LCRC FORM 2

WISCONSIN LEGISLATIVE COUNCIL STAFF

SEP 07 1999

SEP 07 REC'D

RULES CLEARINGHOUSE

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CLEARINGHOUSE REPORT TO AGENCY

[THIS REPORT HAS BEEN PREPARED PURSUANT TO S. 227.15, STATS. THIS IS A REPORT ON A RULE AS ORIGINALLY PROPOSED BY THE AGENCY; THE REPORT MAY NOT REFLECT THE FINAL CONTENT OF THE RULE IN FINAL DRAFT FORM AS IT WILL BE SUBMITTED TO THE LEGISLATURE. THIS REPORT CONSTITUTES A REVIEW OF, BUT NOT APPROVAL OR DISAPPROVAL OF, THE SUBSTANTIVE CONTENT AND TECHNICAL ACCURACY OF THE RULE.]

CLEARINGHOUSE RULE **99–121**

AN ORDER to repeal DFI–Sec 4.035, 9.01 (1) (a) 3. and (b) 4., 14. and 16; to renumber DFI–Sec 1.02 (18), 2.01 (3), 4.01 (4) (f), 4.05 (9) (d), 9.01 (1) (a) 4. and (b) 5. to 13., 15. and 17 to 20; to amend DFI–Sec 1.02 (1) (a) 1., 2.02 (9) (a) and (L), 2.04 (1) (a), 3.03 (3), 4.01 (3) (b) to (e), 4.01 (5) (a) to (d), 4.04 (5) (a) and (6), 5.01 (4) (a), 5.03 (5), 5.04 (1), 5.06 (6) and 7.06 (1) (b); to repeal and recreate 4.01 (3) (a), 4.05 (9) (a), (b), (c) and (e), 5.01 (3) and 5.02 (1) and (2); and to create 2.01 (3) (b), 2.02 (5) (d) 3., 4.01 (3) (f) and (g), (4) (f) and (g) and (5) (e), 4.05 (9) (L), 5.01 (4) (d), 5.03 (1) (o), 5.035 and 5.05 (11) (f), relating to securities broker–dealer, agent and investment adviser licensing requirements and procedures, securities registration exemptions, definitions and forms.

Submitted by **DEPARTMENT OF FINANCIAL INSTITUTIONS**

08–03–99 RECEIVED BY LEGISLATIVE COUNCIL.

08–31–99 REPORT SENT TO AGENCY.

RS:DF:jal;rv

LEGISLATIVE COUNCIL RULES CLEARINGHOUSE REPORT

This rule has been reviewed by the Rules Clearinghouse. Based on that review, comments are reported as noted below:

1. STATUTORY AUTHORITY [s. 227.15 (2) (a)]

   Comment Attached YES ☐ NO ☑

2. FORM, STYLE AND PLACEMENT IN ADMINISTRATIVE CODE [s. 227.15 (2) (c)]

   Comment Attached YES ☑ NO ☐

3. CONFLICT WITH OR DUPLICATION OF EXISTING RULES [s. 227.15 (2) (d)]

   Comment Attached YES ☐ NO ☑

4. ADEQUACY OF REFERENCES TO RELATED STATUTES, RULES AND FORMS [s. 227.15 (2) (e)]

   Comment Attached YES ☐ NO ☑

5. CLARITY, GRAMMAR, PUNCTUATION AND USE OF PLAIN LANGUAGE [s. 227.15 (2) (f)]

   Comment Attached YES ☑ NO ☐

6. POTENTIAL CONFLICTS WITH, AND COMPARABILITY TO, RELATED FEDERAL REGULATIONS [s. 227.15 (2) (g)]

   Comment Attached YES ☐ NO ☑

7. COMPLIANCE WITH PERMIT ACTION DEADLINE REQUIREMENTS [s. 227.15 (2) (h)]

   Comment Attached YES ☐ NO ☑

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CLEARINGHOUSE RULE 99–121

Comments

[NOTE: All citations to "Manual" in the comments below are to the Administrative Rules Procedures Manual, prepared by the Revisor of Statutes Bureau and the Legislative Council Staff, dated September 1998.]

2. Form, Style and Placement in Administrative Code

a. In s. DFI-Sec 2.01 (3) (b), delete the introductory clause and substitute "Pursuant to s. 551.22 (7), Stats.," and insert "qualifies for registration exemption status" before the period.

b. In the treatment clause of SECTION 6, insert "(intro.)" after "(9) (L)" and insert "(intro.)" after "(L)" in the body of that SECTION.

c. In s. DFI-Sec 4.01 (4) (f) and (g), the notation "par." should be replaced by the notation "sub."

d. In s. DFI-Sec 4.05 (9) (b), (d) and (f), the word "must" should be replaced by the word "shall." Also, in par. (b), the phrase "be responsible for ensuring" should be replaced by the word "ensure." In sub. (9) (c) (intro.), the phrase "subd. (c) 1. and 2." should be replaced by the phrase "all of the following." Similarly, in par. (c) 1., the phrase "the information in the following subdivision paragraphs" should be replaced by the phrase "all of the following information." In par. (c) 2., the cross-reference should be "subd. 1." In sub. (9) (g) (intro.), the phrase "language below" should be replaced by the phrase "following language" and the notation "par (h)" should be replaced by the notation "par. (h)." Finally, in sub. (9) (h) (intro.), the phrase "one, two and three, respectively" is unnecessary and should be deleted.

e. In s. DFI-Sec 4.05 (9) (L), the word "Division" should be replaced by the word "division." This change should be made throughout the rule. Also, the word "section" should be replaced by the notation "s." [See also s. DFI-Sec 5.05 (11) (f).]

f. In s. DFI-Sec 5.01 (3), the material after the phrase "passing score" should read: "On either of the following examinations:".

g. In the first sentence of s. DFI-Sec 5.02 (1) and (2), insert "and" after "state." In the second sentence of sub. (2), insert "and" after "state." Also, all references to "chapter 551" should be replaced by references to "ch. 551, Stats." [See also s. DFI-Sec 5.035 (2).]

h. In s. DFI-Sec 5.035 (2), the word "shall" should be replaced by the word "does."

i. The subdivision renumbering contained in SECTION 34 cannot be accomplished in a single SECTION of a rule-making order. Instead, four SECTIONS (SECS. 34 to 37) should be created to renumber these provisions.

5. Clarity, Grammar, Punctuation and Use of Plain Language

a. In light of the extensive redrafting of s. DFI-Sec 4.05 (9), for purposes of clarity, it is suggested that SECTIONS 19 to 21 be combined into a single SECTION which repeals and recreates s. DFI-Sec 4.05 (9) in its entirety.

b. In s. DFI-Sec 4.05 (9) (h) (intro.), how will disclosures be "displayed in a conspicuous manner"?

c. In s. DFI-Sec 5.03 (5), after the first "office," insert a comma.

PROPOSED ORDER OF THE
DIVISION OF SECURITIES
DEPARTMENT OF FINANCIAL INSTITUTIONS
STATE OF WISCONSIN
ADOPTING, AMENDING AND REPEALING RULES

(intro.)

To repeal DFI-Sec 4.035, 9.01(1)(a)3., 9.01(1)(b)4., 14., and 16; to renumber DFI-Sec 1.02(18), 2.01(3), 4.01(4)(f), 4.05(9)(d), 9.01(1)(a)4., 9.01(1)(b) 5. to 13., 9.01(1)(b)15., and 9.01(1)(b)17. to 20.; to amend DFI-Sec 1.02(1)(a)1, 2.02(9)(a) and (L), 2.04(1)(a), 3.03(3), 4.01(3)(b) to (e), 4.01(5)(a) to (d), 4.04(5)(a), 4.04(6), 5.01(4)(a), 5.03(5), 5.04(1), 5.06(6), 7.06(1)(b); to repeal and recreate 4.01(3)(a), 4.05(9)(a), (b), (c) and (e), 5.01(3), 5.02(1) and (2); and to create 2.01(3)(b), 2.02(5)(d)3., 4.01(3)(f) and (g)., 4.01(4)(f) and (g), 4.01(5)(e), 4.05(9)(L), 5.01(4)(d), 5.03(1)(o), 5.035, and 5.05(11)(f) relating to securities broker-dealer, agent and investment adviser licensing requirements and procedures, securities registration exemptions, definitions and forms.

Pursuant to sections. 551.63(1), (2) and (3), 551.22(7), 551.23(11)(b), 551.23(18), 551.29(1), 551.32(4)(5) and (7), and 551.33(1), (2) and (6), Wis. Stats., the Division of Securities of the Department of Financial Institutions repeals, amends and adopts rules interpreting those sections as follows:

7/27/99

DEPARTMENT OF FINANCIAL INSTITUTIONS

DIVISION OF SECURITIES

1999 Rule Revision

SECTION 1. DFI-Sec 1.02(1)(a)1. is amended to read:

DFI-Sec 1.02(1)(a)1. Advertising printed in any newspaper, magazine, periodical or other publication and mailed or delivered to its subscribers or addressees, or communicated by radio, television or similar means, or electronically via the internet; or

ANALYSIS : This amendment adds the World Wide Web/Internet as a specific, listed medium for dissemination of advertising for purposes of being covered by the definition of "publication" under the advertising definitional rule in DFI-Sec 1.02(1)(a).

SECTION 2. DFI-Sec 1.02(18) is renumbered DFI-Sec 1.02(14)(g)

ANALYSIS: The renumbering in this SECTION consolidates this rule (which provides an exclusion from the definition of "investment adviser") with the primary definitional rule of "investment adviser" in DFI-Sec 1.02(14) to which the exclusion relates. The consolidation of the exclusion with the primary definition is needed for readability purposes to ensure that readers of the definition will not fail to see the exclusion.

SECTION 3. DFI-Sec 2.01(3) is renumbered DFI-Sec 2.01(3)(a).

ANALYSIS: This renumbering is needed because of the addition of a second paragraph to subsection 2.01(3) as created in the following SECTION.

SECTION 4. DFI-Sec 2.01(3)(b) is created to read:

DFI-Sec 2.01(3)(b) This ~~paragraph~~ designates for purposes of the ~~exempt security registration exemption~~ pursuant to s. 551.22(7), Stats., any warrant or right to purchase or subscribe to purchase any security listed on either the New York stock exchange, the Pacific stock exchange,

the Philadelphia stock exchange, the Chicago Board Options exchange, or the national market system of the national association of securities dealers, or any security called for by those warrants or subscription rights. shall qualify for registration exemption status.

ANALYSIS: This SECTION creates a new exempt security rule under the "exchange listed security" registration exemption in sec. 551.22(7), Wis. Stats. This new exemption rule is needed as a result of statutory and rule amendments made by the Division in 1998 that were necessitated by language contained in Section 18(b)1 of the National Securities Markets Enhancement Act ("NSMIA") which preempted the "exchange-listed security" registration exemption in all states. However, because of a drafting error in the federal NSMIA legislation that failed to include warrants and subscription rights as well as the securities called for by the warrants or subscription rights, they are neither covered by the current federal provision, nor by the former Wisconsin exemption. Consequently, although corrective legislation on the federal level is being proposed, this rule is needed now to reinstate the registration exemption status in Wisconsin for such warrants and subscription rights that had existed prior to the 1998 Wisconsin statute and rule changes.

SECTION 5. DFI-Sec 2.02(5)(d)3 is created to read:

DFI-Sec 2.02(5)(d)3. Except as provided in this subdivision or subd. 1., any offer or sale of securities being made in reliance on the exemption provided by rule 504 of regulation D under the securities act of 1933, unless prior to the offering in Wisconsin the issuer files a notice of the proposed offer or sale with the division, including any prospectus, circular or other material to be delivered to offerees, and other information as the division may require, and the division does not by order withdraw, deny or revoke the exemption within 10 days.

ANALYSIS: This SECTION creates a third rule under DFI-Sec 2.02(5)(d) using the Division's authority under sec. 551.23(11)(b), Wis. Stats., to withdraw or condition for investor protection purposes, use of the 10-offeree private placement exemption. [The existing rule under DFI-Sec 2.02(5)(d)1 conditions use of the exemption for offerings by limited partnerships involved in oil, gas or mining activities, or for offerings of investment contract securities involving any business activity. The existing rule under DFI-Sec 2.02(5)(d)2 totally withdraws use of the exemption for any offering triggering the so-called "bad boy disqualifier" provision under Rule 505 of Regulation D under the federal Securities Act of 1933, as cross-referenced in sec. 551.23(19)(c), Wis. Stats.]

This rule--which does not preclude use of the exemption, but instead makes its use conditional upon a 10-day pre-offer notice filing of the type specified in current rule DFI-

Sec 2.02(5)(d)1--applies to offerings made under Rule 504 of Regulation D and is needed to deal with fraud problems occurring nationally involving Rule 504 offerings as identified by the U.S. Securities and Exchange Commission ("SEC") in its February 1999 rule adoptions relating to Rule 504. The SEC, in its adopting Release 33-7644, announced limitations imposed on use of Rule 504 primarily as a result of so-called "pump-and-dump" fraudulent schemes involving securities of "microcap" companies that have occurred both in the secondary market and in the initial issuance of Rule 504 securities.

This rule, by establishing a pre-offer filing requirement, would enable the Division to do the following: (1) Conduct an anti-fraud disclosure review of the offering materials; (2) Ascertain how the issuer is establishing that the statutory requirement for use of the exemption is met which requires all Wisconsin purchasers to be "purchasing for investment" without a view to resell (whether or not in a secondary market context); and (3) Review the Division's database, as well as national enforcement databases, to verify whether the names of the officers, directors or controlling persons of the issuer trigger the Wisconsin "bad boy disqualifier" under DFI-Sec 2.02(5)(d)2. A cross-reference to subdivision (5)(d)1 is added in the first part of the rule to provide that the 551.23(11) exemption can still be used pursuant to subd. (5)(d)1 for Regulation D Rule 504 offerings of limited partnership interests or investment contract securities because those types of securities are not traded in the secondary market.

SECTION 6. DFI-Sec 2.02(9)(a) and (9)(L) are amended to read:

DFI-Sec 2.02(9)(a) An exemption under this subsection is available ~~until October 11, 1999~~ for any isolated issuer transaction relating to redeemable securities of an investment company registered under the investment company act of 1940, effected through a licensed broker-dealer pursuant to an unsolicited order or offer to purchase, provided that the broker-dealer obtains from the purchaser a written acknowledgment that the purchase was unsolicited or the confirmation delivered to the purchaser or a memorandum delivered in connection therewith confirms that the purchase was unsolicited by the broker-dealer or any agent of the broker-dealer. A transaction is presumed to be "isolated" if it is one of not more than 3 such transactions during the prior 12 months.

(L) An exemption under this subsection is available ~~until October 11, 1999~~ for any transaction by the sponsor of a unit investment trust involving the resale of a share of beneficial interest in the trust that meets all of the following conditions:

ANALYSIS: The amendments to each rule remove an expiration date for use of those registration exemptions which apply to investment companies as provided therein. The expiration dates were added to each rule incident to the Division's 1998 adoption of comprehensive rules to implement enactment of 1997 Wisconsin Act 316—which made numerous changes to the Wisconsin Uniform Securities Law necessitated by federal legislation in the National Securities Markets Enhancement Act ("NSMIA") that preempted certain areas of state securities regulation. NSMIA contained a provision allowing states a 3-year period (ending October 11, 1999) after enactment of NSMIA to require registration of the securities of an investment company issuer refusing to pay applicable notice filing fees, which date was included for purposes of use of those exemption rules. However, because nothing in NSMIA precludes a state from granting to an issuer of a federal covered security an exemption identical to those granted issuers of other securities—and in fact various exemptions are available for use without a date limitation under the Wisconsin Uniform Securities Law by other non-investment company categories of federal covered security issuers—the expiration dates for use of these exemptions by investment company issuers are deleted.

SECTION 7. DFI-Sec 2.04(1)(a) is amended to read:

DFI-Sec 2.04 FEDERAL COVERED SECURITY NOTICE FILINGS. (1)(a) With respect to a federal covered security referred to in s. 551.29(1)(a), Stats., unless the security is registered or exempt from registration under ss. 551.22 or 551.23, Stats., ~~until October 11, 1999,~~ the issuer or a person acting on behalf of the issuer shall file with the division not later than the initial offer of the security in this state, a consent to service of process signed by the issuer and the notice filing fee prescribed under s. 551.52(1)(a), Stats. If a completed Form NF as prescribed in DFI-Sec 9.01(1)(d) is included with the consent to service of process and the notice filing fee, the issuer need not also include with the filing copies of any documents that are part of the registration statement filed under the securities act of 1933, although the division may at a later time require the filing of a copy of any document that is part of the registration statement filed under the securities act of 1933.

ANALYSIS: See the ANALYSIS to SECTION 6.

SECTION 8. DFI-Sec 3.03(3) is amended to read:

DFI-Sec 3.03(3) The prospectus shall contain a full disclosure of all material facts relating to the issuer and the offering and sale of the registered securities. A prospectus meeting the requirements under the securities act of 1933 that receives full review by the U. S. securities and exchange commission, shall not be subject to disclosure adequacy review or comment by the division. If the offering is being made pursuant to use of either Regulation A or Rule 504 of Regulation D under the securities act of 1933 or rule 147 under section 3(a)(11) of the securities act of 1933, the form U-7 disclosure document as adopted by the North American Securities Administrators Association, Inc. may be used.

ANALYSIS: This amendment will allow use by small businesses and other issuers making Regulation A offerings in Wisconsin, of the NASAA Form U-7 Disclosure Document [a question-and-answer format disclosure document developed by NASAA as an easier-to-prepare alternative to the traditional "legalese" form of prospectus/disclosure document].

SECTION 9. DFI-Sec 4.01(3)(a) is repealed and recreated to read:

DFI-Sec 4.01(3)(a) The Series 7 General Securities Representative Examination or, in the case of applicants not registered with the national association of securities dealers, inc. or any organized stock exchange in the United States, the Series 2 Securities Exchange Commission Only/National Association of Securities Dealers Non-Member General Securities Examination.

ANALYSIS: This change places the principal emphasis in the sentence on the Series 7 examination because the Series 2 examination is no longer being administered (although passage of the Series 2 exam will continue to be recognized for purposes of the rule). The Series 7 examination is now available to all applicants needing a general securities exam.

SECTION 10. DFI-Sec 4.01(3)(b) to (e) are amended to read:

DFI-Sec 4.01(3)(b) The Series 6 Investment Company Products/Variable Contracts Representative Examination.

(c) The Series 22 Direct Participation Programs Representative Examination.

(d) The Series 52 Municipal Securities Representative Examination.

(e) The Series 62 Corporate Securities Limited Representative Examination.

ANALYSIS: These amendments add the NASD Series number to each of the listed examination descriptions for ease of reference because the examination series number is more recognizable than the exam title.

SECTION 11. DFI-Sec 4.01(3)(f) and (g) are created to read:

DFI-Sec 4.01(3)(f) The Series 42 Registered Options Representative Examination.

(g) The Series 72 Government Securities Representative Examination.

ANALYSIS: These new rules list two special-product examinations whose passage will satisfy the exam requirement for issuance of a limited agent license to an applicant whose activities will be restricted to those securities.

SECTION 12. DFI-Sec 4.01(4)(f) is renumbered (4)(h)

ANALYSIS: This renumbering is necessary to make room for two new limited examinations contained in the following SECTION.

SECTION 13. DFI-Sec 4.01(4)(f) and (g) are created to read:

DFI-Sec 4.01(4)(f) The applicant is currently registered and in good standing as an agent with any Canadian stock exchange or with a securities regulator of any Canadian province or territory, or with the Investment Dealers Association of Canada and has passed either the Series 37 or Series 38 Canada modules of the Series 7 general securities representative qualification examination, except that the applicant's activities may not include the offer and sale of municipal securities unless the applicant passes the examination listed in par. (3)(d).

(g) The applicant is currently registered and in good standing as an agent with any Japanese stock exchange or with any Japanese securities dealers association and has passed either the Series 47 Japan module of the Series 7 general securities representative qualification

examination, except that the applicant's activities may not include the offer and sale of municipal securities unless the applicant passes the examination listed in par. (3)(d).

ANALYSIS: The Canada and Japan examination modules referenced in these two new rules permit securities agents in those countries (who meet the licensing requirements of the respective country), to take a limited version of the Series 7 General Securities Registered Representative Examination for licensing purposes in the United States. These two new rules make the Canada and Japan examination modules available to Wisconsin agent applicants.

SECTION 14. DFI-Sec 4.01(5)(a) to (d) are amended to read:

DFI-Sec 4.01(5)(a) The Series 24 General Securities Principal Examination.

(b) The Series 26 Investment Company Products/Variable Contracts Principal Examination.

(c) The Series 39 Direct Participation Programs Principal Examination.

(d) The Series 53 Municipal Securities Principal Examination.

ANALYSIS: These amendments add the NASD Series number to each of the listed principal examination descriptions for ease of reference because the examination series number is more recognizable than the exam title.

SECTION 15. DFI-Sec 4.01(5)(e) is created to read:

DFI-Sec 4.01(5)(e) The Series 4 Registered Options Principal Examination.

ANALYSIS: This new rule establishes the principal examination required for persons supervising the offer and sale of options because the subject matter of other principal examinations listed in pars. (5)(a) to (d) does not cover supervision of options business.

SECTION 16. DFI-Sec 4.035 is repealed.

ANALYSIS: This Section repeals a rule (originally adopted in 1981) that both establishes a customer transaction record-keeping requirement for agents, and requires that broker-dealers deliver copies of customer holding records upon written request by agents who have terminated employment with the broker-dealer. The rule has resulted in the Division being interposed in numerous instances in what essentially are employment disputes--a role not within the scope of the Wisconsin Uniform Law, particularly since the Division has no independent, direct authority to force the providing of the records involved.

Additionally, as a result of development of the electronic era since the rule's adoption, the need for the rule is now less critical for the reasons that: (i) because computer retention of a broker-dealer's customer holding records is now the norm (which facilitates access to, as well as copying of, customer holding records by the customer's agent), it would be expected that an agent anticipating a move would obtain copies of their customers' holding records before departing their broker-dealer employer; and (ii) customers themselves are increasingly able to access their account information directly via the Internet.

SECTION 17. DFI-Sec 4.04(5)(a) is amended to read:

DFI-Sec 4.04(5)(a) Immediate ~~telegraphic~~ electronic or written notice whenever the net capital of the broker-dealer is less than is required under s. DFI-Sec 4.02 (1), specifying the respective amounts of its net capital and aggregate indebtedness on the date of the notice;

ANALYSIS : This amendment updates the terminology used in this net capital deficiency notice requirement rule to eliminate "telegraphic" notice and permit "electronic" notice--which would include notification provided by facsimile and e-mail.

SECTION 18. DFI-Sec 4.04(6) is amended to read:

DFI-Sec 4.04(6) Each broker-dealer shall give immediate electronic or written notice to the division of the theft or disappearance of any Wisconsin customers' securities or funds that are in the custody or control of any of its offices, whether within or outside this state, stating all material facts known to it concerning the theft or disappearance.

ANALYSIS: This amendment updates the terminology used in this reporting rule to permit "electronic" notice--which would include notification provided by facsimile and e-mail.

SECTION 19. DFI-Sec 4.05(9)(d) is renumbered DFI-Sec 4.05(9)(k)

ANALYSIS: This SECTION renumbers existing paragraph (d) from the current Wisconsin rules relating to broker-dealers providing securities services on the premises of financial institutions. That rule paragraph (regarding a broker-dealer's supervisory procedures) is not covered in the NASAA Model Rule adopted in the following SECTION, and therefore is retained by adding it as the final paragraph at the end of the recreated rules DFI-Sec 4.05(9)(a) to (j).

Go line w/ SECTION 20; Repeal and recreate entire S. DFI-Sec 4.05(9). and SEC. 21

SECTION 20. DFI-Sec 4.05(9)(a), (b), (c) and (e) are repealed and recreated to read:

DFI-Sec 4.05(9) No broker-dealer shall conduct broker-dealer services on the premises of a financial institution where retail deposits are taken unless the broker-dealer complies initially and continuously with all of the following requirements:

(a) The broker-dealer services shall be conducted, wherever practical, in a physical location distinct from the area in which the financial institution 's retail deposits are taken. In all situations, the broker-dealer shall identify its services in a manner that clearly distinguishes those services from the financial institution 's retail deposit-taking activities. The broker-dealer 's name shall be clearly displayed in the area in which the broker-dealer conducts its broker-dealer services. Nothing in this paragraph prohibits the financial institution from carrying out other activities within the designated area, provided that no promotional signs or materials shall be displayed in the designated area other than those relating to the securities services.

(b) Networking and brokerage affiliate arrangements shall be governed by a written agreement that sets forth the responsibilities of the parties and the compensation arrangements. Networking and brokerage affiliate arrangements must provide that supervisory personnel of the broker-dealer and representatives of state securities authorities, where authorized by state law, will be permitted access to the financial institution's premises where the broker-dealer conducts broker-dealer services in order to inspect the books and records and other relevant information maintained by the broker-dealer with respect to its broker-dealer services. The broker-dealer shall be responsible for ensuring that the networking and brokerage affiliate arrangement clearly outlines the duties and responsibilities of all parties. For purposes of this paragraph, "networking arrangement" and "brokerage affiliate arrangement" mean a contractual or other arrangement between a broker-dealer and a financial institution pursuant to which the broker-dealer conducts broker-dealer services on the premises of a financial institution where retail deposits are taken.

(c) At or prior to the time that a customer 's securities brokerage account is opened by a broker-dealer on the premises of a financial institution where retail deposits are taken, the broker-dealer shall comply with ~~subd. (c)1 and 2.~~ all of the following

1.Disclose to the customer, orally and in writing, all of the information ~~in the following subdivision paragraphs~~ about the securities products purchased or sold in a transaction with the broker-dealer:

a. The securities products are not insured by the Federal Deposit Insurance Corporation ("FDIC"), or by other deposit insurance required by the financial institution's government regulatory authority.

b. The securities products are not deposits or other obligations of the financial institution, and are not guaranteed by the financial institution.

c. The securities products are subject to investment risks, including possible loss of the principal invested.

2. Make reasonable efforts to obtain from each customer during the account-opening process, a written acknowledgment of the disclosures required by ~~subdivision (c)~~ subd. 1.

(d) If broker-dealer services include any written or oral representations concerning insurance coverage, other than FDIC or similar insurance coverage, then clear and accurate, written or oral explanations of the coverage must also be provided to the customers when the representations are first made.

(e) Recommendations by a broker-dealer concerning any non-deposit investment product with a name similar to that of the financial institution shall occur only pursuant to a sales program designed to minimize the risk of customer confusion.

(f) All confirmations and account statements must indicate clearly that the broker-dealer services are provided by the broker-dealer.

(g) Advertisements and sales literature that announce the location of a financial institution where broker-dealer services are provided by the broker-dealer, or that are distributed by the broker-dealer on the premises of a financial institution, shall disclose using the language ~~below~~ or using the shorter, logo format language in par. (h), the information in each of the following subdivision paragraphs about the securities products purchased or sold in a transaction with the broker-dealer:

1. The securities products are not insured by the FDIC or by other deposit insurance required by the financial institution's governmental regulatory authority.

2. The securities products are not deposits or other obligations of the financial institution, and are not guaranteed by the financial institution.

3. The securities products are subject to investment risks, including possible loss of the principal invested.

(h) The following shorter, logo format disclosures may be used by a broker-dealer in advertisements and sales literature, including material published, or designed for use, in radio or television broadcasts, automated teller machine screens, billboards, signs, posters and brochures, to comply with the requirements of par. (g) ~~1, 2 and 3, respectively,~~ provided that the disclosures are displayed in a conspicuous manner:

1. Not FDIC Insured.

2. No Bank Guarantee.

3. May Lose Value.

(i) Provided that the omission of the disclosures required by par.(g) would not cause the advertisement or sales literature to be misleading in light of the context in which the material is presented, the disclosures in par.(g) shall not be not required with respect to messages contained in any of the following:

1. Radio broadcasts of 30 seconds or less.

2. Electronic signs, including billboard-type signs that are electronic, time, and temperature signs and ticker-tape signs, but excluding messages contained in media such as television, on-line computer services, or automated teller machines.

3. Signs, such as banners and posters, when used only as location indicators.

(j) The broker-dealer shall promptly notify the financial institution if any agent of the broker-dealer who is employed by the financial institution is terminated for cause by the broker-dealer.

ANALYSIS: To achieve uniformity with other NASAA member states as well as with the NASD and federal financial regulatory authorities with regard to the securities law regulatory considerations relating to broker-dealers providing securities services on the premises of financial institutions, this SECTION replaces the existing Wisconsin rules on this subject [as contained in DFI-Sec 4.05(9)(a), (b), (c) and (e)] with the NASAA Model Rules For Sales of Securities at Financial Institutions as adopted by vote of NASAA member states (including Wisconsin) at the NASAA 1999 Fall Conference.

The NASAA rule itself is based on and mirrors the provisions of both the NASD's Rule 2350 on this subject (adopted in 1998) and the Interagency Statement on Retail Sales of Non-Deposit Investment Products (adopted jointly in 1994 by the Federal Reserve System, the Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, and the Office of Thrift Supervision). As stated in the NASAA Rule, the rules apply exclusively to broker-dealer services conducted by broker-dealers on the premises of financial institutions where retail deposits are taken, and do not apply to broker-dealer services provided to non-retail customers. Also, the rules do not apply to or regulate the activities of financial institutions.

The rule provisions in this SECTION correspond with the following provisions from the NASD Rule and the Interagency Statement: (1) Paragraph (a) [physical location and identification]. The introduction and text are from (c) and (c)(1) of the NASD Rule, with the last sentence retained from (9)(a) of the current Wisconsin rule which provides (as an example of the kind of situation the "wherever practical" language from the NASD Rule is meant to cover) a specific waiver allowing a financial institution to carry out other activities within the designated securities area if no signage or materials are displayed. (2) Paragraph (b) [networking]. The first two sentences are from (c)(2) of the NASD Rule with the addition (per the NASAA Rule) of a proviso permitting lawful access by state securities administrators. The third sentence is from Page 9 of the Interagency Statement, and the last sentence containing a definition is from the NASD Rule. (3) Paragraph (c) [customer disclosures and written acknowledgement]. The introduction and subd.1 are from (c)(3) of the NASD Rule. (4) Paragraph (d) [insurance disclosures] and paragraph (e) [products with a name similar to the financial institution] are each from Page 9 of the Interagency Statement. (5) Paragraph (f) [confirmation disclosure] is from (c)(4)(A) of the

NASD Rule. (6) Paragraph (g) [advertising disclosures] is from (c)(4)(B) of the NASD Rule. (7) Paragraphs (h) and (i) [advertising logo format alternatives and waivers] are from (c)(4)(C) and (D), respectively, of the NASD Rule. (7) Paragraph (j) [notice of termination] is from (c)5 of the NASD Rule.

SECTION 21. DFI-Sec 4.05(9)(L) is created to read:

DFI-Sec 4.05(9)(L) Notify the Division at the time of filing the notice of opening or change of address of a branch office as required in ~~section~~ DFI-Sec 4.04(8), that the office is located on the premises of a financial institution in this state, which notification shall include the identity of the institution.

ANALYSIS: This rule requires a broker-dealer to notify the Division when a branch office is located in a financial institution in Wisconsin in order to assist the Department of Financial Institutions in coordinating/combining securities and banking-type examinations of offices of financial institutions in Wisconsin where securities activities are provided on-site. Coordinating such examinations will provide regulatory efficiency and reduce disruption to the locations where the joint examinations will be conducted.

SECTION 22. DFI-Sec 5.01(3) is repealed and recreated to read:

DFI-Sec 5.01(3) Unless waived under sub. (4), each applicant for an initial license as an investment adviser or as an investment adviser representative after January 1, 2000, and each applicant whose application has not become effective by January 1, 2000, is required to provide the Division with proof that he or she has obtained a passing score on the examination specified in par. (3)(a) or each examination specified in par. (3)(b) ~~below~~.

(a)The Series 65 Uniform Investment Adviser Law Examination; or

(b)The Series 7 General Securities Representative Examination as well as the Series 66 Uniform Combined State Law Examination.

ANALYSIS: This SECTION repeals and recreates the existing Wisconsin examination requirements for investment advisers and investment adviser representatives in rule DFI-Sec 5.01(3) (a) and (b) [which consist of the "old" Series 65 and Series 66 examinations] by adopting the "new," completely revised Series 65 and Series 66 examinations developed over a 3-year period by a Project Group of the North American

Securities Administrators Association. The two examinations (and the exam waivers in a following SECTION) were approved by vote of NASAA member states (including Wisconsin) at the NASAA Spring Conference in April 1999, to become effective on December 31, 1999, with a recommendation that for uniformity purposes, NASAA member states complete the necessary steps to adopt the examinations by that date.

The new Series 65 competency exam consists of 130 questions divided into four subject areas: (i) economics and analysis; (ii) investment vehicles; (iii) investment recommendations and strategies; and (iv) ethics and legal guidelines.[The "old" Series 65 exam was a 75-question test that focused mainly on knowledge of securities law and ethics.] Addition of the new categories of questions which an applicant for an investment adviser representative license must answer will help assure investors that their advisers have the minimum skills necessary to provide competent, suitable advice.

The new Series 66 exam was created for broker-dealer agents applying for separate licensure as investment adviser representatives. The 100-question exam is a combination of the current Series 63 exam (a state licensing exam for agents) and the new Series 65 competency exam. The Series 66 exam will be used in Wisconsin for situations where a person already licensed as an agent seeks to become separately licensed as an investment adviser representative. The Series 66 exam will be administered only to those applicants who have passed the NASD's Series 7 exam, which covers investment vehicles and economics. To eliminate the need for agents who have passed the Series 7 from having to be tested on the same exam content in the new Series 66, a NASAA-assembled committee of industry experts compared the two exams and deleted duplicative questions.

NASD Regulation will administer both the Series 65 and Series 66 examinations through its test sites.

SECTION 23. DFI-Sec 5.01(4)(a) is amended to read:

DFI-Sec 5.01(4)(a) The applicant has passed, or has received a waiver from the need to pass, the National Association of Securities Dealers, Inc., Series ~~2,~~ 6 3 7 ~~or 24~~ examination, ~~or predecessor examination,~~ and in addition has passed or received a waiver from the need to pass, ~~either~~ the North American Securities Administrators Association Series 63 ~~or Series 66~~ Examination.

ANALYSIS: In connection with the adoption of the NASAA Series 65 and 66 Investment Adviser Competency Examinations and related exam waivers contained in other SECTIONS of this rule revision, this SECTION makes needed amendments to the existing exam waiver rule in DFI-Sec 5.01(4)(a) in the following respects: (1) deletes the Series 2 and Series 24 (and predecessor) examinations as a basis for a waiver because they are not sufficiently equivalent to the new Series 65 and Series 66; and (2) deletes (as

being unnecessary) the reference to the Series 66 exam in this waiver rule because the combination of the Series 7 exam and the Series 66 exam is one of the two alternatives of the basic examination requirement in recreated rule 5.01(3)(b) in a preceding SECTION.

SECTION 24. DFI-Sec 5.01(4)(d) is created to read:

DFI-Sec 5.01(4)(d) The applicant provides the division with proof that he or she currently holds one of the following professional designations:

1. Certified Financial Planner (CFP) issued by the Certified Financial Planner Board of Standards, Inc.

2. Chartered Financial Consultant (ChFC) awarded by the American College, Bryn Mawr, Pennsylvania.

3. Personal Financial Specialist (PFS) administered by the American Institute of Certified Public Accountants.

4. Chartered Financial Analyst (CFA) granted by the Association for Investment Management and Research.

5. Chartered Investment Counselor (CIC) granted by the Investment Counsel Association of America.

ANALYSIS: This SECTION adopts the examination waivers for the listed professional designations as adopted by NASAA incident to its creation and development of the Series 65 and Series 66 Investment Adviser Competency Examination project. The Wisconsin preamble language to the waivers requires that to obtain a waiver, the applicant must provide proof that he or she currently holds one of the specified professional designations. Because of the need to be able to verify that a person in fact holds a particular designation, the Division will contact the various organizations to ascertain how a designation status claimed by an applicant can be verified by the Division. If a particular organization cannot demonstrate that a reliable verification procedure exists, the waiver designation for the organization will not be adopted in the final version of this rule.

The NASAA waiver provision for discretionary action by order of the Division is not included under this new rule in par. (4)(d) because such discretionary waiver authority is already present in current rule 5.01(4)(c). Similarly, the NASAA 2-year "grandfathering" provision is already present in current rule 5.01(4)(b). Additionally, the NASAA "grandfathering" provision for currently licensed investment advisers and investment

adviser representatives is contained in the preamble language to new rule 5.01(3) in a preceding SECTION.

SECTION 25. DFI-Sec 5.02(1) and (2) are repealed and recreated to read

DFI-Sec 5.02(1) Each investment adviser licensed or required to be licensed under Chapter 551 whose principal office is in this state who accepts prepayment of fees exceeding $500 per client that are collected six or more months in advance, shall maintain at all times a positive net worth. The Division may require that a current appraisal be submitted in order to establish the worth of any asset.

(2) Each investment adviser licensed or required to be licensed under chapter 551 whose principal office is in this state who has custody of client funds or securities shall maintain at all times a minimum net worth of $35,000. Each investment adviser licensed or required to be licensed under chapter 551 whose principal office is in this state who has discretionary authority over customer funds or securities but does not have custody of ~~client~~ these funds or securities, shall maintain at all times a minimum net worth of $10,000.

ANALYSIS: This new Section [which repeals and recreates the existing investment adviser net capital rules in DFI-Sec 5.02(1) and (2)] adopts certain of the Model Investment Adviser Net Capital Rules that were developed by a Project Group of the North American Securities Administrator's Association, Inc. and which were adopted by vote of the NASAA membership (including Wisconsin) at the NASAA Spring Conference in April, 1999. The rules, which apply only to licensed investment advisers with a principal office in this state, will enable Wisconsin's net capital requirements for the protection of Wisconsin customers under the Wisconsin Uniform Securities Law to be uniform with the NASAA rules as they are adopted by other NASAA member states. State administrative rules in this area are critical because as a result of the National Securities Markets Improvement Act of 1996, state-licensed investment advisers are subject only to the substantive licensing requirements regarding matters such as net capital, books and records, and periodic reporting, of the state in which the investment adviser has its principal place of business.

The two repealed and recreated rules adopt subs. (a) and (b) of the NASAA Model Rules which set forth the specific net capital levels and differentiate on the basis of criteria such as custody, discretionary authority, or prepayment of fees beyond specified dollar levels. The provision in

Paragraph (f) of the NASAA Model Rules which enables the Division to require an appraisal to establish the worth of any asset is included in new DFI-Sec 5.02(1). The requirements contained in the NASAA Model Rules paragraphs (c) [regarding reporting capital deficiencies], (d) [defining "net worth"], (e) [defining "custody"] and (g) [home state requirements], are already contained in existing Wisconsin equivalent rule provisions in DFI-Sec 5.04(1), 5.02(5), 1.02(17) and 5.02(4), respectively. The Division is not adopting the bonding provisions contained in the NASAA Model Rules because they would require a state securities administrator to separately evaluate each adviser's client base and assets under management (which can change radically in the near term as well as over time) to establish a specific bonding level for the adviser.

SECTION 26. DFI-Sec 5.03(1)(o) is created to read:

DFI-Sec 5.03(1)(o) A record containing information concerning a customer's net worth, annual income and other financial information, investment objectives and experience and such other information necessary for the investment adviser to determine the suitability of investment recommendations. The record shall be updated when the investment adviser receives information from the customer that results in material changes to the customer's annual income, net worth, investment objectives or other changes to information affecting the investment adviser's ability to make suitable recommendations for the customer as required under s. DFI-Sec 5.06(4).

ANALYSIS: This new rule (which parallels an equivalent rule in DFI-Sec 4.03(1)(k) applicable to securities broker-dealers) requires an investment adviser to maintain a record of prescribed customer information to be used by the adviser in determining whether investment recommendations made by the adviser are suitable for the customer. For the same customer/investor protection reasons that underlie the broker-dealer suitability rule requirement in DFI-Sec 4.06(1)(c)1, an investment adviser must have information about the client's financial condition, investment objectives, investment experience and other relevant information to make suitable investment-related recommendations for an advisory customer. Paralleling the equivalent broker-dealer rule in DFI-Sec 4.05(5), the customer record information under the rule is required to be updated when the investment adviser becomes aware of material changes that would impact recommendations.

SECTION 27. DFI-Sec 5.03(5) is amended to read:

DFI-Sec 5.03(5) Every branch office as defined in s. DFI-Sec 1.02(7)(b), of a licensed investment adviser whose principal office is in this state, shall prepare and keep current the records described in subs. (1) (c), (f), (g), (h), (k), ~~and~~ (L) and (o) and (2) (a) and (b).

ANALYSIS : This amendment adds to the investment adviser branch office record retention rule, a cross-reference to the new customer suitability information rule created above.

SECTION 28. DFI-Sec 5.035 is created to read:

DFI-Sec 5.035 INVESTMENT ADVISERS WITH CUSTODY. (1) Except as provided in sub. (2), every licensed investment adviser whose principal office is in this state that takes or has custody of any securities or funds of any customer shall comply with all of the following:

(a) The investment adviser shall notify the Division in writing within 30 days after the investment adviser first has custody of customer funds or securities, which notification may be given on Form ADV.

(b) The securities of each customer shall be segregated, marked to identify the particular customer having the beneficial ownership or interest in the securities, and held in safekeeping in a place reasonably free from risk of destruction or other loss.

(c) With regard to customer funds, the investment adviser shall comply with all of the following:

1. Deposit all customer funds in one or more bank accounts containing only customer funds.

2. The bank account or accounts shall be maintained in the name of the investment adviser as agent or trustee for the customers.

3. The investment adviser shall maintain a separate record for each bank account showing the name and address of the bank where the account is maintained, the dates and amounts of deposits in and withdrawals from the account, and the exact amount of each customer's beneficial interest in the account.

(d) Immediately after accepting custody or possession of funds or securities from any customer, the investment adviser shall notify the customer in writing of the place where, and the manner in which, the funds and securities will be maintained. If and when there is a subsequent change in the place where, or the manner in which, a customer's funds or securities are maintained, the investment adviser shall give immediate written notice of the change to the customer.

(e) At least once every three months, the investment adviser shall send to each customer an itemized statement showing the customer's funds and securities in the investment adviser's custody at the end of the period, and all debits, credits and transactions in the customer's account during the period.

(f) At least once every calendar year, the investment adviser shall cause an independent certified public accountant or public accountant to conduct an examination at a time chosen by the accountant without prior notice to the investment adviser, for the purpose of verifying the account balances for all customer funds and securities. A copy of a report from the accountant stating that the accountant has made an examination of customer funds and securities, and describing the nature and extent of the examination, shall be filed with the division promptly after the examination.

(2) Subsection (1) shall not apply to an investment adviser also registered as a broker-dealer under section 15 of the securities exchange act of 1934, and licensed as a broker-dealer under chapter 551, Wis. Stats., if either of the following apply:

(a) The broker-dealer is subject to, and is in compliance with, rule 15c3-1 (Net Capital Requirements for Brokers or Dealers) under the securities exchange act of 1934.

(b) The broker-dealer is a member of an exchange whose members are exempt from rule 15c3-1 under the securities exchange act of 1934 by application of paragraph (b)(2) thereof, and the broker-dealer is in compliance with all rules and settled practices of the exchange imposing requirements with respect to financial responsibility and the segregation of funds or securities carried for the account of customers.

ANALYSIS: This new Section mirrors the Model Rule for Investment Advisers Having Custody of Customer Funds or Securities that was developed by a Project Group of the North American Securities Administrator's Association, Inc. and which was adopted by vote of the NASAA membership (including Wisconsin) at the NASAA Spring Conference in April, 1999. The rule, which applies only to licensed investment advisers with a principal office in this state, is needed to particularize requirements in this area for the protection of Wisconsin customers under the Wisconsin Uniform Securities Law because the rule requirements of the U. S. Securities and Exchange Commission (upon which the NASAA Model Rule is based) are no longer applicable to state-licensed investment advisers as a result of the National Securities Markets Improvement Act of 1996. Rather, state-licensed investment advisers are subject only to the substantive licensing requirements regarding matters such as books and records, reporting, and net capital, of the state in which the investment adviser has its principal place of business. The specific requirements in pars. (b) to (f) of the NASAA Model Rule are taken from equivalent federal provisions in rule 206(4)-2 of the Investment Advisers Act of 1940 relating to safekeeping of customer securities in segregated accounts, establishing bank accounts for customer funds, providing notice to customers, and requiring an annual examination by an independent accountant. The provision in par. (a) requiring notice to the Division is derived from the reporting requirement regarding custody contained in federal Form ADV. Also with regard to par. (a), language is added providing for a 30-day filing period in order to provide specificity as to when the notification to the Division is required (which corresponds to the 30-day filing period for amendments to Form ADV). Also added to provide specificity is the term "first" for the purpose of establishing when the 30-day filing period requirement begins to run. Subsection (2) of the rule (which also parallels the federal rule) provides that the custody requirements in sub. (1) are not applicable to an investment adviser that is a federally-registered broker-dealer and is also licensed as a broker-dealer in Wisconsin, and complies with either par. (a) or (b) thereof.

SECTION 29. DFI-Sec 5.04(1) is amended to read:

DFI-Sec 5.04(1) Every investment adviser shall file with the division immediate notice via facsimile or other electronic means whenever the net capital of the investment adviser is less than is required under s. DFI-Sec 5.02(1), specifying the amount of net capital on the date of the notice and the steps the investment adviser has taken or will take to come into compliance.

ANALYSIS: This amendment updates the terminology used in this reporting rule to permit "electronic" notice--which would include notification provided by facsimile and e-mail.

SECTION 30. DFI-Sec 5.05(11)(f) is created to read:

DFI-Sec 5.05(11)(f) Notify the division at the time of filing notice of opening or change of address of a branch office as required in section DFI-Sec 5.04(5), that the office is located on the premises of a financial institution in this state, which notification shall include the identity of the institution.

ANALYSIS: This rule requires an investment adviser to notify the Division when a branch office is located in a financial institution in order to assist the Department of Financial Institutions in coordinating/combining securities and banking-type examinations of offices of financial institutions in Wisconsin where securities activities are provided on-site. Coordinating such examinations will provide regulatory efficiency and reduce disruption to the locations where the joint examinations will be conducted.

SECTION 31. DFI-Sec 5.06(6) is amended to read:

DFI-Sec 5.06(6) Borrowing money or securities from, or lending money or securities to, a customer, unless that customer is a financial institution or institutional investor designated in s. 551.23(8) (a) to (f), Stats. ;

ANALYSIS: This SECTION amends the investment adviser Prohibited Business Practice rule relating to borrowing money or securities from a customer by adding identical exclusionary language from the securities agent Prohibited Business Practices rule in DFI-Sec 4.06(2)(a) which permits borrowing transactions with a customer that is a financial institution or institutional investor entity specified in sec. 551.23(8)(a) to (f).

SECTION 32. DFI-Sec 7.06(1)(b) is amended to read:

DFI-Sec 7.06(1)(b) Examined and reported upon by an independent certified public accountant, provided that this requirement may be waived by the division and does not apply to interim financial statements ~~or to financial statements of investment advisers that are prepared in compliance with DFI-Sec 5.04(1)(a),~~ unless required by the division in particular cases. The accountant's report shall meet the requirements of rule 2-02 of regulation S-X of the U.S. securities and exchange commission and shall accompany the financial statements included in the prospectus.

ANALYSIS: This amendment deletes from the rule a cross-reference to financial statements of investment advisers because the requirement for investment advisers to file financial statements with the Division was repealed in a previous year's rule revision.

SECTION 33. DFI-Sec 9.01(1)(a)3., and (1)(b)4., 14. and 16. are repealed.

ANALYSIS: This SECTION does the following: (1) Repeals the RS-IC Investment Company Report of Sales form because the Form NF prescribed in DFI-Sec 9.01(1)(d) is now uniformly used by investment companies both for purposes of making their initial notice filings under sec. 551.29(1)(a), Wis. Stats., and for making annual reports of sales under the indefinite sales provisions of sec. 551.52(1)(b)2, Wis. Stats.; and (2) Repeals three rule provisions relating to licensing forms BDW(WI), IAW(WI) and IAPC that are no longer used by the Division.

SECTION 34. DFI-Sec 9.01(1)(a)4. is renumbered DFI-Sec 9.01(1)(a)3., DFI-Sec 9.01(1)(b)5. to 13. are renumbered DFI-Sec 9.01(1)(b)4. to 12., DFI-Sec 9.01(1)(b)15. is renumbered DFI-Sec 9.01(1)(b)13., and DFI-Sec 9.01(1)(b)17. to 20. are renumbered DFI-Sec 9.01(1)(b)14. to 17.

ANALYSIS: These renumberings are necessary to maintain sequential numbering following the repeals in the previous SECTION.

* * * * *

The rules and amendments contained in this Order shall take effect as provided in s. 227.22(2) (intro.), Stats., on the first day of the month following the date of publication in the Wisconsin Administrative Register.

DATED at Madison, Wisconsin, this _____ day of _____, 1999.

[SEAL]

_____
PATRICIA D. STRUCK
Administrator
Division of Securities

PROPOSED FINAL ORDER OF THE
DIVISION OF SECURITIES
DEPARTMENT OF FINANCIAL INSTITUTIONS
STATE OF WISCONSIN
ADOPTING, AMENDING AND REPEALING RULES

To repeal DFI-Sec 4.035, 9.01(1)(a)3., 9.01(1)(b)4., 14., and 16; to renumber DFI-Sec 1.02(18), 2.01(3), 4.01(4)(f), 9.01(1)(a)4., 9.01(1)(b) 5. to 13., 9.01(1)(b)15., and 9.01(1)(b)17. to 20.; to amend DFI-Sec 1.02(1)(a)1, 2.02(9)(a) and (L), 2.04(1)(a), 3.03(3), 4.01(3)(b) to (e), 4.01(5)(a) to (d), 4.04(5)(a), 4.04(6), 5.01(4)(a), 5.03(5), 5.04(1), 5.06(6), 7.06(1)(b); to repeal and recreate 4.01(3)(a), 4.05(9), 5.01(3), 5.02(1) and (2); and to create 2.01(3)(b), 4.01(3)(f) and (g)., 4.01(4)(f) and (g), 4.01(5)(e), 5.01(4)(d), 5.03(1)(o), 5.035, and 5.05(11)(f) relating to securities broker-dealer, agent and investment adviser licensing requirements and procedures, securities registration exemptions, definitions and forms.

Pursuant to sections. 551.63(1), (2) and (3), 551.22(7), 551.23(11)(b), 551.23(18), 551.29(1), 551.32(4)(5) and (7), and 551.33(1), (2) and (6), Wis. Stats., the Division of Securities of the Department of Financial Institutions repeals, amends and adopts rules interpreting those sections as follows:

Proposed Final Rules

DEPARTMENT OF FINANCIAL INSTITUTIONS

DIVISION OF SECURITIES

1999 Rule Revision

SECTION 1. DFI-Sec 1.02(1)(a)1. is amended to read:

DFI-Sec 1.02(1)(a)1. Advertising printed in any newspaper, magazine, periodical or other publication and mailed or delivered to its subscribers or addressees, or communicated by radio, television or ~~similar~~ other electronic means, including via the internet; or

ANALYSIS : This amendment provides language to specifically include the World Wide Web/Internet as a type of electronic, specifically-listed medium for dissemination of advertising for purposes of being covered by the definition of "publication" under the advertising definitional rule in DFI-Sec 1.02(1)(a). As a result of the public hearing and comment process, modification language was added to the Public Comment Draft form of the rule to provide that the reference in the rule to the Internet be included as a type of electronic dissemination of advertising. The public comment draft language had the potential to be interpreted as unduly limiting the scope of the rule such that other types of electronic means of communication, such as facsimile, could be inadvertently omitted from coverage.

SECTION 2. DFI-Sec 1.02(18) is renumbered DFI-Sec 1.02(14)(g)

ANALYSIS: The renumbering in this SECTION consolidates this rule (which provides an exclusion from the definition of "investment adviser") with the primary definitional rule of "investment adviser" in DFI-Sec 1.02(14) to which the exclusion relates. The consolidation of the exclusion with the primary definition is needed for readability purposes to ensure that readers of the definition will not fail to see the exclusion.

SECTION 3. DFI-Sec 2.01(3) is renumbered DFI-Sec 2.01(3)(a).

ANALYSIS: This renumbering is needed because of the addition of a second paragraph to subsection 2.01(3) as created in the following SECTION.

SECTION 4. DFI-Sec 2.01(3)(b) is created to read:

DFI-Sec 2.01(3)(b) Pursuant to s. 551.22(7), Stats., any warrant or right to purchase or subscribe to purchase any security listed on either the New York stock exchange, the American stock exchange, the Pacific stock exchange, the Philadelphia stock exchange, the Chicago Board Options exchange, or the national market system of the national association of securities dealers, or any security called for by those warrants or subscription rights, qualifies for registration exemption status.

ANALYSIS: This SECTION creates a new exempt security rule under the "exchange listed security" registration exemption in sec. 551.22(7), Wis. Stats. This new exemption rule is needed as a result of statutory and rule amendments made by the Division in 1998 that were necessitated by language contained in Section 18(b)1 of the National Securities Markets Enhancement Act ("NSMIA") which preempted the "exchange-listed security" registration exemption in all states. However, because of a drafting error in the federal NSMIA legislation that failed to include warrants and subscription rights as well as the securities called for by the warrants or subscription rights, they are neither covered by the current federal provision, nor by the former Wisconsin exemption. Consequently, although corrective legislation on the federal level is being proposed, this rule is needed now to reinstate the registration exemption status in Wisconsin for such warrants and subscription rights that had existed prior to the 1998 Wisconsin statute and rule changes.

As a result of the public hearing and comment process, the rule was modified by adding a reference to the American Stock Exchange (which was inadvertently omitted in the Public Comment Draft from the list of exchanges designated for purposes of the rule).

SECTION 5. DFI-Sec 2.02(9)(a) and (9)(L)(intro.) are amended to read:

DFI-Sec 2.02(9)(a) An exemption under this subsection is available ~~until October 11, 1999~~ for any isolated issuer transaction relating to redeemable securities of an investment company registered under the investment company act of 1940, effected through a licensed broker-dealer pursuant to an unsolicited order or offer to purchase, provided that the broker-dealer obtains from the purchaser a written acknowledgment that the purchase was unsolicited or the confirmation delivered to the purchaser or a memorandum delivered in connection therewith confirms that the purchase was unsolicited by the broker-dealer or any agent of the broker-dealer.

A transaction is presumed to be "isolated" if it is one of not more than 3 such transactions during the prior 12 months.

(L)(intro.) An exemption under this subsection is available ~~until October 11, 1999~~ for any transaction by the sponsor of a unit investment trust involving the resale of a share of beneficial interest in the trust that meets all of the following conditions:

ANALYSIS: The amendments to each rule remove an expiration date for use of those registration exemptions which apply to investment companies as provided therein. The expiration dates were added to each rule incident to the Division's 1998 adoption of comprehensive rules to implement enactment of 1997 Wisconsin Act 316—which made numerous changes to the Wisconsin Uniform Securities Law necessitated by federal legislation in the National Securities Markets Enhancement Act ("NSMIA") that preempted certain areas of state securities regulation. NSMIA contained a provision allowing states a 3-year period (ending October 11, 1999) after enactment of NSMIA to require registration of the securities of an investment company issuer refusing to pay applicable notice filing fees, which date was included for purposes of use of those exemption rules. However, because nothing in NSMIA precludes a state from granting to an issuer of a federal covered security an exemption identical to those granted issuers of other securities—and in fact various exemptions are available for use without a date limitation under the Wisconsin Uniform Securities Law by other non-investment company categories of federal covered security issuers—the expiration dates for use of these exemptions by investment company issuers are deleted.

SECTION 6. DFI-Sec 2.04(1)(a) is amended to read:

DFI-Sec 2.04 FEDERAL COVERED SECURITY NOTICE FILINGS. (1)(a) With respect to a federal covered security referred to in s. 551.29(1)(a), Stats., unless the security is registered or exempt from registration under ss. 551.22 or 551.23, Stats., ~~until October 11, 1999,~~ the issuer or a person acting on behalf of the issuer shall file with the division not later than the initial offer of the security in this state, a consent to service of process signed by the issuer and the notice filing fee prescribed under s. 551.52(1)(a), Stats. If a completed Form NF as prescribed in DFI-Sec 9.01(1)(d) is included with the consent to service of process and the notice filing fee, the issuer need not also include with the filing copies of any documents that are part of the registration statement filed under the securities act of 1933, although the division may at a later

time require the filing of a copy of any document that is part of the registration statement filed under the securities act of 1933.

ANALYSIS: See the ANALYSIS to SECTION 5.

SECTION 7. DFI-Sec 3.03(3) is amended to read:

DFI-Sec 3.03(3) The prospectus shall contain a full disclosure of all material facts relating to the issuer and the offering and sale of the registered securities. A prospectus meeting the requirements under the securities act of 1933 that receives full review by the U. S. securities and exchange commission, shall not be subject to disclosure adequacy review or comment by the division. If the offering is being made pursuant to use of either Regulation A or Rule 504 of Regulation D under the securities act of 1933 or rule 147 under section 3(a)(11) of the securities act of 1933, the form U-7 disclosure document as adopted by the North American Securities Administrators Association, Inc. may be used.

ANALYSIS: This amendment will allow use by small businesses and other issuers making Regulation A offerings in Wisconsin, of the NASAA Form U-7 Disclosure Document [a question-and-answer format disclosure document developed by NASAA as an easier-to-prepare alternative to the traditional "legalese" form of prospectus/disclosure document].

SECTION 8. DFI-Sec 4.01(3)(a) is repealed and recreated to read:

DFI-Sec 4.01(3)(a) The Series 7 General Securities Representative Examination or, in the case of applicants not registered with the national association of securities dealers, inc. or any organized stock exchange in the United States, the Series 2 Securities Exchange Commission Only/National Association of Securities Dealers Non-Member General Securities Examination.

ANALYSIS: This change places the principal emphasis in the sentence on the Series 7 examination because the Series 2 examination is no longer being administered (although passage of the Series 2 exam will continue to be recognized for purposes of the rule). The Series 7 examination is now available to all applicants needing a general securities exam.

SECTION 9. DFI-Sec 4.01(3)(b) to (e) are amended to read:

DFI-Sec 4.01(3)(b) The Series 6 Investment Company Products/Variable Contracts Representative Examination.

(c) The Series 22 Direct Participation Programs Representative Examination.

(d) The Series 52 Municipal Securities Representative Examination.

(e) The Series 62 Corporate Securities Limited Representative Examination.

ANALYSIS: These amendments add the NASD Series number to each of the listed examination descriptions for ease of reference because the examination series number is more recognizable than the exam title.

SECTION 10. DFI-Sec 4.01(3)(f) and (g) are created to read:

DFI-Sec 4.01(3)(f) The Series 42 Registered Options Representative Examination.

(g) The Series 72 Government Securities Representative Examination.

ANALYSIS: These new rules list two special-product examinations whose passage will satisfy the exam requirement for issuance of a limited agent license to an applicant whose activities will be restricted to those securities.

SECTION 11. DFI-Sec 4.01(4)(f) is renumbered (4)(h)

ANALYSIS: This renumbering is necessary to make room for two new limited examinations contained in the following SECTION.

SECTION 12. DFI-Sec 4.01(4)(f) and (g) are created to read:

DFI-Sec 4.01(4)(f) The applicant is currently registered and in good standing as an agent with any Canadian stock exchange or with a securities regulator of any Canadian province or territory, or with the Investment Dealers Association of Canada and has passed either the Series 37 or Series 38 Canada modules of the Series 7 general securities representative qualification examination, except that the applicant's activities may not include the offer and sale of municipal securities unless the applicant passes the examination listed in sub. (3)(d).

(g) The applicant is currently registered and in good standing as an agent with any Japanese stock exchange or with any Japanese securities dealers association and has passed either the Series 47 Japan module of the Series 7 general securities representative qualification examination, except that the applicant's activities may not include the offer and sale of municipal securities unless the applicant passes the examination listed in sub. (3)(d).

ANALYSIS: The Canada and Japan examination modules referenced in these two new rules permit securities agents in those countries (who meet the licensing requirements of the respective country), to take a limited version of the Series 7 General Securities Registered Representative Examination for licensing purposes in the United States. These two new rules make the Canada and Japan examination modules available to Wisconsin agent applicants.

SECTION 13. DFI-Sec 4.01(5)(a) to (d) are amended to read:

DFI-Sec 4.01(5)(a) The Series 24 General Securities Principal Examination.

(b) The Series 26 Investment Company Products/Variable Contracts Principal Examination.

(c) The Series 39 Direct Participation Programs Principal Examination.

(d) The Series 53 Municipal Securities Principal Examination.

ANALYSIS: These amendments add the NASD Series number to each of the listed principal examination descriptions for ease of reference because the examination series number is more recognizable than the exam title.

SECTION 14. DFI-Sec 4.01(5)(e) is created to read:

DFI-Sec 4.01(5)(e) The Series 4 Registered Options Principal Examination.

ANALYSIS: This new rule establishes the principal examination required for persons supervising the offer and sale of options because the subject matter of other principal examinations listed in pars. (5)(a) to (d) does not cover supervision of options business.

SECTION 15. DFI-Sec 4.035 is repealed.

ANALYSIS: This Section repeals a rule (originally adopted in 1981) that both establishes a customer transaction record-keeping requirement for agents, and requires that broker-dealers deliver copies of customer holding records upon written request by agents who have terminated employment with the broker-dealer. The rule has resulted in the Division being interposed in numerous instances in what essentially are employment disputes--a role not within the scope of the Wisconsin Uniform Law, particularly since the Division has no independent, direct authority to force the providing of the records involved. Additionally, as a result of development of the electronic era since the rule's adoption, the need for the rule is now less critical for the reasons that: (i) because computer retention of a broker-dealer's customer holding records is now the norm (which facilitates access to, as well as copying of, customer holding records by the customer's agent), it would be expected that an agent anticipating a move would obtain copies of their customers' holding records before departing their broker-dealer employer; and (ii) customers themselves are increasingly able to access their account information directly via the Internet.

SECTION 16. DFI-Sec 4.04(5)(a) is amended to read:

DFI-Sec 4.04(5)(a) Immediate ~~telegraphic~~ electronic or written notice whenever the net capital of the broker-dealer is less than is required under s. DFI-Sec 4.02 (1), specifying the respective amounts of its net capital and aggregate indebtedness on the date of the notice;

ANALYSIS : This amendment updates the terminology used in this net capital deficiency notice requirement rule to eliminate "telegraphic" notice and permit "electronic" notice--which would include notification provided by facsimile and e-mail.

SECTION 17. DFI-Sec 4.04(6) is amended to read:

DFI-Sec 4.04(6) Each broker-dealer shall give immediate electronic or written notice to the division of the theft or disappearance of any Wisconsin customers' securities or funds that are in the custody or control of any of its offices, whether within or outside this state, stating all material facts known to it concerning the theft or disappearance.

ANALYSIS: This amendment updates the terminology used in this reporting rule to permit "electronic" notice--which would include notification provided by facsimile and e-mail.

SECTION 18. DFI-Sec 4.05(9) is repealed and recreated to read:

DFI-Sec 4.05(9) No broker-dealer shall conduct broker-dealer services on the premises of a financial institution where retail deposits are taken unless the broker-dealer complies initially and continuously with all of the following requirements:

(a) The broker-dealer services shall be conducted, wherever practical, in a physical location distinct from the area in which the financial institution 's retail deposits are taken. In all situations, the broker-dealer shall identify its services in a manner that clearly distinguishes those services from the financial institution 's retail deposit-taking activities. The broker-dealer 's name shall be clearly displayed in the area in which the broker-dealer conducts its broker-dealer services. Nothing in this paragraph prohibits the financial institution from carrying out other activities within the designated area, provided that no promotional signs or materials shall be displayed in the designated area other than those relating to the securities services.

(b) Networking and brokerage affiliate arrangements shall be governed by a written agreement that sets forth the responsibilities of the parties and the compensation arrangements. Networking and brokerage affiliate arrangements shall provide that supervisory personnel of the broker-dealer and representatives of state securities authorities, where authorized by state law, will be permitted access to the financial institution's premises where the broker-dealer conducts broker-dealer services in order to inspect the books and records and other relevant information maintained by the broker-dealer with respect to its broker-dealer services. The broker-dealer shall ensure that the networking and brokerage affiliate arrangement clearly outlines the duties and responsibilities of all parties. For purposes of this paragraph, "networking arrangement" and "brokerage affiliate arrangement" mean a contractual or other arrangement between a broker-dealer and a financial institution pursuant to which the broker-dealer conducts broker-dealer services on the premises of a financial institution where retail deposits are taken.

(c) At or prior to the time that a customer 's securities brokerage account is opened by a

broker-dealer on the premises of a financial institution where retail deposits are taken, the broker-dealer shall comply with all of the following.

1. Disclose to the customer, orally and in writing, all of the following information about the securities products purchased or sold in a transaction with the broker-dealer:

a. The securities products are not insured by the Federal Deposit Insurance Corporation ("FDIC"), or by other deposit insurance required by the financial institution's government regulatory authority.

b. The securities products are not deposits or other obligations of the financial institution, and are not guaranteed by the financial institution.

c. The securities products are subject to investment risks, including possible loss of the principal invested.

2. Make reasonable efforts to obtain from each customer during the account-opening process, a written acknowledgment of the disclosures required by subd. 1.

(d) If broker-dealer services include any written or oral representations concerning insurance coverage, other than FDIC or similar insurance coverage, then clear and accurate, written or oral explanations of the coverage shall also be provided to the customers when the representations are first made.

(e) Recommendations by a broker-dealer concerning any non-deposit investment product with a name similar to that of the financial institution shall occur only pursuant to a sales program designed to minimize the risk of customer confusion.

(f) All confirmations and account statements shall indicate clearly that the broker-dealer services are provided by the broker-dealer.

(g) Advertisements and sales literature that announce the location of a financial institution

where broker-dealer services are provided by the broker-dealer, or that are distributed by the broker-dealer on the premises of a financial institution, shall disclose using the following language or using the shorter, logo format language in par. (h), the information in each of the following subdivision paragraphs about the securities products purchased or sold in a transaction with the broker-dealer:

1. The securities products are not insured by the FDIC or by other deposit insurance required by the financial institution's governmental regulatory authority.

2. The securities products are not deposits or other obligations of the financial institution, and are not guaranteed by the financial institution.

3. The securities products are subject to investment risks, including possible loss of the principal invested.

(h) The following shorter, logo format disclosures may be used by a broker-dealer in advertisements and sales literature, including material published, or designed for use, in radio or television broadcasts, automated teller machine screens, billboards, signs, posters and brochures, to comply with the requirements of par. (g), provided that the disclosures are displayed in a conspicuous manner:

1. Not FDIC Insured.

2. No Bank Guarantee.

3. May Lose Value.

(i) Provided that the omission of the disclosures required by par.(g) would not cause the advertisement or sales literature to be misleading in light of the context in which the material is presented, the disclosures in par.(g) shall not be not required with respect to messages contained in any of the following:

1. Radio broadcasts of 30 seconds or less.

2. Electronic signs, including billboard-type signs that are electronic, time, and temperature signs and ticker-tape signs, but excluding messages contained in media such as television, on-line computer services, or automated teller machines.

3. Signs, such as banners and posters, when used only as location indicators.

(j) The broker-dealer shall promptly notify the financial institution if any agent of the broker-dealer who is employed by the financial institution is terminated for cause by the broker-dealer.

(k) The broker-dealer shall establish written supervisory procedures and a system for applying the procedures. The procedures shall comply with sub.(2) and shall be designed to accomplish certain supervisory functions, including but not limited to the following:

1. Prevention and detection of violations of ch. 551, Stats., and any applicable rules and orders thereunder;

2. Establishment of a system under which the broker-dealer approves prior to use copies of all advertising used by the financial institution relating to the securities services conducted on the premises of the financial institution for the purpose of ensuring compliance with ss. 551.41 and 551.53, Stats.; and

3. Establishment of a system for prompt and proper execution and settlement of securities transaction orders, the safekeeping of customer funds and securities, and the maintenance of books and records.

(L) Notify the division at the time of filing the notice of opening or change of address of a branch office as required in s DFI-Sec 4.04(8), that the office is located on the premises of a financial institution in this state, which notification shall include the identity of the institution.

ANALYSIS: To achieve uniformity with other NASAA member states as well as with the NASD and federal financial regulatory authorities with regard to the securities law regulatory considerations relating to broker-dealers providing securities services on the premises of financial institutions, this SECTION replaces the existing Wisconsin rules on this subject [as contained in DFI-Sec 4.05(9)(a), (b), (c) and (e)] with the NASAA Model Rules For Sales of Securities at Financial Institutions as adopted by vote of NASAA member states (including Wisconsin) at the NASAA 1999 Fall Conference.

The NASAA rule itself is based on and mirrors the provisions of both the NASD's Rule 2350 on this subject (adopted in 1998) and the Interagency Statement on Retail Sales of Non-Deposit Investment Products (adopted jointly in 1994 by the Federal Reserve System, the Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, and the Office of Thrift Supervision). As stated in the NASAA Rule, the rules apply exclusively to broker-dealer services conducted by broker-dealers on the premises of financial institutions where retail deposits are taken, and do not apply to broker-dealer services provided to non-retail customers. Also, the rules do not apply to or regulate the activities of financial institutions.

The rule provisions in this SECTION correspond with the following provisions from the NASD Rule and the Interagency Statement: (1) Paragraph (a) [physical location and identification]. The introduction and text are from (c) and (c)(1) of the NASD Rule, with the last sentence retained from (9)(a) of the current Wisconsin rule which provides (as an example of the kind of situation the "wherever practical" language from the NASD Rule is meant to cover) a specific waiver allowing a financial institution to carry out other activities within the designated securities area if no signage or materials are displayed. (2) Paragraph (b) [networking]. The first two sentences are from (c)(2) of the NASD Rule with the addition (per the NASAA Rule) of a proviso permitting lawful access by state securities administrators. The third sentence is from Page 9 of the Interagency Statement, and the last sentence containing a definition is from the NASD Rule. (3) Paragraph (c) [customer disclosures and written acknowledgement]. The introduction and subd.1 are from (c)(3) of the NASD Rule. (4) Paragraph (d) [insurance disclosures] and paragraph (e) [products with a name similar to the financial institution] are each from Page 9 of the Interagency Statement. (5) Paragraph (f) [confirmation disclosure] is from (c)(4)(A) of the NASD Rule. (6) Paragraph (g) [advertising disclosures] is from (c)(4)(B) of the NASD Rule. (7) Paragraphs (h) and (i) [advertising logo format alternatives and waivers] are from (c)(4)(C) and (D), respectively, of the NASD Rule. (7) Paragraph (j) [notice of termination] is from (c)5 of the NASD Rule.

As a result of a recommendation by the Wisconsin Legislative Council's Rules Clearinghouse in its Report relating to the Division's proposed rules, the separate Sections in the Public Comment Draft renumbering DFI-Sec 4.05(9)(d) as (k) and creating new DFI-Sec 4.05(9)(L) were all combined together with the creation of the new rules in Section 20 of the Public Comment Draft into a single SECTION repealing and recreating the entirety of DFI-Sec 4.05(9). Because existing rule DFI-Sec 4.05(9)(d) [regarding a broker-dealer's supervisory procedures] is not covered in the NASAA Model Rule, it is retained by adding it as paragraph (k) of the new, recreated DFI-Sec 4.05(9). As stated in the Public Comment Draft, new rule paragraph (L) requires a broker-dealer to notify the Division when a branch office is located in a financial institution in Wisconsin in order to assist the Department of Financial Institutions in coordinating/combining securities and banking-type examinations of offices of financial institutions in Wisconsin where securities activities are provided on-site. Coordinating such examinations will provide regulatory efficiency and reduce disruption to the locations where the joint examinations will be conducted.

SECTION 19. DFI-Sec 5.01(3) is repealed and recreated to read:

DFI-Sec 5.01(3) Unless waived under sub. (4), each applicant for an initial license as an investment adviser or as an investment adviser representative after January 1, 2000, and each applicant whose application has not become effective by January 1, 2000, is required to provide the Division with proof that he or she has obtained a passing score on the examination specified in par. (3)(a) or each examination specified in par. (3)(b) below.

(a)The Series 65 Uniform Investment Adviser Law Examination.

(b)The Series 7 General Securities Representative Examination as well as the Series 66 Uniform Combined State Law Examination.

ANALYSIS: This SECTION repeals and recreates the existing Wisconsin examination requirements for investment advisers and investment adviser representatives in rule DFI-Sec 5.01(3) (a) and (b) [which consist of the "old" Series 65 and Series 66 examinations] by adopting the "new," completely revised Series 65 and Series 66 examinations developed over a 3-year period by a Project Group of the North American Securities Administrators Association. The two examinations (and the exam waivers in a following SECTION) were approved by vote of NASAA member states (including Wisconsin) at the NASAA Spring Conference in April 1999, to become effective on December 31, 1999, with a recommendation that for uniformity purposes, NASAA member states complete the necessary steps to adopt the examinations by that date.

The new Series 65 competency exam consists of 130 questions divided into four subject areas: (i) economics and analysis; (ii) investment vehicles; (iii) investment recommendations and strategies; and (iv) ethics and legal guidelines.[The "old" Series 65 exam was a 75-question test that focused mainly on knowledge of securities law and ethics.] Addition of the new categories of questions which an applicant for an investment adviser representative license must answer will help assure investors that their advisers have the minimum skills necessary to provide competent, suitable advice.

The new Series 66 exam was created for broker-dealer agents applying for separate licensure as investment adviser representatives. The 100-question exam is a combination of the current Series 63 exam (a state licensing exam for agents) and the new Series 65 competency exam. The Series 66 exam will be used in Wisconsin for situations where a person already licensed as an agent seeks to become separately licensed as an investment adviser representative. The Series 66 exam will be administered only to those applicants who have passed the NASD's Series 7 exam, which covers investment vehicles and economics. To eliminate the need for agents who have passed the Series 7 from having to

be tested on the same exam content in the new Series 66, a NASAA-assembled committee of industry experts compared the two exams and deleted duplicative questions.

NASD Regulation will administer both the Series 65 and Series 66 examinations through its test sites.

SECTION 20. DFI-Sec 5.01(4)(a) is amended to read:

DFI-Sec 5.01(4)(a) The applicant has passed, or has received a waiver from the need to pass, the National Association of Securities Dealers, Inc., Series ~~2~~, 7 ~~or 24~~ examination, ~~or predecessor examination,~~ and in addition has passed or received a waiver from the need to pass, ~~either~~ the North American Securities Administrators Association Series 63 ~~or Series 66~~ Examination.

ANALYSIS: In connection with the adoption of the NASAA Series 65 and 66 Investment Adviser Competency Examinations and related exam waivers contained in other SECTIONS of this rule revision, this SECTION makes needed amendments to the existing exam waiver rule in DFI-Sec 5.01(4)(a) in the following respects: (1) deletes the Series 2 and Series 24 (and predecessor) examinations as a basis for a waiver because they are not sufficiently equivalent to the new Series 65 and Series 66; and (2) deletes (as being unnecessary) the reference to the Series 66 exam in this waiver rule because the combination of the Series 7 exam and the Series 66 exam is one of the two alternatives of the basic examination requirement in recreated rule 5.01(3)(b) in a preceding SECTION.

SECTION 21. DFI-Sec 5.01(4)(d) is created to read:

DFI-Sec 5.01(4)(d) The applicant provides the division with proof that he or she currently holds one of the following professional designations:

1. Certified Financial Planner (CFP) issued by the Certified Financial Planner Board of Standards, Inc.

2. Chartered Financial Consultant (ChFC) awarded by the American College, Bryn Mawr, Pennsylvania.

3. Personal Financial Specialist (PFS) administered by the American Institute of Certified Public Accountants.

4. Chartered Financial Analyst (CFA) granted by the Association for Investment Management and Research.

5. Chartered Investment Counselor (CIC) granted by the Investment Counsel Association of America.

ANALYSIS: This SECTION adopts the examination waivers for the listed professional designations as adopted by NASAA incident to its creation and development of the Series 65 and Series 66 Investment Adviser Competency Examination project. The Wisconsin preamble language to the waivers requires that to obtain a waiver, the applicant must provide proof that he or she currently holds one of the specified professional designations. Because of the need to be able to verify that a person in fact holds a particular designation, the Division will contact the various organizations to ascertain how a designation status claimed by an applicant can be verified by the Division. If a particular organization cannot demonstrate that a reliable verification procedure exists, the waiver designation for the organization will not be adopted in the final version of this rule.

The NASAA waiver provision for discretionary action by order of the Division is not included under this new rule in par. (4)(d) because such discretionary waiver authority is already present in current rule 5.01(4)(c). Similarly, the NASAA 2-year "grandfathering" provision is already present in current rule 5.01(4)(b). Additionally, the NASAA "grandfathering" provision for currently licensed investment advisers and investment adviser representatives is contained in the preamble language to new rule 5.01(3) in a preceding SECTION.

SECTION 22. DFI-Sec 5.02(1) and (2) are repealed and recreated to read:

DFI-Sec 5.02(1) Each investment adviser licensed or required to be licensed under ch. 551, Stats., whose principal office is in this state and who accepts prepayment of fees exceeding $500 per client that are collected six or more months in advance, shall maintain at all times a positive net worth. The Division may require that a current appraisal be submitted in order to establish the worth of any asset.

(2) Each investment adviser licensed or required to be licensed under ch. 551, Stats., whose principal office is in this state who has custody of client funds or securities shall maintain at all times a minimum net worth of $35,000.

ANALYSIS: This new Section [which repeals and recreates the existing investment adviser net capital rules in DFI-Sec 5.02(1) and (2)] adopts certain of the Model Investment Adviser Net Capital Rules that were developed by a Project Group of the North American Securities Administrator's Association, Inc. and which were adopted by vote of the NASAA membership (including Wisconsin) at the NASAA Spring Conference in April, 1999. The rules, which apply only to licensed investment advisers with a principal office in this state, will enable Wisconsin's net capital requirements for the protection of Wisconsin customers under the Wisconsin Uniform Securities Law to be uniform with the NASAA rules as they are adopted by other NASAA member states. State administrative rules in this area are critical because as a result of the National Securities Markets Improvement Act of 1996, state-licensed investment advisers are subject only to the substantive licensing requirements regarding matters such as net capital, books and records, and periodic reporting, of the state in which the investment adviser has its principal place of business.

The two repealed and recreated rules adopt sub. (a) and part of sub. (b) of the NASAA Model Rules which set forth the specific net capital levels and differentiate on the basis of the criteria of: (i) prepayment of fees beyond specified dollar levels (in sub. (1) of the Wisconsin rule); and (ii) custody of customer funds or securities (in sub. (2) of the Wisconsin rule).

As a result of the public comment and hearing process, the second part of proposed rule DFI-Sec 5.02(2) was deleted. The Division staff noted that in its experience conducting on-site examinations of Wisconsin-licensed investment advisers, there are at least 32 advisers that have some degree of discretion over customer accounts (but do not have custody of customer funds or securities). Most of those advisers are small businesses with only 1 or 2 advisory personnel and have few (typically 1 to 5) customer accounts, such that (i) requiring them to maintain $10,000 net capital solely because they have discretionary authority would cause an undue financial hardship on them; and (ii) the net capital requirement as to such non-custodial advisers would not provide significant investor protection for customers of such advisers.

The provision in Paragraph (f) of the NASAA Model Rules which enables the Division to require an appraisal to establish the worth of any asset is included in new DFI-Sec 5.02(1). The requirements contained in the NASAA Model Rules paragraphs (c) [regarding reporting capital deficiencies], (d) [defining "net worth"], (e) [defining "custody"] and (g) [home state requirements], are already contained in existing Wisconsin equivalent rule provisions in DFI-Sec 5.04(1), 5.02(5), 1.02(17) and 5.02(4), respectively. The Division is not adopting the bonding provisions contained in the NASAA Model Rules because they would require a state securities administrator to separately evaluate each adviser's client base and assets under management (which can change radically in the near term as well as over time) to establish a specific bonding level for the adviser.

SECTION 23. DFI-Sec 5.03(1)(o) is created to read:

DFI-Sec 5.03(1)(o) A record containing information concerning a customer's net worth, annual income and other financial information, investment objectives and experience and such

other information necessary for the investment adviser to determine the suitability of investment recommendations. The record shall be updated when the investment adviser receives information from the customer that results in material changes to the customer's annual income, net worth, investment objectives or other changes to information affecting the investment adviser's ability to make suitable recommendations for the customer as required under s. DFI-Sec 5.06(4).

ANALYSIS: This new rule (which parallels an equivalent rule in DFI-Sec 4.03(1)(k) applicable to securities broker-dealers) requires an investment adviser to maintain a record of prescribed customer information to be used by the adviser in determining whether investment recommendations made by the adviser are suitable for the customer. For the same customer/investor protection reasons that underlie the broker-dealer suitability rule requirement in DFI-Sec 4.06(1)(c)1, an investment adviser must have information about the client's financial condition, investment objectives, investment experience and other relevant information to make suitable investment-related recommendations for an advisory customer. Paralleling the equivalent broker-dealer rule in DFI-Sec 4.05(5), the customer record information under the rule is required to be updated when the investment adviser becomes aware of material changes that would impact recommendations.

SECTION 24. DFI-Sec 5.03(5) is amended to read:

DFI-Sec 5.03(5) Every branch office, as defined in s. DFI-Sec 1.02(7)(b), of a licensed investment adviser whose principal office is in this state, shall prepare and keep current the records described in subs. (1) (c), (f), (g), (h), (k), ~~and~~ (L) and (o) and (2) (a) and (b).

ANALYSIS : This amendment adds to the investment adviser branch office record retention rule, a cross-reference to the new customer suitability information rule created above.

SECTION 25. DFI-Sec 5.035 is created to read:

DFI-Sec 5.035 INVESTMENT ADVISERS WITH CUSTODY. (1) Except as provided in subs. (2) and (3), every licensed investment adviser whose principal office is in this state that takes or has custody of any securities or funds of any customer shall comply with all of the following:

(a) The investment adviser shall notify the Division in writing within 30 days after the investment adviser first has custody of customer funds or securities, which notification may be given on Form ADV.

(b) The securities of each customer shall be segregated, marked to identify the particular customer having the beneficial ownership or interest in the securities, and held in safekeeping in a place reasonably free from risk of destruction or other loss.

(c) With regard to customer funds, the investment adviser shall comply with the following:

1. Deposit all customer funds in one or more bank accounts containing only customer funds.

2. The bank account or accounts shall be maintained in the name of the investment adviser as agent or trustee for the customers.

3. The investment adviser shall maintain a separate record for each bank account showing the name and address of the bank where the account is maintained, the dates and amounts of deposits in and withdrawals from the account, and the exact amount of each customer's beneficial interest in the account.

(d) Immediately after accepting custody or possession of funds or securities from any customer, the investment adviser shall notify the customer in writing of the place where, and the manner in which, the funds and securities will be maintained. If and when there is a subsequent change in the place where, or the manner in which, a customer's funds or securities are maintained, the investment adviser shall give immediate written notice of the change to the customer.

(e) At least once every three months, the investment adviser shall send to each customer an itemized statement showing the customer's funds and securities in the investment adviser's

custody at the end of the period, and all debits, credits and transactions in the customer's account during the period.

(f) At least once every calendar year, the investment adviser shall cause an independent certified public accountant or public accountant to conduct an examination at a time chosen by the accountant without prior notice to the investment adviser, for the purpose of verifying the account balances for all customer funds and securities. A copy of a report from the accountant stating that the accountant has made an examination of customer funds and securities, and describing the nature and extent of the examination, shall be filed with the division promptly after the examination.

(2) Subsection (1) does not apply to an investment adviser also registered as a broker-dealer under section 15 of the securities exchange act of 1934, and licensed as a broker-dealer under chapter 551, Wis. Stats., if either of the following apply:

(a) The broker-dealer is subject to, and is in compliance with, rule 15c3-1 (Net Capital Requirements for Brokers or Dealers) under the securities exchange act of 1934.

(b) The broker-dealer is a member of an exchange whose members are exempt from rule 15c3-1 under the securities exchange act of 1934 by application of paragraph (b)(2) thereof, and the broker-dealer is in compliance with all rules and settled practices of the exchange imposing requirements with respect to financial responsibility and the segregation of funds or securities carried for the account of customers.

(3) An investment adviser who acts as a trustee of a beneficial trust is not required to comply with the requirements in sub. (1) if all of the following conditions are met for each trust:

(a) The only accounts for which the adviser maintains custody of funds or securities are those in which the adviser acts as trustee of a trust beneficially owned by a parent, a grandparent, a spouse, a sibling, a child or a grandchild of the adviser.

(b) For each account under par. (a), the adviser complies with all of the following:

1. The adviser provides a written statement to each beneficial owner of the account setting forth a description of the requirements of sub. (1) and the reasons why the adviser will not be complying with the rule requirements.

2. The adviser obtains from each beneficial owner a signed statement acknowledging the receipt of the written statement required under subpar. (b)1.

3. The adviser maintains a copy of both the written statement required under subpar. (b)1., and the signed acknowledgement required under subpar. (b)2. from each beneficial owner, until the account is closed or the adviser relinquishes trusteeship.

ANALYSIS: This new Section mirrors the Model Rule for Investment Advisers Having Custody of Customer Funds or Securities that was developed by a Project Group of the North American Securities Administrator's Association, Inc. and which was adopted by vote of the NASAA membership (including Wisconsin) at the NASAA Spring Conference in April, 1999. The rule, which applies only to licensed investment advisers with a principal office in this state, is needed to particularize requirements in this area for the protection of Wisconsin customers under the Wisconsin Uniform Securities Law because the rule requirements of the U. S. Securities and Exchange Commission (upon which the NASAA Model Rule is based) are no longer applicable to state-licensed investment advisers as a result of the National Securities Markets Improvement Act of 1996. Rather, state-licensed investment advisers are subject only to the substantive licensing requirements regarding matters such as books and records, reporting, and net capital, of the state in which the investment adviser has its principal place of business. The specific requirements in pars. (b) to (f) of the NASAA Model Rule are taken from equivalent federal provisions in rule 206(4)-2 of the Investment Advisers Act of 1940 relating to safekeeping of customer securities in segregated accounts, establishing bank accounts for customer funds, providing notice to customers, and requiring an annual examination by an independent accountant. The provision in par. (a) requiring notice to the Division is derived from the reporting requirement regarding custody contained in federal Form ADV. Also with regard to par. (a), language is added providing for a 30-day filing period in order to provide specificity as to when the notification to the Division is required (which corresponds to the 30-day filing period for amendments to Form ADV). Also added to provide specificity is the term "first" for the purpose of establishing when the 30-day filing period requirement begins to run. Subsection (2) of the rule (which also parallels the federal rule) provides that the custody requirements in sub. (1) are not applicable to an investment adviser that is a federally-registered broker-dealer and is also licensed as a broker-dealer in Wisconsin, and complies with either par. (a) or (b) thereof.

As a result of the public hearing and comment process, the Section was modified by

adding a new sub. (3) to provide an exemption from the requirements in sub. (1) of the rule under situations where an adviser's "custody" results from being a trustee of a trust account for a family member. The exemption for such so-called "family trusts," and the requirements for use of the exemption the adviser must meet (that are set forth in subpars. (b)1. to 3.), correspond to the U.S. Securities and Exchange Commission's 1986 "no action" letter In the Matter of Kathryn Bondoux wherein the SEC would not require its custody rules to be complied with in the context of so-called "family trusts" meeting prescribed requirements. The requirements in subpars. (b)1. to 3. (to provide written disclosure to, and obtain acknowledgement from, each beneficial owner of the family trust, together with an obligation to retain copies of such) parallel the SEC's requirements. The Wisconsin rule in par. (a) provides more particularity than the SEC's Bondoux letter (which involved a son-parent situation) by setting forth the particular family relationships that can seek to claim the exemption.

SECTION 26. DFI-Sec 5.04(1) is amended to read:

DFI-Sec 5.04(1) Every investment adviser shall file with the division immediate notice via facsimile or other electronic means whenever the net capital of the investment adviser is less than is required under s. DFI-Sec 5.02(1), specifying the amount of net capital on the date of the notice and the steps the investment adviser has taken or will take to come into compliance.

ANALYSIS: This amendment updates the terminology used in this reporting rule to permit "electronic" notice--which would include notification provided by facsimile and e-mail.

SECTION 27. DFI-Sec 5.05(11)(f) is created to read:

DFI-Sec 5.05(11)(f) Notify the division at the time of filing notice of opening or change of address of a branch office as required in section DFI-Sec 5.04(5), that the office is located on the premises of a financial institution in this state, which notification shall include the identity of the institution.

ANALYSIS: This rule requires an investment adviser to notify the Division when a branch office is located in a financial institution in order to assist the Department of Financial Institutions in coordinating/combining securities and banking-type examinations of offices of financial institutions in Wisconsin where securities activities are provided on-site. Coordinating such examinations will provide regulatory efficiency and reduce disruption to the locations where the joint examinations will be conducted.

SECTION 28. DFI-Sec 5.06(6) is amended to read:

DFI-Sec 5.06(6) Borrowing money or securities from, or lending money or securities to, a customer, unless that customer is a financial institution or institutional investor designated in s. 551.23(8) (a) to (f), Stats. ;

ANALYSIS: This SECTION amends the investment adviser Prohibited Business Practice rule relating to borrowing money or securities from a customer by adding identical exclusionary language from the securities agent Prohibited Business Practices rule in DFI-Sec 4.06(2)(a) which permits borrowing transactions with a customer that is a financial institution or institutional investor entity specified in sec. 551.23(8)(a) to (f).

SECTION 29. DFI-Sec 7.06(1)(b) is amended to read:

DFI-Sec 7.06(1)(b) Examined and reported upon by an independent certified public accountant, provided that this requirement may be waived by the division and does not apply to interim financial statements ~~or to financial statements of investment advisers that are prepared in compliance with DFI-Sec 5.04(1)(a),~~ unless required by the division in particular cases. The accountant's report shall meet the requirements of rule 2-02 of regulation S-X of the U.S. securities and exchange commission and shall accompany the financial statements included in the prospectus.

ANALYSIS: This amendment deletes from the rule a cross-reference to financial statements of investment advisers because the requirement for investment advisers to file financial statements with the Division was repealed in a previous year's rule revision.

SECTION 30. DFI-Sec 9.01(1)(a)3., and (1)(b)4., 14. and 16. are repealed.

ANALYSIS: This SECTION does the following: (1) Repeals the RS-IC Investment Company Report of Sales form because the Form NF prescribed in DFI-Sec 9.01(1)(d) is now uniformly used by investment companies both for purposes of making their initial notice filings under sec. 551.29(1)(a), Wis. Stats., and for making annual reports of sales under the indefinite sales provisions of sec. 551.52(1)(b)2, Wis. Stats.; and (2) Repeals three rule provisions relating to licensing forms BDW(WI), IAW(WI) and IAPC that are no longer used by the Division.

SECTION 31. DFI-Sec 9.01(1)(a)4. is renumbered DFI-Sec 9.01(1)(a)3.

ANALYSIS: The renumberings in this SECTION and the three following SECTIONS are necessary to maintain sequential numbering due to the repeals in SECTION 30. The renumberings are made in separate SECTIONS (instead if the single-SECTION treatment in the Public Comment Draft form of the proposed rules) as a result of a comment from the Rules Clearinghouse of the Wisconsin Legislative Council.

SECTION 32. DFI-Sec 9.01(1)(b)5. to 13. are renumbered DFI-Sec 9.01(1)(b)4. to 12.

SECTION 33. DFI-Sec 9.01(1)(b)15. is renumbered DFI-Sec 9.01(1)(b)13.

SECTION 34. DFI-Sec 9.01(1)(b)17. to 20. are renumbered DFI-Sec 9.01(1)(b)14. to 17.

* * * * *

The rules and amendments contained in this Order shall take effect as provided in s. 227.22(2) (intro.), Stats., on the first day of the month following the date of publication in the Wisconsin Administrative Register.

DATED at Madison, Wisconsin, this _____ day of _____, 1999.

[SEAL]

PATRICIA D. STRUCK
Administrator
Division of Securities

JCRAR / Senate Co-Chair Robson

State of Wisconsin

Department of Financial Institutions

SEP 2 0 1999

Tommy G. Thompson, **Governor**

Richard L. Dean, **Secretary**

September 20, 1999

The Honorable Fred Risser, President
Wisconsin State Senate
Attn: Donna Doyle
c/o Office of Senate Journal and Records
1 E. Main St., Ste. 402
Madison, WI 53702

The Honorable Scott Jensen
Speaker of the Assembly
Attn: Ken Stigler
c/o Office of Assembly Records
1 E. Main St., Ste. 402
Madison, WI 53702

Re: Clearinghouse Rule 99-121/Administrative Rule-Making Notice and Report to Legislative Standing Committees Under secs. 227.19(2) and (3), Wis. Stats.

Gentlemen:

The Division of Securities of the Department of Financial Institutions hereby submits for filing with the Wisconsin Legislature pursuant to the administrative rule-making requirements of secs. 227.19(2) and (3), Wis. Stats., copies in triplicate of the Notice and Report required thereunder consisting of:

(1) Proposed administrative rules in proposed final draft form as specified in sec. 227.14(1), Wis. Stats.

(2) A Report as prescribed in sec. 227.19(3), Wis. Stats.

(3) A fiscal estimate for the proposed rules.

(4) A copy of the Clearinghouse Report of the Wisconsin Legislative Council relating to the published, public comment draft form of the proposed rules.

If you have any comments or questions regarding the above, please telephone me at 266-3414.

Very truly yours,

Randall E. Schumann
Legal Counsel for the Division

RES:gat
Attachments
cc: Revisor of Statutes
Joint Committee for Review of Administrative Rules
Patricia D. Struck, Administrator, Division of Securities
David Anderson, Executive Assistant, DFI

Your Money Matters
DFI Financial Education

REPORT PREPARED BY THE
DEPARTMENT OF FINANCIAL INSTITUTIONS, DIVISION OF SECURITIES
RELATING TO PROPOSED FINAL FORM OF AMENDMENTS TO
THE RULES OF THE DIVISION OF SECURITIES

(a) Statement Explaining Need for Proposed Rules

The rulemaking procedures under Chapter 227 of the Wisconsin Statutes are being implemented for the purpose of effectuating the Division's annual review of the Rules of the Division of Securities. The Division's annual rule revision process is conducted for the following purposes: (1) revising several securities law definitional rules to clarify language; (2) developing new securities registration exemptions and making modifications to several existing securities registration exemptions to reflect new legal or interpretive issues under the federal and state securities laws; and (3) adopting new rules, or amending existing rules, relating to the securities broker-dealer, agent, investment adviser, and investment adviser representative licensing procedures, examination and examination waiver requirements, net capital requirements, securities agent customer record requirements, and rules of conduct provisions for broker-dealers and investment advisers, to effectively regulate new securities licensing developments that have occurred in the securities industry and marketplace that require regulatory treatment.

Proposed revisions are being made in a total of 34 different Sections. A summary of the subject matter and nature of the more significant rule revisions follows:

(1) Addition of a reference to the Internet in definitional rule DFI-Sec 1.02(1)(a)1 relating to the use of media advertising;

(2) Deletion of "sunset dates" for use of the registration exemptions in DFI-Sec 2.02(9)(a) and (9)(L) and the notice filing provision in DFI-Sec 2.04(1)(a);

(3) Designation under current rule DFI-Sec 2.01(3) [relating to securities traded on certain exchanges] of warrants and rights for securities traded on the major stock exchanges;

(4) Addition of the NASD Series number to the examination description of all of the prescribed securities agent examinations and securities principal examinations listed in DFI-Sec 4.01(3), (4) and (5), and adopting three new limited activity agent examinations and one new principal examination;

(5) Repeal of existing rule DFI-Sec 4.035 that requires securities agents to keep certain customer records and provides that agents receive copies thereof from the agent's employing broker-dealer;

(6) Adoption of the North American Securities Administrator's Association Model Rules applicable to securities broker-dealers providing securities services on the premises of financial institutions, which Model Rules follow both equivalent rules adopted by the National Association of Securities Dealers (applicable to securities broker-dealers), and regulatory Guidelines in an Interagency Statement jointly developed by federal financial institution

regulatory authorities (the Office of the Comptroller of the Currency, the Federal Reserve Board, and the Federal Deposit Insurance Corporation);

(7) Creation of a rule requiring licensed investment advisers to create and maintain a record of customer information that would facilitate determining suitability of investment recommendations.

(8) Creation of rules requiring a broker-dealer or investment adviser to notify the Division if they open an office in a financial institution in Wisconsin.

(9) Adoption of the NASAA Investment Adviser Competency Examination.

(10) Adoption of the recent amendments to the NASAA Model Rules regarding investment adviser net capital and custody-of-customer-funds-and-securities requirements.

Each Section that adopts, amends or repeals a rule is followed by a separate Analysis which discusses the nature of the revision as well as the reason for it.

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(b) Explanation of Modifications Made as a Result of the Public Hearing and Comment Letter Process

- As a result of the public hearing and comment process, modification language was added to the Public Comment Draft form of proposed rule DFI-Sec 1.02(1)(a)1 defining "publication" to provide that the reference in the rule to the Internet be included as a type of electronic dissemination of advertising. The Public Comment Draft language had the potential to be interpreted as unduly limiting the scope of the rule such that other types of electronic means of communication, such as facsimile, could be inadvertently omitted from coverage.

- As a result of the public hearing and comment process, proposed rule DFI-Sec 2.01(3)(b) [which creates a new exempt security rule under the "exchange-listed security" exemption in sec. 551.22(7), Wis. Stats.,] was revised by adding a reference to the American Stock Exchange (which was inadvertently omitted in the Public Comment Draft from the list of exchanges designated for purposes of the rule).

- As a result of the public hearing and comment process, proposed rule DFI-Sec 2.02(5)(d)3 was withdrawn. That proposed rule would have imposed a notice filing requirement with the Division for use of the private placement registration exemption in sec. 551.23(11), Wis. Stats., for any offering of securities made under Rule 504 of Regulation D under the federal Securities Act of 1933. The rule was proposed for the purpose of preventing misuse of the exemption in so-called "pump and dump" fraudulent schemes identified by the U.S. Securities & Exchange Commission ("SEC") involving securities of "microcap" companies that have occurred both in the secondary market and in connection with the initial issuance of securities in federal Regulation D/ Rule 504 offerings. The proposed rule was withdrawn because the final rulemaking action taken by the SEC in Release 33-7644 to remedy the perceived misuse of the Regulation D/Rule 504 exemption in microcap/pump and dump situations appears to obviate the need (at this time) for Wisconsin rule-making action that would restrict use of the 551.23(11) exemption in Wisconsin for all federal Regulation D/Rule 504 offerings. Thus the Division is deferring rulemaking on this subject for a period of time to enable federal and state securities regulators to monitor and evaluate the effectiveness of the SEC rulemaking in curtailing abusive Regulation D/Rule 504 offerings. If in the future it is determined that the Regulation D/Rule 504 abusive practices were not curtailed by the SEC's rulemaking action, the Division can re-propose the rule or a variation of it.

- As a result of the public hearing and comment process, the second part of proposed rule DFI-Sec 5.02(2) [which would have imposed a $10,000 net worth requirement for any investment adviser having discretionary authority (but not custody) over customer funds or securities] was deleted. The Division staff noted that in its experience conducting on-site examinations of Wisconsin-licensed investment advisers , there are at least 32 advisers that have some degree of discretion over customer accounts (but do not have custody of customer funds or securities). Most of those advisers are small businesses with only 1 or 2 advisory personnel and have few (typically1 to 5) customer accounts, such that: (i) requiring them to maintain $10,000 net capital solely because they have

discretionary authority would cause an undue financial hardship on them; and (ii) the net capital requirement as to such non-custodial advisers would not provide significant investor protection for customers of such advisers.

- As a result of the public hearing and comment process, modifications were made to proposed rule DFI-Sec 5.035 which sets forth regulatory requirements for Wisconsin-licensed investment adviser who have custody of customer funds or securities. A new sub. (3) was added to provide an exemption from the requirements in sub. (1) of the rule where an adviser's "custody" results from being a trustee of a trust account for a family member. The exemption for such so-called "family trusts" and the requirements for use of the exemption the adviser must meet (that are set forth in subpars. (b)1 to 3), correspond to the U.S. Securities and Exchange Commission's 1986 "no action" letter In the Matter of Kathryn Bondoux wherein the SEC would not require its custody rules to be complied with in the context of so-called "family trusts" meeting prescribed requirements. The requirements in subpars. (b)1 to 3 (to provide written disclosure to, and obtain acknowledgement from, each beneficial owner of the family trust, together with an obligation to retain copies of such) parallel the SEC's requirements. The Wisconsin rule in par. (a) provides more particularity than the SEC's Bondoux letter (which involved a son-parent situation) by setting forth the particular family relationships that can seek to claim the exemption.

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(c) List of Persons Appearing or Registering at Public Hearing Conducted by Patricia D. Struck, Division of Securities, Department of Financial Institutions, as Hearing Officer, and Comment Letters Received.

- Randall E. Schumann, Legal Counsel for the Division of Securities, Department of Financial Institutions, made an appearance on behalf of the Division's staff to submit documents and information for the record and to be available both to ask questions and to respond to questions regarding hearing testimony.

- Kenneth L. Hojnacki, Director of the Regulation & Licensing Section for the Division of Securities, Department of Financial Institutions, made an appearance on behalf of the Division's staff to summarize a staff comment letter/memo submitted into the hearing record and to be available both to ask questions and to respond to questions regarding hearing testimony.

- James R. Fischer, Director of the Registration & Enforcement Section for the Division of Securities, Department of Financial Institutions, made an appearance on behalf of the Division's staff to summarize a staff comment letter/memo submitted into the hearing record and to be available both to ask questions and to respond to questions regarding hearing testimony.

- Daniel J. Eastman of Segerdahl & Co., Milwaukee, Wisconsin.

- John D. Geder of Geder Investment Management, Inc., Brookfield, Wisconsin.

Comment Letters Received

(1) Comment letter dated August 10, 1999 from the Investment Company Institute, Washington, DC, received August 13, 1999.

(2) Comment letter dated August 20, 1999 from the National Association of Securities Dealers, Inc., Washington, D.C. received August 25, 1999.

(3) Comment letter sent by facsimile dated August 19, 1999 from the Investment Counsel Association of America, Inc., Washington, D.C.

(4) Comment letter dated August 26, 1999 from the Certified Financial Planner Board Standards, Arlington. Virginia, dated August 26, 1999, received August 30, 1999.

(5) Comment letter dated August 30, 1999 from Attorney Terry F. Peppard, Madison, Wisconsin, received August 31, 1999.

(6) Comment letter dated August 30, 1999 from the Association for Investment Management and Research, Charlottesville, Virginia, received September 3, 1999.

(7) Comment letter sent by facsimile dated September 3, 1999 from The American College, Bryn Mawr, PA.

(8) Memorandum dated September 7, 1999 from Division Licensing & Regulation Section Director Kenneth Hojnacki.

(9) Memorandum dated September 7, 1999 from Division Securities Registration Section Director James Fischer.

(10) Comment letter dated September 3, 1999 from A. G. Edwards & Sons, Inc., St. Louis, Missouri, received September 7, 1999.

(11) Comment letter sent by facsimile dated September 8, 1999 from M&I Brokerage Services, Inc.

(12) Comment letter sent by e-mail dated September 8, 1999 from the American Institute of Certified Public Accountants, Jersey City, New Jersey.

(13) Memorandum dated September 10, 1999 from Division Licensing & Regulation Section staff members.

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(d) Response to Legislative Council/Rules Clearinghouse Report Recommendations

(1) Acceptance of recommendations in whole:

Under 2. Form, Style and Placement in Administrative Code

- Consistent with the Rules Clearinghouse comment in paragraph a. regarding DFI-Sec 2.01(3)(b), the introductory clause was deleted and suggested revised language was substituted. Also, suggested language was added before the period.

- Consistent with the Rules Clearinghouse comment in paragraph b. regarding DFI-Sec 2.02(9)(a) and (L), in the treatment clause to proposed final Section 5, "(intro)" was inserted after "(9)(L)," and in the body of that Section.

- Consistent with the Rules Clearinghouse comment paragraph c. regarding DFI-Sec 4.01(4)(f) and (g), the notation "par." was replaced by the notation "sub."

- Consistent with the Rules Clearinghouse comment in paragraph d. regarding DFI-Sec 4.05(9)(b), (d) and (f), the word "must" was replaced by the word "shall." In par. (b), the word "ensure" was substituted for "be responsible for ensuring". In sub. (9)(c)(intro.), the phrase "all of the following" was substituted for a rule citation. In par. (c)1, substitute language "all of the following information" was used to replace "the information in the following subdivision paragraphs." In par. (c)2, the cross-reference was changed to read "subd. 1." In sub. (9)(g)(intro.), the phrase "following language" was substituted for "language below," and the notation "par (h)" was replaced by the notation "par. (h)." In sub. (9)(h)(intro.), the phrase "one, two and three" was deleted.

- Consistent with the Rules Clearinghouse comment in paragraph e. regarding DFI-Sec 4.05(9)(L), the word "Division" was replaced by the word "division"—which change was made throughout the rule. The word "section" was replaced by the notation "s."

- Consistent with the Rules Clearinghouse comment in paragraph g. regarding DFI-Sec 5.02(1) and (2), the word "and" was inserted after "state" in the first sentence, as well as the second sentence of sub. (2). Also, each reference to "chapter 551" was replaced by a reference to "ch. 551, Stats."

- Consistent with the Rules Clearinghouse comment in paragraph h. relating to DFI-Sec 5.035(2), the word "shall" is replaced by the word "does."

- Consistent with the Rules Clearinghouse comment in paragraph i. regarding the subdivision renumberings contained in Section 34 of the Public Comment Draft, the

renumberings are now accomplished in 4 separate Sections (in Sections 31 to 34) of the proposed final form of the rules.

Under 5. Clarity, Grammar, Punctuation and Use of Plain Language

- Consistent with the Rules Clearinghouse comment in paragraph a. regarding DFI-Sec 4.05(9), the three separate Sections (in Sections 19 to 21) of the Public Comment Draft form of the rules relating to DFI-Sec 4.05(9) were combined into a single Section (Section 18) of the proposed final rules.

- Consistent with the Rules Clearinghouse comment in paragraph b. regarding DFI-Sec 4.05(9)(h)(intro.), the rule requirement that the prescribed disclosures "be displayed in a conspicuous manner " will be dependent on the facts of each situation where the issue is presented.

- Consistent with the Rules Clearinghouse comment in paragraph c. regarding DFI-Sec 5.03(5), a comma was inserted after the first "office."

(2) Rejection of recommendations and reasons therefor:

Under 2. Form, Style and Placement in Administrative Code

- Following discussion with the Rules Clearinghouse staff regarding the Rules Clearinghouse comment in paragraph f. concerning DFI-Sec 5.01(3)(intro.) in the Public Comment Draft of the rules, the suggested language "on either of the following examinations" was not used. The Public Comment Draft language was retained because for clarity purposes it specifically states that both examinations contained in the par. (3)(b) alternative must be passed, and the Division is more comfortable with the specificity in the Division's proposed language.

****

(e) No final regulatory flexibility analysis is included on the basis that the Division of Securities has determined, after complying with s. 227.016(1) to (5), Wis. Stats., that the proposed rules will not have a significant economic impact on a substantial number of small businesses.

* * * *

1999 Session

LRB or Bill No./Adm. Rule No.

Amendment No. if Applicable

☒ ORIGINAL ☐ UPDATED

FISCAL ESTIMATE ☐ CORRECTED ☐ SUPPLEMENTAL

DOA-2048 N(R10/98)

Subject Proposed amendments to Rules of the Division of Securities Under Chapters DFI-Sec 1,2,3,4,5,7 and 9, Wis. Adm. Code

Fiscal Effect

State: ☐ No State Fiscal Effect

Check columns below only if bill makes a direct appropriation or affects a sum sufficient appropriation.

☐ Increase Existing Appropriation ☒ Increase Existing Revenues

☐ Decrease Existing Appropriation ☐ Decrease Existing Revenues

☐ Create New Appropriation

☐ Increase Costs - May be possible to Absorb Within Agency's Budget ☐ Yes ☐ No

☐ Decrease Costs

Local: ☒ No local government costs

1. ☐ Increase Costs ☐ Permissive ☐ Mandatory
2. ☐ Decrease Costs ☐ Permissive ☐ Mandatory
3. ☐ Increase Revenues ☐ Permissive ☐ Mandatory
4. ☐ Decrease Revenues ☐ Permissive ☐ Mandatory
5. Types of Local Governmental Units Affected: ☐ Towns ☐ Villages ☐ Cities ☐ Counties ☐ Others _____ ☐ School Districts ☐ WTCS Districts

Fund Sources Affected ☐ GPR ☐ FED ☒ PRO ☐ PRS ☐ SEG ☐ SEG-S

Affected Ch. 20 Appropriations None

Assumption Used in Arriving at Fiscal Estimate

This fiscal estimate relates to the annual revision of the Rules of the Division of Securities under the Wisconsin Uniform Securities Law. The particular fiscal effects of the proposed rule revisions are as follows:

(1) No one-time revenue fluctuations.

(2) An estimated increase of $9,600 in annual securities registration exemption fee revenue as a result of proposed rule DFI-Sec 2.02(5)(d)3 establishing a pre-offering Notice filing requirement for use of the registration exemption in sec. 551.23(11), Stats., for securities offerings made in Wisconsin under Rule 504 of Regulation D under the federal Securities Act of 1933. The estimate is based on an assumption that there will be approximately 4 exemption Notice filings per month times the $200 Notice filing fee for registration exemptions as prescribed in DFI-Sec 7.01(2)(b) [48 X $200 = $9,600].

Long-Range Fiscal Implications

None beyond annual fiscal effects

Agency/Prepared by: (Name & Phone No.)	Authorized Signature/Telephone No.	Date
DFI/Division of Securities Randall Schumann, Division Counsel 266-3414	Patricia D. Struck, Administrator 266-3432	8-3-99

FISCAL ESTIMATE WORKSHEET — **1999 Session**

Detailed Estimate of Annual Fiscal Effect
DOA-2047 (R10/98)

☒ ORIGINAL ☐ UPDATED ☐ CORRECTED ☐ SUPPLEMENTAL

LRB or Bill No./Adm. Rule No.	Amendment No.

Subject Proposed amendments to Rules of the Division of Securities under Chapters DFI-Sec 1,2,3,4,5,7 and 9, Wis. Adm. Code

I. One-time Costs or Revenue Impacts for State and/or Local Government (do not include in annualized fiscal effect):
None

II. Annualized Costs:	**Annualized Fiscal impact on State funds from:** Increased Costs	Decreased Costs
A. State Costs by Category State Operations - Salaries and Fringes	$ 0	$ 0
(FTE Position Changes)	(0 FTE)	(0 FTE)
State Operations - Other Costs	0	0
Local Assistance		
Aids to Individuals or Organizations		
TOTAL State Costs by Category	$ 0	$ 0
B. State Costs by Source of Funds	Increased Costs	Decreased Costs
GPR	$	$
FED		
PRO/PRS	0	0
SEG/SEG-S		
State Revenues Complete this only when proposal will increase or decrease state revenues (e.g., tax increase, decrease in license fee, etc.)	Increased Rev.	Decreased Rev.
GPR Taxes	$	$
GPR Earned		
FED		
PRO/PRS	$9,600	0
SEG/SEG-S		
TOTAL State Revenues	$ 9600	$ 0

NET ANNUALIZED FISCAL IMPACT

	STATE	LOCAL
NET CHANGE IN COSTS	$ 0	$ 0
NET CHANGE IN REVENUES	$ +9600	$ 0

Agency/Prepared by: (Name & Phone No.)	Authorized Signature/Telephone No.	Date
DFI/Division of Securities Randall E. Schumann, Division Counsel 266-3414	Patricia D. Struck, Administrator 266-3432	8-3-99