



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

Investment Adviser Newsletter

Fall 2016

Our periodic newsletter for investment advisers registered in Wisconsin is published twice per year. Past editions can be found at: <http://wdfi.org/fi/securities/registration/iaNewsletter.htm>

Time to Renew for 2017

It's almost time to renew your firm and individual registrations through IARD (Investment Adviser Registration Depository). Your renewal statement will be available on IARD beginning on November 14th. Renewal payments for firm, individual, and branch registrations are due on December 16th. Other important dates are listed in the 2017 Renewal Program Calendar: https://www.iard.com/sites/default/files/2017_renewal_calendar.pdf If you have any questions regarding the renewal process or your status, please contact either the IARD Call Center at (240) 386-4848 or our Examiner of the Day at (608) 266-2139.

Client Passwords and Fraud Protection

When managing a client's account, an investment adviser typically establishes a formal limited power of attorney through the custodian, giving the adviser account access, trading functions, and fee withdrawal privileges. The investment adviser's agreement with the custodian links the clients' accounts to the adviser's master account. If instead, the adviser accesses a client account online with the client's username and password, the adviser is essentially impersonating the client which raises numerous compliance and regulatory concerns.

Therefore, when investment advisers are offering software help or providing other conveniences or services to their clients, it is crucial that the clients not share their custodial log-in information, including passwords. The issues that are triggered by password sharing include: creating client custody, circumventing books and records requirements, and violating the client's user agreement with their custodian which may cause clients to lose custodian-

provided fraud protections. Any of these issues can increase the adviser's liability to the client and result in exam deficiencies.

Custody is one of the first concerns identified by regulators when they learn that an adviser is accessing client accounts with client usernames and passwords. Advisers who do this have custody of client accounts and must therefore comply with the additional custody requirements under [DFI – Sec 5.035](#) such as maintaining an appropriate net worth.

With respect to books and records, advisers are required under [DFI – Sec 5.03\(1\)\(f\)](#) to maintain a memorandum of each order given by the adviser for the purchase or sale of securities; advisers usually use the trade blotter from the custodian to meet this requirement. However, if using the client's username and password to buy/sell securities, it is not possible for the adviser to use the custodian's trade blotter to create an order memorandum.

Concerning the risk to fraud protection, if the adviser knows the client's password, the client's fraud protection may be diminished or nullified depending on the situation and the custodian's account coverage. The limits exist because once the client shares a personal password, it implies the client is granting the adviser authority to all of the client's account user privileges such as changing addresses and transferring assets. Further, when the client shares their password with a third party (i.e., the adviser), the fraud protection does not cover the client if the adviser's computer system is breached by malware. Similarly, the client's fraud protection could be voided if an employee in the adviser's firm obtains the password and misuses it or is negligent when performing actions in the account.

Conflicts of Interest

Under state law, investment advisers are fiduciaries and must make full disclosure to their clients of all material facts relating to the advisory relationship. As a fiduciary, you also must seek to avoid conflicts of interest with your clients, and, at a minimum, make full disclosure of all material conflicts of interest between you and your clients that could affect the advisory relationship.

This obligation requires that you provide the client with sufficiently specific facts so that the client is able to understand the conflicts of interest you have and how they affect the business practices in which you engage, and can give informed consent to such conflicts and practices or reject them.

The best place to disclose conflicts of interest is within the relevant items of Form ADV Part 2. Common conflicts of interest include, but are not limited to, the following:

- Acting as broker-dealer agent (i.e., transaction-based compensation along with investment advisory fees)
- Effecting insurance sales
- Recommending proprietary products
- Allowing soft dollar arrangements
- Accepting other fees including brokerage and insurance compensation

Always remember to disclose outside business activities, since they can often lead to conflicts of interest.

What Does the New DOL Rule Mean for You?

Investment advisers already have fiduciary obligations to their clients, so they may believe that the Department of Labor's controversial fiduciary regulation does not impact them. However, the DOL's extension of fiduciary responsibilities under the Employee Retirement Income Security Act (ERISA) may affect an adviser's business. Helping clients roll over a retirement account or receive a retirement plan distribution can subject an adviser to the rule, and certain activities that are deemed "prohibited transactions" will require compliance with a "best interest contract exemption" for those transactions to move forward. The exemption requires a contractual agreement documenting, among other things, the rationale behind the investment recommendation.

Following the adoption of the new Department of Labor Rule last April, there are two deadlines: April 10, 2017, and the full implementation date of January 1, 2018. Transactions prior to April 10, 2017 are not subject to the new rule. During the time between the partial implementation on April 10, 2017, and the full implementation date of January 1, 2018, firms are to adhere to "impartial conduct standards," which in general require advisers and financial institutions to:

- Act in the client's best interest
- Charge no more than reasonable compensation
- Make no misleading statements about investment transactions or compensation
- Disclose any conflicts of interest

On January 1, 2018, firms need to be fully compliant with the DOL rule and if receiving commissions, fees and revenue sharing on retirement accounts, will enter into a Best Interest Contract (BIC) with clients. This means that firms, including advisers, will need to document their processes for accounts subject to the DOL rule, provide training to staff, review advertisements and other materials presented to the public or clients, and revise policies and

procedures as necessary.

Fiduciary duties apply to all accounts subject to the DOL Rule. Your fiduciary duty is comprised of mainly three parts:

- Loyalty - do what is in the client's best interest
- Care - know your products and how to advise clients
- Utmost good faith - do not withhold anything from your client

Although there are some exceptions, essentially any tax-deferred account is subject to the new DOL rules. The rules apply to your advice on the source of money (i.e., advice on a 401K rollover), application of advice (i.e., while retirement money is managed), and any recommendation to withdraw or annuitize funds. Under the DOL rules, you are required to document the facts and circumstances supporting your advice. For example, you will need to document details on why you gave advice to move a client's money from a 401K plan to a retirement account managed by your investment advisory firm.

Receiving both fees and commissions is a conflict under the rule. Firms that charge fees and commissions (e.g., dual registrants) are subject to the new BIC exemption, and will be required to enter into contracts with their clients that memorialize how the clients' best interests are served. The DOL rule does not dictate the type of compensation a firm or representative can charge, only that the firm enter into a BIC with a client if there is a conflict or prohibited transaction.

The DOL recently released its first set of FAQs, consisting of 34 questions and answers that provide further guidance on the fiduciary rule: <http://bit.ly/2dMctqQ>

For "level fee" fiduciaries, the BIC exemption provides streamlined relief, sometimes referenced in the industry as "BIC Lite." As described in the FAQs (Q13), "level fee" fiduciaries are those who receive a fee or compensation on the basis of a fixed percentage of the value of the assets or a set fee that does not vary with the particular investment recommended. Level fees do not include commissions or other transaction-based fees (including 12b1s, revenue sharing, etc.). A level fee fiduciary can either meet the streamlined conditions of the BIC exemption or can avoid prohibited transactions by executing the Best Interest Contract with clients and complying with the conditions of the full BIC exemption.

Two more sets of FAQs are expected from DOL in the future so please stay tuned.....

A GUIDE FOR DEVELOPING PRACTICES
AND PROCEDURES FOR PROTECTING
SENIOR INVESTORS AND VULNERABLE
ADULTS FROM FINANCIAL EXPLOITATION

NORTH AMERICAN SECURITIES
ADMINISTRATORS ASSOCIATION



Resources to Help Serve Senior Investors

Your ongoing relationships with clients place you in a unique position to identify signs of diminished capacity or red flags indicating possible financial exploitation. Have you considered how you might assist the client under those circumstances? Who can you reach out to?

The North American Securities Administrators Association (NASAA) encourages the reporting of suspected financial exploitation even in the absence of a legal obligation to report. As reported in our last newsletter, NASAA's membership voted to adopt a model act designed to protect vulnerable adults from financial exploitation. The Act to Protect Vulnerable Adults from Financial Exploitation mandates reporting to state securities regulators and adult protective services when there's a reasonable belief that financial exploitation has been attempted or occurred and authorizes notification to third parties previously designated by the client. Not yet enacted in Wisconsin, the full text of the model act can be reviewed at:

<http://serveourseniors.org/about/policy-makers/nasaa-model-act/>

NASAA recently also prepared a guide for investment advisers and broker-dealers with information for detecting, reporting and mitigating senior financial exploitation. The guide can be found on the ServeOurSeniors.org website:

<http://serveourseniors.org/about/industry/practices-procedures-guide/>

According to the Guide, the signs and red flags that a senior client could be the victim of financial exploitation include but are not limited to:

- Uncharacteristic and repeated cash withdrawals or wire transfers
- Appearing with new and unknown associates, friends, or relatives who may be interfering with the client relationship
- Uncharacteristic nervousness or anxiety when visiting the office or on the phone
- Lacking knowledge about his or her current financial status
- Unusual excitement about a potential windfall with possible reluctance to discuss the details
- Sudden or uncharacteristic changes to financial documents such as powers of attorney or wills

The Guide was designed to complement the NASAA model act. We will alert you if and when the model act is adopted in our state. In the meantime, you can be better prepared to serve your elderly clients if you are familiar with:

- Recognizing diminished capacity and potential financial exploitation
- Knowing who you may want to report such issues to such as your county adult protective services office (<https://www.dhs.wisconsin.gov/aging/index.htm>)
- Your ability to have clients authorize you to contact a trusted third party

Clients may be reluctant to discuss issues such as cognitive decline but may be willing to discuss and complete a form regarding who to contact about their finances in the event of a medical or other emergency (e.g., including whether they have powers of attorney or other advance directives in place). The issue can be raised at the time of an account opening and/or at regular intervals thereafter or if warranted by developing circumstances.

We anticipate the future release of a form template to facilitate the authorization and collection of the identity of a third party who may be contacted by you with concerns regarding the client. If you are currently collecting this information, we would be interested in hearing from you regarding your practice and experience. Please feel free to contact Deb Fabritz at deborah.fabritz@wisconsin.gov or (608) 266-3414.

How to Reach the Examiner of the Day

Our current examiner staff includes: Mark Eisenmann, Charlie Benson, Joe Friesen, Jenny Acker, and Rob Monroe. You can expect one or more of our securities examiners to visit your office when you are next due for an examination by our Division of your business practices and your books and records. Exams for investment advisers with assets under management are typically on a three year cycle. In the meantime, questions regarding compliance with Wisconsin Uniform Securities Law and the administrative code may be directed to our Examiner of the Day at (608) 266-2139.

More Ways to Connect with DFI

The Wisconsin Department of Financial Institutions (DFI) Facebook page provides information on financial literacy, investor education, scam warnings and other timely news to help protect investors. Please check out DFI's Facebook page (using the link below) and share any content that you find useful. Feel free to "Like" our page so that you receive future posts in your Facebook newsfeed.

This past June, DFI also joined the flock on Twitter. Our Twitter page aims to highlight the outreach efforts of our Department across the state. In a recent tour of the north woods, our Twitter page followed Secretary Lon Roberts as he covered over 600 miles of Wisconsin meeting with community leaders and other DFI stakeholders.

To keep up with the latest from DFI - follow us on Twitter at: [@WIS_DFI](https://twitter.com/WIS_DFI)

