



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

## Investment Adviser Newsletter

Spring 2017

*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>*

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### **Make Time for Business Continuity & Succession Planning**

Does your firm have a business continuity and succession plan in place? Although the Wisconsin Uniform Securities Law does not currently require that firms establish a business continuity and succession plan, the Division of Securities considers it a best business practice for all investment advisers to have a plan in place. Business continuity and succession planning is critical to your firm's ability to continue daily operations in the event of a significant disruption of your business. Having a plan in place would likely reduce the recovery time of your operations after a catastrophic event or unexpected loss of key personnel.

In addition, investment advisers have a fiduciary duty to put clients' interests first – this means establishing a business continuity and succession plan to minimize the risk and disruption to your clients by ensuring their continued access to their funds and the management of those funds.

For investment advisers considering retirement or close to retirement age, it can be a daunting task to find a suitable successor to take over your business. However, it's a best business practice to establish a succession plan that details your transition out of the business and a smooth transition for clients to a new investment adviser. The successor may be internal or external to the firm. Internal successions may be another adviser who is already working with your firm or joins your firm in anticipation of eventually assuming the existing business. External successions may involve the sale of your business to another investment adviser.

Whether it is for an unexpected event or a planned retirement, the details of the plan you create will depend on the firm's business model, firm size, number of clients and other factors specific to your firm. Various resources are available to assist in this process. For instance, the North American Securities Administrators Association (NASAA) issued 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 review the NASAA Model Rule on Business Continuity and Succession Planning and IA BCP Rule and Guidance, go [here](#). You may wish to consult with an attorney or firm that specializes in creating business continuity and succession plans.

Although it is not easy to plan for the “what ifs,” today is a good time to consider establishing a business continuity and succession plan to protect your clients and your business, if you don’t already have a plan in place. Once you have a business continuity plan, another important task is periodically reviewing 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. You should also consider periodically testing the plan.

Be prepared during the next examination scheduled by our Division for us to ask about your current business continuity and succession plan.

### **Caution: Pension Stream Investing**

Investment advisers should be aware of the significant risks associated with pension stream investing. An adviser’s fiduciary duty and other professional obligations owed to clients make these investments unsuitable. To the extent an adviser has sold a pension stream, it is almost certain that problems arose and the client incurred large losses, often in the range of 40 - 50 %.

Pension stream investing involves three parties: 1) the investor and their investment representative; 2) the company transacting the deal; and 3) the seller of the pension payments. These investments can seem appealing because they offer the investor monthly payments with returns of 5 - 8 %. The deals are usually structured over a set time period of eight to ten years, and often seniors seeking consistent income are targeted as potential investors. To entice investment advisers, the companies pay out large commissions which may violate the adviser’s fiduciary duty to the client.

The seller is persuaded by the companies to sell their pension income stream in exchange for a lump sum that will facilitate their payment of debt or other expenses. Federal/state pensioners may be targeted as potential sellers due to the stability of public pensions versus private corporate pensions. However, a comparison of the net lump sum received (after fees to the adviser and pension company) to the sum of the assigned monthly pension payments can reveal the effective interest rate paid if the same amount of money had been borrowed. In one

court case, the receiver calculated that the sellers were paying an effective annual interest rate of 28.55 %.

These schemes usually end badly because of complaints, lawsuits, and seller defaults. Complaints arise when the sellers realize the impact of the fees on the transaction. The complaints are then investigated by federal or state authorities who file lawsuits against the companies brokering the sales. Defaults take place when the court suspends the payments to the investors in order to protect the seller or a seller redirects the payments so they no longer go to the investor. Defaults can also occur due to the bankruptcy or death of the seller. As a result, the companies brokering the pension stream deals typically had a short life span following the defaults and lawsuits.

The company's marketing material may attempt to reassure investment advisers and investors with default protection and other related guarantees. One example is the creation of reserve funds that are utilized when sellers are in default, causing the pension payments to stop going to the investor. These reserves are funded by the fees charged to the investor and/or the seller. When defaults occur, the company is forced to tap the reserve fund, and when the fund shrinks, the only way to replenish the fund is to keep selling the products. This lead to a Ponzi-scheme-like environment.

Depending on a particular state's laws, the assignment of a pension may be prohibited. For Wisconsin, it appears that Wisconsin Statutes § 40.08 and § 40.01 restrict the assignment of state employees' pension payments. In a recent case, the federal court stopped all payments to investors and required the sellers in default (except for those who were deceased) to pay back the net lump sum they received – easier said than done since often, the money received by the seller is long gone.

### **How to Find WI Statutes & Rules**

The Division recommends that all investment advisers be familiar with how to locate the Wisconsin statutes and rules that regulate the securities industry, including investment advisers. These regulations are an excellent resource to help industry professionals remain compliant with the applicable law and administrative code. In addition, the investment adviser examinations conducted by our Division, and any resulting deficiencies, are based on the provisions of the Wisconsin Uniform Securities Law.

To easily access the statutes and rules from the web, go to the DFI website at [www.wdfi.org](http://www.wdfi.org). Then, on the top banner in blue click "Securities." Next, move the cursor to the right hand side of the screen and find the column in black with the links labeled "Fees, Forms, FAQ-Securities,

FAQ-Crowdfunding, FAQ-Franchise, and Statutes” listed vertically. Now, click on the bottom link labeled “Statutes.” On the screen titled “Securities & Franchising Statutes and Rules,” there are two main headings in the center of the screen labeled “Statutes” and “Rules.” For statutes, click the last link labeled “Chapter 551”. This will display the Wisconsin Uniform Securities Law with links to each statute.

You may find it helpful to save and/or print a PDF of the statutes. On the top right corner of the screen you will see a small PDF symbol. Click this and the statutes are automatically savable and printable as a PDF file (next to “Help”).

For the rules, return to the screen titled “Securities & Franchising Statutes and Rules,” and click the link to “Chapter DFI-SEC of the Wisconsin Administrative Code.” The screen will automatically display Sections 1 - 36. While Sections 1 - 9 are applicable to the securities industry, Section 5 covers procedures, records, practice rules, and prohibited conduct for investment advisers. The PDF symbol is next to each numbered section if you wish to save and/or print any of the Sections. (Consider merging Sections 1 - 9 and saving them on your computer.) To research a topic, you can reference the index or open an electronic copy and hit Ctrl F (F is for find) on the keyboard. The computer will then display a search box where you can enter a word or phrase.

If you have any questions, feel free to contact the Examiner of the Day at (608) 266-2139 or speak with an examiner during your next office examination.

### **The Importance of Updating Your Form U4**

Investment adviser firms are required to keep the Form U4 updated for each investment adviser representative, pursuant to DFI-Sec 5.04(3)(c). Any amendments to Form U4 must be filed through the Central Registration Depository (“CRD”) within 30 days of the date of the event that requires the filing of an amendment.

The failure to maintain a current Form U4 could lead to regulatory action. This is especially true if investment adviser representatives are dually registered as broker-dealer agents. In some cases, FINRA has fined and suspended broker-dealer agents for the failure to disclose (on the Form U4) liens, civil judgements, outside business activities, bankruptcies, and criminal matters.

Other states have taken regulatory actions against investment adviser representatives for failing to maintain a current Form U4. In one example, the investment adviser representative was named a co-trustee to a trust but did not notify his investment adviser so it could update

his Form U4 within the required 30 day timeframe. The failure to keep the Form U4 updated was one of the grounds that resulted in the denial of his future securities registration applications.

A review of the Form U4 for investment adviser representatives is part of our examination program in Wisconsin. It is also a best practice to have written procedures and a system in place to review Form U4 accuracy on a regular basis.

### **How Sound is Your Clients' Cyber Security?**

The firms that we examine generally have sound cyber security policies and procedures. However, there have been unforeseen problems. On occasion, the Division has encountered Wisconsin-based advisers and broker-dealers who were duped into sending client money to an e-mail hacker.

On more than one occasion, e-mail hackers convinced advisers and/or brokers to send client money. Examinees have indicated during an exam, "this could not happen to me – I have cyber security policies in place." However, e-mail hackers are very creative; never underestimate the creativity of new swindlers and their scams. The firms that have caught the e-mail hacker before money is lost have done so through identity verification protocols included in the firm's procedures.

**E-mail hacker example:** After hacking into a person's e-mail account, the criminal reads personal client e-mail and becomes familiar with the adviser and client interactions. The hacker waits for the right opportunity to make a request for money from the adviser using a subject from previous e-mail communications while pretending to be the client. Consequently, the adviser is convinced by the hacker's request for money that it is a legitimate request from the client, since the subject matter in the e-mail relates to an earlier communication between the client and adviser. The money is transferred out expediently, and generally it goes to an overseas account where there is no jurisdiction to reverse it.

As a result, representatives have sent money to a third party because the perpetrator knows the client's habits and life events from an e-mail hack. The transfer of money request may appear to come from the client while on vacation, or when client identity verification by the adviser is difficult. Even if cyber security policies and procedures are sound within your firm, the client's e-mail account may be the weakness.

## **Wisconsin Dementia Friendly Businesses**

According to the Wisconsin Department of Health Services, in 2015 approximately 115,000 people had some form of dementia in Wisconsin. Dementia commonly impairs memory, judgement, perception, reasoning, attention and mood, which in turn, increases the odds of financial exploitation.

For individuals in the early stages of dementia, there is a growing desire to continue to live as independently as they are able for as long as possible. To that end, cities across Wisconsin are transforming themselves into more dementia friendly communities. Part of becoming a Dementia Friendly Community is encouraging local businesses to become certified as a Dementia Friendly Businesses.

Some best practices for financial businesses wanting to become more dementia friendly include:

- Being able to identify any atypical withdrawals, transfers or simple math mistakes that might indicate a change in the investor's behavior and capacity.
- Developing written policies and procedures for employees to follow if signs of dementia occur.
- Knowing how to appropriately escalate issues as the needs arise.

To learn more about how your firm can become more dementia friendly, please visit the following resources:

- [Dementia-Capable Wisconsin](#)
- [A Took Kit for Building Dementia-Friendly Communities](#)
- [Dementia Friendly Community](#)
- [Dementia Friendly Business](#)

## **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, including 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. In addition, to keep up with the latest from DFI - follow us on Twitter at: [@WIS\\_DFI](https://twitter.com/WIS_DFI)

