

Massachusetts Securities Division

▲ 2014 NEWSLETTER ▲

A Division of William Francis Galvin, Secretary of the Commonwealth

A MESSAGE FROM THE SECRETARY

December 22, 2014

Dear Investment Adviser:

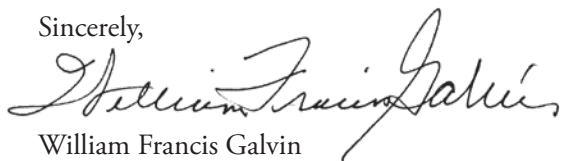
It is my pleasure to send you this inaugural issue of the Massachusetts Securities Division's (the "Division") investment adviser newsletter. This newsletter is designed to inform Massachusetts-registered investment advisers of current regulations, reports, statistics, upcoming events and other topical information. The Division hopes this newsletter will advance an already mutually beneficial dialog between registrants and the regulator. Protecting Massachusetts investors is paramount to the Division and developing a stronger relationship with the investment adviser community will help both the Division and industry in our shared ongoing objective to better serve and safeguard Massachusetts investors.

This newsletter has been created completely in-house by the Office of the Secretary of Commonwealth and the Massachusetts Securities Division. All articles, drawings, and other content have been authored by Division staff. The subject matter of the articles selected for this newsletter address various issues that directly relate to the duties and obligations of Massachusetts-registered investment advisers. The Division aims to issue future newsletters on a biannual basis.

We hope that you will find this newsletter informative. We look forward to your feedback and we appreciate your continued efforts to treat your clients with the utmost care.

Please feel free to contact our office at 617-727-3548 or 1-800-269-5428.

Sincerely,



William Francis Galvin
Secretary of the Commonwealth

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MEET THE RICE SECTION

With this inaugural issue of the Division's investment adviser newsletter, it is fitting to take this opportunity to familiarize or re-familiarize the investment adviser community with the Registration, Inspections, Compliance and Examinations Section ("RICE Section") of the Division. The RICE

Section was restructured in March 2012 shortly after the implementation of many regulatory changes imposed by the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"). While the RICE Section performs many functions, one of its most important roles is overseeing the

Massachusetts-registered investment adviser community. If your advisory firm became registered after or has been examined since March 2012, then you have previously dealt with the RICE Section. There are more

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CORI ACKNOWLEDGMENT FORM

In order to further fulfill its mission of protecting Massachusetts investors, the Massachusetts Securities Division (the “Division”) updated its regulations at the beginning of 2014 to require each investment adviser representative (“IAR”) applying for registration in Massachusetts to submit an executed Criminal Offender Record Information (“CORI”) Acknowledgement Form to the Division as a part of each individual’s application.¹ The CORI Acknowledgement Form asks questions designed to properly identify the applicant for purposes of the criminal background check, including the applicant’s partial social security number and date of birth. A



completed CORI Acknowledgement Form indicates the applicant’s consent to allow the Division to run such a criminal background check. The Division conducts criminal background checks of these applicants in order to ensure that the applicant 1) is not subject to a statutory disqualification² and 2) has truthfully and accurately disclosed any criminal background that is otherwise required to be disclosed on the individual’s Form U4.³

This requirement applies to all IARs applying for registration in Massachusetts, irrespective of whether they are associated with state or federally-registered investment advisers. Importantly, however, this requirement does not apply to applicants for annual renewal registration which have made timely renewal filings with the Division: it only applies to individual applicants who file a new application with any firm.

Before enacting the new regulation, a complete application for IAR registration had consisted of: 1) a complete and current Form U4 indicating Massachusetts as a jurisdiction for registration; 2) a non-refundable fee of \$50, and 3) proof that the applicant met the regulations’ examination or certification requirements.⁴ Upon filing of an individual’s IAR application, the Division is afforded thirty days to review the application.⁵ Under the new regulations, because the thirty-day statutory review period does not begin tolling until each of the application’s elements has been filed (as the application will not be deemed complete until all elements have been filed), in no scenario will the Division’s thirty-day review period begin until the completed, signed and notarized CORI Acknowledgement Form has been filed with the Division. Applicants should note that the Central Registration Depository system is not capable of accepting the CORI Acknowledgement Form as part of the electronic submission process, and as a result the CORI Acknowledgement Form must be filed electronically with the Division via e-mail submission to the address CORI@sec.state.ma.us. An applicant that fails to complete the CORI Acknowledgement Form will be deemed to have an incomplete application and could be denied registration in the Commonwealth. ▲

¹ See 950 Mass. Code Regs. 12.205(2)(d)1.

² The Secretary may by order deny any registration if he finds that the order is in the public interest and that the applicant has been convicted within the past ten years of any misdemeanor involving a security or any aspect of the securities business, or any felony. See Mass. Gen. Laws c. 110A § 204(a)(2)(C).

³ Questions 14A and 14B of Form U4 require an applicant to disclose, among other things, all felony and certain misdemeanor charges, regardless of the timeframe in which those charges were incurred.

⁴ See 950 CMR 12.205(2)(c).

⁵ If no denial order is in effect and the Division has not instituted a proceeding against the applicant under Mass. Gen. Laws c. 110A, § 204, the individual’s investment adviser representative registration becomes effective at noon on the thirtieth day after the application is filed. See Mass. Gen. Laws c. 110A, § 202(a).



ARE YOU CYBER SECURE?

October was “Cybersecurity Month” in the Commonwealth of Massachusetts, but cybersecurity should be a regular focus for all Massachusetts-registered investment advisers. As this year’s JPMorgan data breach shows, state-registered investment advisers are not immune to data breaches, as hackers have more recently shifted their target from bigger institutions to middle markets. Moreover, according to a 2014 Illinois cybersecurity survey of its state-registered investment advisers, 1% of its 827 state-registered investment advisers reported having encountered a data breach. While 1% may not sound like a large number, it is important to note that data breaches often go undetected and unreported.

On June 3, 2014, the RICE Section conducted a twenty-three question survey on the cybersecurity practices of its 903 Massachusetts-registered investment advisers (“IAs”) (the “Cybersecurity Survey”). The Cybersecurity Survey’s purpose was to address IAs’ cybersecurity readiness and to determine whether promulgating guidance on cybersecurity practices was necessary or appropriate. The survey questions addressed broad areas of cybersecurity such as the control and management of data access; antivirus protection; proper destruction techniques; and information technology (“IT”) operational budgets. The Cybersecurity Survey also inquired as to IA firm practices for the general oversight of the firm’s IT systems.

The survey’s results provided the RICE Section with significant insight in the area of cybersecurity. Regarding the topic of accessibility to sensitive data, 72% of survey participants reported

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RICE SECTION

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than nine hundred investment advisers currently registered with the Division. The RICE Section has a staff of attorneys and non-attorneys that work directly with investment advisers on investment adviser-related issues. If you have contacted the Division recently with an investment adviser-related question, chances are you spoke with one of these individuals. The RICE Section staff always welcomes your questions and insights.

In light of these facts, the Division believes that it is especially important that it maintains an open line of communication with the investment adviser community. A healthy dialogue benefits the Division because it keeps the RICE Section informed of current concerns and issues facing industry, which in turn assists the Division in performing its regulatory obligations. Furthermore, communication with the RICE Section aids investment advisers because it allows registrants to seek answers to compliance-related questions while also providing a platform whereby the Division can keep investment advisers informed of upcoming outreach and training efforts.

In January 2012, the Division held an investment adviser training conference which sought to assist the investment adviser community during the transitional period following the passage of the Dodd-Frank Act. The Dodd-Frank Act imposed significant regulatory changes on investment advisers. This well-received conference was attended by more than four hundred persons and provided an opportunity for the Division to address several pertinent compliance-related topics directly with Massachusetts-registered investment advisers. The Division intends to hold another investment adviser training conference on March 19, 2015 (See Page 4 for more details).

One of the particularly well-received and informative panels at the Division's January 2012 investment adviser training conference pertained to the Division's books and records examination process, which is spearheaded by the RICE Section. The Division's examinations program is an essential component of its regulatory and investor protection mission. Massachusetts investment advisers typically have questions about the Division's examinations program only after they have received notice that the Division has scheduled a books and records examination of their investment advisory practice. Because this newsletter is geared towards maintaining a helpful dialogue with Massachusetts-registered investment advisers, below are the Division's standard responses to common examination questions:

Question: Can I reschedule this examination?

Answer: Generally the Division does not reschedule its examinations. In extreme circumstances, however, the Division may consider a postponement. One such example of an extreme circumstance would be if an investment adviser is scheduled to be out of Massachusetts for work purposes. As part of its consideration, the Division typically requires that the adviser provide copies of its airfare, itinerary and hotel confirmation. Investment advisers should note that the Division does pay attention to when the airfare tickets were purchased and when the hotel reservation was made: a request for a postponement will likely be denied if those actions were taken after the investment adviser received notice of the examination. The Division is unwilling to freely grant postponements for several reasons. Besides investor protection, one of the main reasons for this reluctance is that the vast majority of the documents examined by the Division should be readily available at any given time. Keep in mind that the Division does not need to schedule a

books and records examination in order to conduct one, as the Division has the statutory authority to conduct both announced and unannounced examinations.

Question: How long will the examination take?

Answer: The on-site portion of an examination typically takes one day, but could be prolonged depending on the size, scope, and organization of the specific advisory practice. The Division appreciates investment advisers that keep their records in an organized fashion because it allows Division staff to do its job more efficiently.

Question: Besides the on-site portion, what else does the examination entail?

Answer: Approximately two weeks after the conclusion of the examination's on-site portion, the Division staff will send correspondence to the investment adviser memorializing the Division's findings. This correspondence will specify any necessary remedial action and request any additional documentation or information, if necessary. The Division requests that the registrant respond in writing to the Division's correspondence, at which point, assuming a satisfactory response, the Division will close the examination.

Protecting Massachusetts investors is at the heart of why the Division examines investment advisers. The Division is the sole regulator for the vast majority of Massachusetts-registered investment advisers, and as a result, serves as the only line of protection for clients of these advisory practices.

Most of the examinations the Division conducts are routine and all of the Division's examinations are performed with the purpose of protecting Massachusetts investors. We should be treated fairly. ▲



requiring a form of password protection in order to access data. While single-factor authentication (such as requiring an ID and password) was the most prevalent form of authentication, fewer firms indicated the use of more sophisticated methods (for example, biometric identification). Additionally, while 92% of participants reported using some form of antivirus protection, experts say that antivirus protection alone may not be enough to prevent a cybersecurity threat, as 100% of data breach victims have antivirus protection. With regard to outsourcing of oversight of IT systems by IA firms, 59% of participants indicated that their own employees maintain the firm's IT systems, while 29% of participants indicated an exclusive reliance on outside vendors. Furthermore, 7% of those relying exclusively on external vendors had not entered into confidentiality agreements with the vendors accessing the firm's IT systems. Based on survey findings, the Division intends to implement an increased focus on the area of cybersecurity during its examination process, and to provide further education to the IA community as to the importance of having cybersecurity protocols in place for the protection of investors. ▲

JUMBLE

Unscramble the words below then unscramble the circled letters for the final answer!

NEXDI

I N D E X

GEITINSVN

I N V E S T I N G

HHAEERDLOR

S H A R E H O L D E R

KBNAHMCER

B E N C H M A R K

ATNIYUN

A N N U I T Y

DDDENVII

D I V I D E N D

RTUEFSU

F U T U R E S

Hint: Basket of Assets

EXCHANGE TRADED FUNDS

MEET THE RICE SECTION EVENT

March 19, 2015
 9 a.m. – 11 a.m.
 One Ashburton Place
 Boston, MA 20108
 21st Floor Conference Room

Please join the Registration, Inspections, Compliance and Examinations Section ("RICE Section") for an informational session on the registration and examinations process. Panelists will discuss a range of topics, including cybersecurity readiness. More RSVP details will follow.

***Free continental breakfast will be provided.**