

Clearinghouse Rule 10-062**PROPOSED ORDER OF THE STATE OF WISCONSIN,
DEPARTMENT OF FINANCIAL INSTITUTIONS, DIVISION OF SECURITIES
ADOPTING RULES**

1 The Wisconsin Department of Financial Institutions, Division of Securities proposes an order to
2 repeal and recreate s. DFI-Sec 1.02(7), create s. DFI-Sec 1.02(8), amend s. DFI-Sec 1.02(14)
3 (intro) and (c), amend s. DFI-Sec 2.02(5)(d)1., amend s. DFI-Sec 2.02(9)(c), amend DFI-Sec
4 2.028 (intro), repeal s. DFI-Sec 4.01(4)(g), create s. DFI-Sec 4.04(7)(d), create s. DFI-Sec
5 5.01(2)(f)3., repeal and recreate s. DFI-Sec 5.01(4)(a), create s. DFI-Sec 5.04(5)(d), amend s.
6 DFI-Sec 5.04(6)(b), repeal s. DFI-Sec 5.05(8)(i), create s. DFI-Sec 5.06(25), repeal and recreate
7 s. DFI-Sec 5.10, repeal and recreate s. DFI-Sec 5.13(2), amend s. DFI-Sec 7.01(3)(a), repeal s.
8 DFI-Sec 8.03 (note), and amend s. DFI-Sec 32.07(1), relating to minor revisions to securities law
9 and franchise law administrative code sections.

Analysis Prepared by the Department of Financial Institutions, Division of Securities

Statute(s) interpreted: s. 551.615, Stats.

Statutory authority: ss. 551.406(5), 551.412(5), 551.605(1), 553.31(1), 553.58(1) and 227.11(2), Stats.

Related statute or rule: none.

Explanation of agency authority: Pursuant to chs. 551 and 553, Stats., the division regulates securities and franchise investment.

10 Summary of proposed rule: The objective of the rule is to repeal and recreate s. DFI-Sec 1.02(7),
11 create s. DFI-Sec 1.02(8), amend s. DFI-Sec 1.02(14) (intro) and (c), amend s. DFI-Sec
12 2.02(5)(d)1., amend s. DFI-Sec 2.02(9)(c), amend DFI-Sec 2.028 (intro), repeal s. DFI-Sec
13 4.01(4)(g), create s. DFI-Sec 4.04(7)(d), create s. DFI-Sec 5.01(2)(f)3., repeal and recreate s.
14 DFI-Sec 5.01(4)(a), create s. DFI-Sec 5.04(5)(d), amend s. DFI-Sec 5.04(6)(b), repeal s. DFI-Sec
15 5.05(8)(i), create s. DFI-Sec 5.06(25), repeal and recreate s. DFI-Sec 5.10, repeal and recreate s.
16 DFI-Sec 5.13(2), amend s. DFI-Sec 7.01(3)(a), repeal s. DFI-Sec 8.03 (note), and amend s. DFI-
17 Sec 32.07(1), relating to minor revisions to securities law and franchise law administrative code
18 sections. The purpose of the rule is as follows: Section 1: The branch office definition for
19 broker-dealers has been harmonized with FINRA and other state regulators for many years.
20 However, with the change in the Uniform Securities Act in 2009, the branch office definition in
21 the rule was changed to refer to a slightly different statutory definition of “place of business.”
22 The statutory definition works for investment advisers but not broker-dealers, hence the change

23 in this rule. Section 2: This is a new definition to accompany the solicitor rules proposed for s.
24 DFI-Sec 5.06(25) based on language developed by the NASAA IA Regulatory Policy and
25 Review Project Group. Section 3: These changes clarify that the definition applies to investment
26 advisers as well as investment adviser representatives and the nature of the solicitations made by
27 third party solicitors.

28 Section 4: This amendment changes the terminology used in the current rule (which limits
29 applicability of its coverage solely to limited partnerships) by substituting the term “entity” to
30 thereby have the rule apply to any type of business organization. Section 5: Incident to the
31 Division’s 2008 rules revision to coordinate with the adoption of the new Wisconsin Securities
32 Law effective January 1, 2009, current rule DFI-Sec 2.02(9)(c) inadvertently cross-referenced
33 statute section 551.102(11) rather than the proper corresponding statute in sec. 551.202(13)
34 [which specifically refers to “accredited investors,” whereas sec. 551.102(11) does not]. This
35 amendment corrects that cross-referencing error. Section 6: This amendment would limit use of
36 this registration exemption to sales of equity securities by Wisconsin-based entities meeting the
37 exemption’s requirements. This exemption provision was originally created in 1986 for use by
38 early-stage Wisconsin businesses to raise risk capital for its operations. As such, the
39 exemption’s original language was specifically limited to sales of common stock of the business
40 (which don’t obligate a business to redeem/payback the invested funds). Debt securities --
41 which require payback to investors -- could not be sold under the original language of this
42 exemption. The original language of the exemption restricting its use to sales of common stock
43 was changed in 1991 to read “securities,” thus enabling the exemption to be used for sales of
44 debt as well as equity securities. Subsequently, some filings have been made by Wisconsin
45 businesses for the purpose of selling their debt securities, including sales by a Wisconsin finance
46 company of several million dollars of its Notes that currently are in default, and the company is
47 in bankruptcy. To restore the exemption’s use back to its original purpose of enabling Wisconsin
48 businesses to raise risk capital -- not capital from debt securities requiring repayment -- the
49 language of the preamble is changed to permit only sales of equity securities. Section 7: In a
50 FINRA rule change comment published as Notice 09-70, FINRA recommended the repeal of the
51 S47 Japan Module of the General Securities Representative examination. However, FINRA
52 indicated that the examination was never actually implemented and therefore is not an available
53 examination anyone can take in lieu of the Series 7 exam. Section 8: This new section clarifies
54 that a notice of the opening of a branch office is not complete and therefore, not deemed “filed”
55 until all fees, including any applicable late filing fees, are received. This parallels the fee
56 payment component in the broker-dealer application rule in s. DFI-Sec 4.01(2)(b) and the agent
57 rule in s. DFI-Sec 4.01(2)(c). Section 9: S. DFI-Sec 4.01(6) currently provides the same review
58 authority as s. DFI-Sec 5.01(2)(f) except for the ability to perform a pre-registration examination of
59 the adviser’s records. This provision was inadvertently left out of the investment adviser rules.
60 Section 10: This amendment clarifies that the Series 65 and 66 exams referred to are the post-
61 1999 version as specified in subd. 2. It also adds clarification that if the applicant was registered
62 as an agent of a broker-dealer within two years of the application and the approval of that
63 registration was based on passage of the Series 7 and 66 exams, those exams would still be
64 considered active for purposes of meeting the exam requirement in subd. 3. Section 11: This
65 new section clarifies that a notice of the opening of a branch office is not complete and therefore,
66 not deemed “filed” until all fees, including any applicable late filing fees, are received. This
67 parallels the fee payment component in the investment adviser application rule in s. DFI-Sec
68 5.01(2)(a) and the investment adviser representative rule in s. DFI-Sec 5.01(2)(b). Section 12:

69 Because applications are effective 30 days after filing, a renewal for January 1 effectiveness
70 must be filed by December 1st. The date of November 30th is incorrect. Section 13: This
71 provision was instituted to require all investment advisers to deliver updated disclosure
72 documents to clients by January 1, 2002 to comply with changes to the law at that time. This
73 subsection has met its sunset date and is no long applicable. Section 14: This section specifies
74 what activity constitutes solicitation on behalf of an investment adviser and parallels the
75 disclosure and agreement requirements found in U.S. Securities & Exchange Commission rule
76 206(4)-3 under the Investment Advisers Act of 1940 but with much more clarity and is based on
77 language developed by the NASAA IA Regulatory Policy and Review Project Group. Section
78 15: The Division currently requires only the ADV Part 1 to be filed electronically. This rule
79 change will require advisers to file their initial and updated Form ADV Part II electronically via
80 the Investment Adviser Registration Depository rather than in paper. Sub. 1 is the general
81 requirement to file both parts of the form via the Investment Adviser Registration Depository and
82 sub. (3) mandates existing registrants to have their Part II filed electronically by July 1, 2011.
83 The software is available for free to convert their Part II disclosure document for electronic
84 filing. Because this is the public disclosure portion of the application, it is in the interest of
85 investors in Wisconsin to be able to review this document via the Investment Adviser Public
86 Disclosure website. Requiring all advisers to make such filings will automatically add them to
87 the public disclosure website. It will also relieve Division staff from processing paper
88 applications, especially since all application materials are now retained by the Division in
89 electronic format only. Section 16: This rule changes the exemption provision for investment
90 adviser solicitors following an exemption developed by the NASAA IA Regulatory Policy and
91 Review Project Group. This exemption is based on “impersonal investment advice” and
92 eliminates the de minimis exemption that was unique to Wisconsin and in effect permitted an
93 unlimited total number of solicitations so long as no more than 9 per year were for any one
94 adviser. Section 17: Corrects a statutory citation. Section 18: This amendment deletes the Note
95 at the end of rule DFI-Sec 8.03 (which deals with appearances and defaults before the Division
96 of Securities) because the 2003 *Krahenbuhl* case cited in the Note has been superseded by
97 Supreme Court Rule 40.05 (effective January 1, 2009) which establishes new
98 criteria/requirements regarding the ability of non-Wisconsin attorneys to represent clients in
99 contested case proceedings before Wisconsin state agencies. Section 19: This rule contains the
100 following amendments: (1) specifies that the application to amend should use the Uniform
101 Franchise Registration Application Form (Form A); and (2) changes the franchise statute cross-
102 referenced in the rule to be sec. 553.31(1), Stats., which is the statute specifically dealing with
103 amendments.

Summary of and preliminary comparison with existing or proposed federal regulation: There are no newly-developed or proposed federal regulations addressed by this rule. However, Wisconsin Securities Law and rules are generally coordinated with corresponding federal requirements, pursuant to s. 551.615, Stats.

Comparison with rules in adjacent states: These rule chapters reflect the 2002 Uniform Securities Act which Iowa and Minnesota have adopted and written rules; Illinois and Michigan have not.

Summary of factual data and analytical methodologies: The division applied its own experience in its regulation of securities generally for the minor clarifications, corrections, revisions and other matters addressed by the rule.

Analysis and supporting documentation used to determine effect on small business: The rule makes minor clarifications, corrections and revisions for conformity with existing statutes; imposes no additional substantive requirements; and reduces the same.

Summary of Final Regulatory Flexibility Analysis: This proposed rule will have no adverse impact on small businesses.

Agency Contact Persons

To obtain a copy of the proposed rule or fiscal estimate at no charge, to submit written comments regarding the proposed rule, or for questions regarding the agency's internal processing of the proposed rule, contact Mark Schlei, Deputy General Counsel, Department of Financial Institutions, Office of the Secretary, P.O. Box 8861, Madison, WI 53708-8861, tel. (608) 267-1705, e-mail mark.schlei@wisconsin.gov. A copy of the proposed rule may also be obtained and reviewed at the Department of Financial Institution's website, www.wdfi.org. Written comments must be received by the conclusion of the department's hearing regarding the proposed rule.

For substantive questions on the rule, contact Randall Schumann, Attorney, Department of Financial Institutions, Division of Securities, P.O. Box 1768, Madison, WI 53701-1768, tel. (608) 266-3414, e-mail randall.schumann@wisconsin.gov.

Pursuant to the statutory authority referenced above, the Department of Financial Institutions, Division of Securities adopts the following:

104 SECTION 1. DFI-Sec 1.02(7) is repealed and recreated as DFI-Sec 1.02(7)(a) and (b) to
105 read:

106 **DFI-Sec 1.02(7)** (a) For purposes of ch. DFI-Sec 4, "branch office" has the same meaning as
107 FINRA rule 3010(g)(2).

108 (b) For purposes of ch. DFI-Sec 5, "branch office" has the same meaning as "place of business"
109 in s. 551.102 (21), Stats.

110 SECTION 2. DFI-Sec 1.02(8) is created to read:

111 **DFI-Sec 1.02(8)** "Solicitor" means any individual, person, or entity who, directly or indirectly,
112 receives a cash fee or any other economic benefit for soliciting, referring, offering or otherwise
113 negotiating for the sale or selling of investment advisory services to clients, including
114 prospective clients, on behalf of an investment adviser.

115 SECTION 3. DFI-Sec 1.02(14) (intro) and (c) are amended to read:

116 **DFI-Sec 1.02(14)(intro)** The following defined terms apply for purposes of the definition of
117 "investment adviser" in s. 551.102(15), Stats., and "investment adviser representative" in s.
118 551.102 (16), Stats.:

119 (c) "Third party solicitor" means a person soliciting others to become clients on behalf of a
120 registered investment adviser or a federal covered investment adviser who is neither a partner,
121 officer, director, or employee of the adviser, nor a supervised person of that adviser.

122 SECTION 4. DFI-Sec 2.02(5)(d)1. is amended to read:

123 **DFI-Sec 2.02(5)(d)1.** Except as provided in this subdivision, any offer or sale of interests in a
124 ~~limited partnership~~ an entity that is or will be primarily engaged in oil, gas or mining activities,
125 any investment contract irrespective of the kind of assets held or business engaged in by the
126 enterprise, or any certificate of interest or participation in an oil, gas or mining title or lease, or in
127 payments out of production under the title or lease, if the aggregate offering price or face
128 amount, whichever is greater, of all securities to be offered by or on behalf of the issuer, together
129 with the value of any securities sold to persons in this state by or on behalf of the issuer during
130 the prior 12 months, exceeds \$100,000, unless prior to the offering the issuer files a notice of the
131 proposed offer or sale with the division, including any prospectus, circular or other material to be
132 delivered to offerees, and other information as the division may require, and the division does
133 not by order withdraw, deny or revoke the exemption within 10 days. This paragraph is not

134 applicable to any offer or sale made by a broker-dealer registered in Wisconsin if the broker-
135 dealer is not affiliated with either the issuer or sponsor of the issuer by means of direct or indirect
136 common control;

137 SECTION 5. DFI-Sec 2.02(9)(c) is amended to read:

138 **DFI-Sec 2.02(9)(c)** Any transaction pursuant to an offer to existing security holders of the issuer,
139 and to not more than 25 other persons in this state less the number of persons in this state with
140 whom the issuer has effected any transactions during the period of 12 months preceding the offer
141 pursuant to s. 551.202 (14) and (24), Stats., excluding persons listed in s. ~~51.102–(11)~~
142 551.202(13) , Stats., and rules there under, if no commission or other remuneration other than a
143 standby commission is paid or given directly or indirectly for soliciting any security holder in
144 this state; and if the issuer files with the division prior to the offering a notice specifying the
145 terms of the offer, including any prospectus, circular or other material to be delivered to offerees
146 in connection with the transaction and such other information as the division may require, and
147 the division does not by order disallow the exemption within 10 days.

148 SECTION 6. DFI-Sec 2.028 (intro) is amended to read:

149 **DFI-Sec 2.028 (intro) Wisconsin issuer registration exemption by filing.** If all of the
150 following conditions are met, other than any condition or conditions waived by the division upon
151 a showing of good cause, a transaction registration exemption is available under s. 551.203,
152 Stats., for any offer or sale for cash of the equity securities of an issuer having, both before and
153 upon completion of the offering, its principal office and a majority of the full-time employees
154 located in this state:

155 SECTION 7. DFI-Sec 4.01(4)(g) is repealed.

156 SECTION 8. DFI-Sec 4.04(7)(d) is created to read:

157 **DFI-Sec 4.04(7)(d)** The notice filed for a branch opening pursuant to sub. (a) is deemed filed in
158 accordance with sub. (c) upon receipt by the division of the appropriate filing fee and any late
159 filing fee due pursuant to s. DFI-Sec 7.01(6)(d).

160 SECTION 9. DFI-Sec 5.01(2)(f)3. is created to read:

161 **DFI-Sec 5.01(2)(f)3.** Before action on an application, the division may designate an employee to
162 make an examination of the books, records and affairs of the applicant at the applicant's expense.

163 SECTION 10. DFI-Sec 5.01(4)(a) is repealed and recreated as DFI-SEC 5.01(4)(a)1. and
164 2. to read:

165 **DFI-Sec 5.01(4)(a)1.** The applicant has taken and passed either the post-1999 version of the
166 Series 65 Uniform Investment Adviser State Law Examination, or both the post-1999 version of
167 the Series 66 Uniform Combined State Law Examination and the Series 7 General Securities
168 Representative Examination within 2 years prior to the date the application is filed with the
169 division; or

170 2. The applicant has been registered as an agent of a broker-dealer within two years prior to the
171 date the application is filed, based on having passed the post-1999 version of the Series 66
172 examination and the Series 7 examination.

173 SECTION 11. DFI-Sec 5.04(5)(d) is created to read:

174 **DFI-Sec 5.04(5)(d)** The notice filed for a branch opening pursuant to sub. (a) is deemed filed in
175 accordance with sub. (c) upon receipt by the division of the appropriate filing fee and any late
176 filing fee due pursuant to s. DFI-Sec 7.01(6)(d).

177 SECTION 12. DFI-Sec 5.04(6)(b) is amended to read:

178 **DFI-Sec 5.04(6)(b)** Directly with the division for federal covered investment advisers, not later
179 than ~~November 30~~ December 1.

180 SECTION 13. DFI-Sec 5.05(8)(i) is repealed.

181 SECTION 14. DFI-Sec 5.06(25)(intro)(a) – (e) is created to read:

182 **DFI-Sec 5.06(25)** Paying a cash fee or any other economic benefit, directly or indirectly, in
183 connection with solicitation activities unless:

184 (a) The solicitor is registered as an investment adviser or investment adviser representative or is
185 exempt from registration as provided for in s. DFI-Sec 5.13(2); and

186 (b) The cash fee or any other economic benefit is paid by the investment adviser with respect to
187 solicitation activities that are impersonal in nature in that they are provided solely by means of:

188 1. Written material or oral statements which do not purport to meet the objectives or needs of
189 the specific client; or

190 2. Statistical information containing no expressions of opinions as to the merits of particular
191 securities or investment advisers; or

192 3. Any combination of the foregoing services; and

193 (c) The cash fee or any other economic benefit is paid pursuant to a written agreement to which
194 the investment adviser is a party and all of the following conditions are met:

195 1. The written agreement;

196 a. Describes the solicitation or referral activities to be engaged in by the solicitor on behalf of
197 the investment adviser and the cash fee or any other economic benefit to be received for such
198 activities; and

199 b. Contains an undertaking by the solicitor to perform its duties under the agreement in a manner
200 consistent with the instructions of the investment adviser and the provisions of ch. 551, Stats.,

201 and rules there under; and

202 c. Requires that the solicitor, at the time of any solicitation or referral activities for which a cash
203 fee or any other economic benefit is paid or to be paid by the investment adviser, provide the
204 client with a current copy of the investment adviser's disclosure document required under s. DFI-
205 Sec 5.05(8) and a separate disclosure statement as described in subsection (d) of this rule, either
206 in paper or electronic format; and

207 2. The investment adviser receives from the client, prior to or at the time of entering into any
208 written investment advisory contract, a signed and dated acknowledgement of receipt of the
209 investment adviser's written disclosure statement and the solicitor's written disclosure document;
210 and

211 3. The investment adviser makes a bona fide effort and has a reasonable basis for believing that
212 the solicitor has complied with the agreement; and

213 4. The foregoing requirements in subd. 1., 2. and 3. shall not apply where the solicitor is;

214 a. A partner, officer, director or employee of such investment adviser; or

215 b. A partner, officer, director or employee of a person that controls, is controlled by, or is under
216 common control with such investment adviser, provided the status of the solicitor is disclosed to
217 the client at the time of the solicitation or referral; and

218 (d) The separate written disclosure document required to be furnished by the solicitor to the
219 client pursuant to subd. (c)1.c. shall contain the following information:

220 1. The name of the solicitor;

221 2. The name of the investment adviser;

222 3. The nature of the relationship, including any affiliation, between the solicitor and the
223 investment adviser;

224 4. A statement that the solicitor will be compensated for solicitation or referral services by the
225 investment adviser;

226 5. The terms of the compensation arrangement including a description of the cash fee or any
227 other economic benefit paid or to be paid to the solicitor; and

228 6. The amount of compensation the client will pay, if any, in addition to the advisory fees, and
229 whether the cash fee or any other economic benefit paid to the solicitor will be added to the
230 advisory fee, creating a differential with respect to the amount charged to other advisory clients
231 who are not subject to the solicitor compensation arrangement.

232 (e) Nothing in this rule shall be deemed to relieve any person of any fiduciary or other
233 obligation to which such person may be subject under any law.

234 SECTION 15. DFI-Sec 5.10 is repealed and recreated as. DFI-Sec 5.10(1) – (3) to read:

235 **DFI-Sec 5.10 Electronic filing. (1)** Each investment adviser shall file a copy of its current form
236 ADV Parts 1 and II electronically with the Investment Adviser Registration Depository.

237 **(2)** Any documents or fees required to be filed with the division that are not permitted to be filed
238 with, or cannot be accepted by, the investment adviser registration depository or the central
239 registration depository shall be filed directly with the division.

240 **(3)** Each investment adviser that is registered in this state on December 31, 2010 shall file a
241 copy of its current form ADV Part II electronically with the Investment Adviser Registration
242 Depository by no later than July 1, 2011.

243 SECTION 16. DFI-Sec 5.13(2) is repealed and recreated as 5.13(2)(intro)(a) – (b) to read:

244 **DFI-Sec 5.13(2)** A solicitor is not required to be registered as an investment adviser or as an
245 investment adviser representative if the solicitor is in compliance with all requirements of s. DFI-
246 Sec 5.06(25), and the solicitor satisfies par. (a) or (b):

247 (a) Provides solicitation activities that are impersonal in nature as set forth in s. DFI-Sec
248 5.06(25)(b) and the solicitor to whom a cash fee or any other economic benefit is paid for such
249 referral does not trigger any of the following as being a person:

250 1. Subject to an order of the U.S. Securities & Exchange Commission issued under section 203(f)
251 of the Investment Advisers Act of 1940;

252 2. Subject to an order of the administrator, the securities administrator of any other state, the U.S.
253 Securities and Exchange Commission, or any self regulatory organization denying, suspending,
254 or revoking registration as a broker-dealer, agent, investment adviser, or investment adviser
255 representative or barring the person from the securities or advisory industry or associating or
256 affiliating with the securities or advisory industry, entered after notice and opportunity for
257 hearing;

258 3. Convicted within the previous ten years of any felony, or any misdemeanor involving conduct
259 described in section 203(e)(2)(A) through (D) of the Investment Advisers Act of 1940;

260 4. Convicted within the previous ten years of any felony, or any misdemeanor involving conduct
261 described in s. 551.412(4)(c) Stats.;

262 5. Found by the U.S. Securities & Exchange Commission to have engaged, or has been convicted
263 of engaging in, any of the conduct specified in sections 203(e)(1), (5) or (6) of the Investment
264 Advisers Act of 1940;

265 6. Found by the administrator to have engaged, or has been convicted of engaging in, any of the
266 conduct specified in ss. 551.412(4)(a), (b) or (f) Stats.;

267 7. Subject to an order, judgment or decree described in section 203(e)(4) of the Investment
268 Advisers Act of 1940;

269 8. Subject to an order, judgment or decree described in s. 551.412(4)(d) Stats.;

