



State of Wisconsin
Department of Financial Institutions
Strengthening Wisconsin's Financial Future

Investment Adviser Newsletter

Fall 2013

This is the third edition of our periodic newsletter from the Wisconsin Division of Securities to investment advisers registered in our state. We welcome your suggestions for future content.

Renewal Season

It's almost time to renew your firm, individual and branch registrations for the next year. Your renewal statement will be available through IARD beginning on November 11th and all renewal payments are due on December 13th. Check your email inbox for a November 1st email sent by our Division regarding 2014 registration renewals. If you have questions regarding your annual renewals, please contact our Examiner of the Day phone line at (608) 266-2139.

Avoiding Common Deficiencies in ADV Part 2

In order to be registered as an investment adviser in Wisconsin, Form ADV Part 2 must be uploaded to the IARD website (www.iard.com) to be reviewed by a securities examiner. To avoid common deficiencies during on-site examinations, please follow these guidelines:

1. Ensure all 19 items in Part 2A are addressed. For example, if an item such as performance-based fees does not apply to your firm, simply state that your firm does not charge performance-based fees. Do not omit a non-applicable item – this results in an incomplete ADV Part 2.
2. Make sure that the fee schedule listed in Item 5 of Part 2A matches the fee schedule in your investment advisory agreement or contract.
3. State whether fees are billed in advance or in arrears in Item 5 of Part 2A. This section should be consistent with your investment advisory agreement or contract.
4. If your firm has discretionary authority to manage securities on behalf of your clients, indicate this authority in Item 8 C of Part 1 and include a description in Item 16 of Part 2A. You must also discuss any restrictions or limitations imposed by your clients.
5. Update references from "ADV Part II" to the newly adopted notation "ADV Part 2".

Documenting Your Client's Risk Tolerance

Risk tolerance assessment is a fundamental part of your fiduciary duty. Wisconsin Rule 5.032(c) requires an adviser to “maintain written information, investment objectives, and experience and such other information necessary ... to determine the suitability of any investment recommendation or investment advice to the client.” This information should be updated anytime the adviser receives new information from the client affecting risk tolerance.

Risk tolerance is the client's emotional risk tolerance and the adviser's perception of the client's risk tolerance. Studies show that people feel the negative effects of a financial loss more intensely than the positive effects of a gain. As a result, a client may overestimate his or her ability to handle loss when discussing risk tolerance. The adviser's risk assessment of the client requires the adviser to use their knowledge of the market's historical investment risk and return, and then balance it against the client's emotional threshold for loss.

“Cookie-cutter” questionnaires may not provide a complete picture of a client's risk tolerance. Instead of “Are you more or less aggressive than the average investor?” (who is this average investor anyway?), an adviser might ask, “If your entire investment portfolio is down 20% two years from now, what would you do?” This information should be supplemented with other relevant documents, such as copies of financial profiles, trusts, wills, death certificate copies, family member health care powers, and tax records. As a best practice, questionnaires should be updated every three years.

By creating a thorough and effective assessment policy, an adviser can keep a complete client picture on file, as well as documentation for regulators to verify during periodic examinations. Best practices for client files include an up to date client contract describing the adviser's services and obligations, ongoing documentation of risk tolerance factors, and client specific notes used for reference in making recommendations. When the adviser's ongoing assessment of a client's suitability and risk tolerance, contract for services, and ADV Part 2 all align with the investment strategy recommended by the adviser, the adviser is going a long way toward meeting your fiduciary obligation (i.e., loyalty, care, utmost good faith, etc.).

Reg D General Solicitation Changes

Earlier this summer, the SEC issued its final amendments to Rule 506 as directed by the passage of the JOBS Act. Those amendments lifted the ban on general solicitation for securities issued under the Rule 506 (Reg D) exemption. On September 23, 2013, this amendment went live, allowing solicitation of Reg D securities to accredited investors through 506(c) offerings.

For issuers of 506(c) offerings that forgo using a broker dealer and instead advertise directly to the public, the responsibility for due diligence, ordinarily conducted by a broker dealer, is passed on to the investment adviser recommending the offering.

For investment advisers planning on utilizing these offerings for their clients, it is reasonable to expect a heightened level of scrutiny from state regulators with regard to these offerings. In order to show due diligence, advisers should, at minimum, be able to provide documentation that a Reg D has been filed with the SEC and that a background search has been performed which verifies that the issuer and all affiliates are not disqualified as “bad actors” under the Reg D 506 provision. In addition, any red flags should be investigated by the adviser. Examiners will also review client records for suitability and compliance procedures for 506(c) securities.

More information about the amendment can be found via the [SEC’s factsheet](#) or by viewing the amended code directly at www.ecfr.gov.

Switch Update

In 2012, mid-sized investment advisers with assets under management between \$25 and \$100 million were required to switch from SEC to state registration. As a result, 54 advisers registered with the Wisconsin Division of Securities, including 31 located in Wisconsin. We have now completed the on-site examinations of those 31 investment advisers, and are pleased to report that the advisers are, for the most part, in compliance with books and records requirements. Some of the more common deficiencies or concerns included issues relating to invoices, client contracts, and custody.

NASAA Announces IARD System Fee Waiver

The North American Securities Administrators Association (NASAA) recently announced the waiver in 2014 of the Investment Adviser Registration Depository (IARD) system fees for investment adviser firms and the continuation of substantially reduced initial set-up and annual system fees paid by investment adviser representatives (IARs). For 2014, the initial IARD set-up and system fee will be \$10 for IARs. This fee was \$45 when the IARD system first became operational and is separate from the state registration and renewal fees.

DOS Staff Updates

This summer, we welcomed two new examiners to our Division of Securities team: Lindsay Fedler and Joseph Friesen. Lindsay is a recent graduate of the UW-Madison Law School. Joe had been with the Division in another role since September 2012. Lindsay and Joe

join Examiners Mark Eisenmann, Judy Wilson, and Charles Benson in the Professional Registration & Compliance Bureau.

Contact an Examiner

If you have questions relating to professional registration and/or compliance, please feel free to contact our Examiner of the Day phone line at (608) 266-2139.

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Please forward your ideas for future newsletter topics, events or other communications to the investment adviser community to Bureau Director Deborah Fabritz at deborah.fabritz@wisconsin.gov.