated business offices of the adviser. However, we also go to residential homes and have been dismayed to find that the adviser has expected us to conduct the interview and review documents in a basement, closet or other cramped or uncomfortable space. We don't need much, but it's preferable for us to work from an office desk or dining table. If you don't have an office and your residence doesn't lend itself to the examination process, let us know and we'll discuss alternatives such as an exam at our office in Madison.

### **5. Participate in exam follow up**

After the day of the exam is over, the examiner continues reviewing information collected before and during the exam, as well as anything produced in response to a follow up request. After the completion of the review process, the examiner will produce an invoice and exam letter detailing the findings of the exam along with any required updates or actions to be taken by the adviser. It's important to follow through with the required actions and promptly pay the invoice. The exam will not be closed until both steps have been completed.

### **6. Stay current and informed**

The Division's exams are a great way for firms to make updates and ask the examiner(s) questions about changes in the regulatory space. However, if you have questions outside of the exam timeframe, please feel free to reach out to us with your questions. We realize that the majority of our registered investment advisers do not have compliance departments to stay on top of every regulatory development. While we can't give legal advice, we can be a resource for our registrants.

Beyond asking us questions individually, another way to stay current is to read the Division's newsletters. We strive to address timely, helpful topics with these articles that often describe best practices. If you have suggestions for future topics, please let us know.

## Handle Customer Complaints with Care



Investment advisers should respond to client complaints with the appropriate level of care. Below are recommendations to help ensure you are meeting Wisconsin regulatory requirements.

### What is a complaint?

Under [DFI-Sec 5.03\(1\)\(h\)](#), “complaint” means any written or oral statement of a client, or any person acting on behalf of a client, alleging a grievance. It does not matter whether the complaint is verbal or in writing, nor whether the complainant is a client, a former client, or a third party or family member representing that client. The definition does not require that the complainant use the word “complaint.”

### Plan ahead

[DFI-Sec 5.05\(1\)](#) requires advisers to establish supervisory procedures, which in turn should be where you document your procedures for handling complaints. Don’t wait until your first complaint to create your procedure! Having an established procedure in place will help guide you through the process and ensure you are meeting your business and regulatory requirements along the way. Consider including in your procedure the name of the contact person who will be handling complaints, the expected turn-around time for responding to a complaint, record retention requirements, and a brief description of when complaints should be reported on a Form U4 and/or to the Division of Securities.

### Documentation is your friend

Clients are happy, until they’re not. Although it can feel comfortable to discuss portfolio changes with a client via a friendly verbal conversation, recognize that interpretations and memories of what was discussed and agreed to during that meeting can differ, especially over time. If you are not already doing so, get into the habit of taking notes during or promptly after your meetings to document what was discussed and any actions or changes to be implemented. You may also want to create a summary and email it to the client. That way, not only is your discussion documented for future reference, but the client will have a chance to review the planned changes and share any concerns, which can help prevent complaints before they occur.

### Tips for when complaints occur

1. Don’t panic! And don’t take it personally. This is a chance for you to problem-solve and demonstrate your customer service skills.
2. Notify the appropriate personnel, such as a supervisor or CCO.
3. Contact the complainant as soon as possible, and listen to their concerns. Make sure you fully understand their complaint before taking any action.
4. Apologize and offer solutions to resolve the complaint, if appropriate under the circumstances. Work with the client to address the concerns and/or find an agreeable solution.





# Customer Complaints Continued

- 5. Document the complaint and the firm’s responses. Include copies in your complaint file.
- 6. Follow up with the client, if appropriate.

### What to keep in your records

[DFI-Sec 5.03\(1\)\(h\)](#) requires advisers to create a dedicated complaint file and keep it current. During an exam, the examiner will ask to review your complaint file. Complaint records must be kept for a minimum of 5 years, and must contain:

- All complaints made by clients relating to investment activities
- All investigative inquiries made by law enforcement or securities regulatory authorities regarding the investment advisory business
- Evidence relating to the above
- Copies of the firm’s response to the above

### When to report complaints to DOS

Under [DFI-Sec 5.04\(2\)](#), copies of complaints must be sent to the Division of Securities within 20 days of the date the complaint is served only if the adviser or any of its reps is:

- A defendant in a civil or criminal proceeding
- The subject of any administrative or disciplinary proceeding by any public or private regulatory agency

Planning ahead and having specific procedures for handling client complaints can help the complaint handling process go more smoothly by preventing violations of Wisconsin rules and avoiding other missteps. Feel free to call the Examiner of the Day phone line at (608) 266-2139 with any questions.



# Do You Have Business Continuity and Succession Plans?

As our Division conducts examinations of your advisory business, we may ask if you have a business continuity and succession plan. We have noticed a significant number of advisers do not have these plans and while it is not currently a regulatory requirement, it is a best practice for all firms to have a plan in place to meet your fiduciary duties to your clients.

## Succession Plans Continued



Business continuity planning is critical to your firm's ability to continue daily operations in the event of a significant disruption of your business caused by natural disasters, health issues or other unexpected events. Since many of our investment advisers in Wisconsin are small one-person firms, it is especially important to have plans in place to minimize disruptions in operations and to reduce recovery time in case of a catastrophic event. Business continuity plans should be in place for all advisers, regardless of age, since none of us can predict everything that lies ahead of us.

The details of your firm's business continuity plan will depend on your firm's business model, size, number of clients and other factors specific to your firm. Once your firm has a plan in place, you should periodically review and test the plan to ensure it is adequate and updated to reflect any changes in the firm's business practices or personnel assigned specific designated duties.

A similar type of planning takes place when an adviser expects to transition out of the advisory business. Our population of investment advisers is aging and a recent [report](#) estimates 40% of advisory assets will transition by 2030 due to advisers retiring. If you are within 15 years of retiring, it makes sense to consider developing a succession plan to facilitate a planned exit from the industry. A plan could involve your business merging with another investment adviser or simply passing the clients to another employee or registered family member. If you are years away from retirement and circumstances impact your succession plan, you'll have time to revise the plan.

The North American Securities Administrators Association (NASAA) issued a Guidance on Business Continuity and Succession Planning for State Registered Investment Advisers and adopted a model rule in April 2015. The Guidance provides helpful information, case studies, and questions for state-registered advisers to consider when creating a plan for significant business interruptions or unexpected succession situations. To read the NASAA Model Rule on Business Continuity and Succession Planning and IA BCP Rule and Guidance, go [here](#) (link will download a .PDF file). Wisconsin has not yet adopted the model rule but could do so in the future.



## DFI Settles with Crypto Platform Nexo Capital

The Wisconsin Department of Financial Institutions and several other states, along with the SEC, reached a settlement agreement with Nexo Capital Inc. (Nexo) in regards to enforcement action taken against Nexo's Earn Interest Product (EIP) program. This program enabled investors to earn interest on digital assets that they loaned to Nexo, making claims such as "Nexo is safer than your average bank." However, the EIP program was not registered (nor exempt) as a security in Wisconsin--nor in any other U.S. state--and Nexo failed to disclose material facts to its investors, such as the product's material risks and the firm's own financial solvency.

The total settlement amount is \$45 million, with the states and the SEC both receiving \$22.5 million. As part of the agreement, NEXO will phase out this program and other products and services in the United States. The DFI recommends Wisconsin investors withdraw all assets from Nexo platforms.

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

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



## Enforcement Bureau Sees Increase in "Pig Butchering" Scams

Romance scams are scams in which the fraudster pretends to build a romantic relationship with the victim in order to convince the victim to send the fraudster money. According to [Chainalysis](#), romance scams are the most destructive scams on a revenue-per-victim basis, averaging almost \$16,000 in loss per victim, nearly triple the next closest category of fraud.

Romance scams also include "pig butchering" scams, which blend elements of romance scams and investment scams. The scammers are often based in Asia, where the con is known as "pig butchering"—a reference to the practice of first "fattening" the victim's cryptocurrency account with fake gains before stealing all of their money. Last year, "pig butchering" scams cost U.S. victims more than \$429 million in losses, according to the FBI's Internet Crime Complaint Center. The Division of Securities is seeing an increase

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## “Pig Butchering” Scams Continued

in this type of scam.

Like romance scams, “pig butchering” scams focus on building trusted relationships. The scammers create fake social media accounts and dating site profiles showcasing lavish lifestyles and send random messages to connect with victims through sites like WhatsApp or Tinder. While the scammers are building the relationship, they are also acquiring financial information about the victim. Eventually the scammer will convince the victim to set up digital currency accounts through which money can be moved internationally in seconds.

The scammer usually refers the victim to a bogus website or app that looks authentic but is controlled by the scammer. The victim is encouraged to initially invest a small amount in cryptocurrency and the scammer will make sure to post a modest gain on the investment. As the fake gains increase, the victim invests larger amounts on the fake platform, and may even encourage family members to also invest.

When the victim tries to withdraw the profits, the scammer will double down, telling the victim to deposit additional assets to pay for fees or taxes before a withdrawal will be processed. Once the scammer has taken all of the victim’s funds, the scammer disappears, resulting in significant losses to the victim.

Cryptocurrency scams have bilked billions of dollars from unsuspecting investors worldwide and most people don’t recover the money. Victims of such scams should report the losses to their bank, the [FTC](#), the [Internet Crime Center](#), the Wisconsin Division of Securities and/or the [local FBI office](#) as soon as possible. The longer someone waits, the harder it is to trace stolen funds.

### Connect with DFI on Social Media

Visit the DFI’s Social media profiles on [Facebook](#), [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.

