

# Massachusetts Securities Division

▲ 2015 MID-YEAR NEWSLETTER ▲

*A Division of William Francis Galvin, Secretary of the Commonwealth*

## MEET THE RICE SECTION CONFERENCE

On Thursday, March 19, 2015, the Massachusetts Securities Division's ("the Division") Registration, Inspections, Compliance and Examinations ("RICE") Section hosted a "Meet the RICE Section" conference. The conference's goal was to provide state-registered investment advisers, investment adviser representatives, broker-dealers and broker-dealer agents with an opportunity



to meet the primary regulator responsible for administering their firms and representatives for compliance with state and federal securities laws and regulations. The approximately two hundred attendees included registrants, applicants for state registration, and other industry

professionals. The Meet the RICE Section conference was presented in identical morning and afternoon sessions, both of which lasted three hours.

Each session included three informative panel presentations. Panelists presented on: (1) the registration process; (2) the examination process; and (3) cybersecurity readiness and awareness. The registration process panel was moderated by a RICE Section attorney and included RICE Section staff members. The panel featured a discussion on a range of topics, including when an applicant's file is deemed complete for purposes of starting the substantive review of a firm's application, ongoing compliance obligations for registered firms and individuals, and the appropriate timeframes in which firms must file annual and other-than-annual amendments to their Form ADV. The second panel included RICE Section attorneys discussing the Division's examination process. Topics discussed during the panel included the process by which the Division selects an investment adviser for a books and records examination, how an investment adviser can prepare for the examination, and what the investment adviser should expect during and after the on-site

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portion of the examination. The final presentation pertained to cybersecurity readiness and awareness, and was given by Kevin Burns, the Chief Information Security Officer for the Commonwealth of Massachusetts. Mr. Burns provided a high level review of cybersecurity, discussing issues such as how smaller investment adviser firms can avoid becoming the target of a data breach or cyber-attack, available information-sharing resources, and the benefits of cloud computing.

The RICE Section received a substantial amount of feedback generally indicating that the conference's attendees found the information presented to be insightful. Based in part on that feedback, the RICE Section will host another conference this fall. See page 4 for more information. ▲



# TOP FIVE 2014 EXAMINATION DEFICIENCIES

The Massachusetts Securities Division's Registration, Inspections, Compliance and Examinations Section (the "RICE Section") utilizes a comprehensive investment adviser examination program to protect Massachusetts investors by ensuring investment advisory firms' compliance with Massachusetts regulations. The RICE Section has reviewed the results of its 2014 on-site examinations, and has compiled the following list of investment advisers' most common deficiencies:



## 1 Compliance with 950 CMR 12.205(6)(a)1. (Form ADV Amendments)

The most common deficiency identified by RICE Section examiners in 2014 pertained to investment advisers' ability to consistently maintain a Form ADV that accurately reflected their firms' current practices. 950 CMR 12.205(6)(a)1. reads as follows, in pertinent part:

*An investment adviser...shall file the following information with the Division: annual and other-than-annual amendments in compliance with the language, organizational format and the timing of filing requirements as specified in the Instructions to Form ADV, including the requirements for both annual and other-than-annual amendments[.]*

The Form ADV is a voluminous document consisting of both formatted and narrative elements, so even the most attentive investment advisers may run into trouble correctly providing the requested information. As such, and because 950 CMR 12.205(6)(a)1. specifically requires that they be followed, the Securities and Exchange Commission's Instructions to Form ADV are a helpful guide for investment advisers in complying with this regulation. These instructions are located on the SEC's website at <https://www.sec.gov/about/forms/formadv.pdf>.

Common areas in the Form ADV in which the RICE Section found deficiencies include Form ADV Part 1A, Items 5B, 5D, 5E, 5F, 5G (all pertaining to Information About Your Advisory Business) and 9 (Custody); Form ADV Part 1B, Item 2I (Additional Information: Custody); and Form ADV Part 2A, Items 4 (Advisory Business) and 5 (Fees and Compensation).

## 2 Requests for Further Documents and Information

While not necessarily a "deficiency" in the sense that a RICE Section examiner has determined that an investment adviser has violated Massachusetts law, another common element of 2014 examinations was illustrated by the high number of examiner requests for additional documents and information. RICE Section examinations continue after the conclusion of an examination's on-site portion, and a request for further documents and information generally occurs once the examiners have combed through the documents provided by investment advisers. Additional requests are made in an effort to answer new questions resulting from further review.



## 3 Compliance with 950 CMR 12.205(8)(d) (Statement as to Disciplinary History)

950 CMR 12.205(8)(d) explains as follows:

*The disclosure obligations required by M.G.L. c. 110A, § 203A(a) will be met if prior to the client entering into an advisory contract, the investment adviser delivers the Form ADV Part 2 (or the brochure) and any additional information required to be disclosed under the Investment Advisers Act of 1940 together with a notice that disciplinary history of the investment adviser and its representatives can be obtained from the Division.*

While RICE Section examiners have found that most Massachusetts investment advisers regularly comply with the regulation's first component, many neglect the second element, informing potential clients that they can contact the MSD to learn more information regarding the investment adviser and its representatives' disciplinary histories. Compliant firms often include language meeting this regulation's requirement in their Form ADV Part 2, Item 9 (the section pertaining to Disciplinary History).

## WHAT'S NEW AT THE DIVISION

### Massachusetts Crowdfunding Exemption

On January 15, 2015, Secretary Galvin adopted an emergency regulation permitting intra-state crowdfunding offerings (the "Crowdfunding Exemption"). After holding a notice and comment period, the Division conducted a hearing on March 24, 2015 seeking public input regarding the Crowdfunding Regulation. Based on those comments, Secretary Galvin promulgated the Crowdfunding Exemption under the Massachusetts Uniform Securities Act, M.G.L. c. 110A, with the Secretary

filing the Crowdfunding Exemption regulation on April 10, 2015. See 950 CMR 14.402(B)(13)(o).

The Crowdfunding Exemption will foster job creation by helping small and early-stage Massachusetts companies find investors and gain greater access to capital with fewer restrictions. To provide necessary investor protections, it requires key disclosures and makes the exemption unavailable to bad actors that have violated securities laws or committed financial fraud. For more specifics regarding the Crowdfunding Exemption, including a more detailed summary of the new regulation, please visit the Secretary's website at [www.sec.state.ma.us/sct/crowdfundingreg/crowdfundingidx.htm](http://www.sec.state.ma.us/sct/crowdfundingreg/crowdfundingidx.htm).

### Challenge to SEC "Regulation A" Rules

On May 26, 2015, Secretary Galvin filed a legal challenge to the Securities and Exchange Commission's new Regulation A rules under the 2012 Jumpstart Our Business Startups (JOBS) Act governing certain small public offerings. The Commonwealth requests that the U.S. Appeals Court for the District of Columbia vacate the SEC's rule and issue a permanent injunction prohibiting the rule from going into effect on June 19. In doing so, the Commonwealth alleges that the SEC arbitrarily and capriciously violated congressional intent by greatly reducing states' authority to review select public offerings of larger than \$20 million before their public sale. Commenting on the matter, Secretary Galvin stated: "What the SEC did was wrong. We're not going to sit by and let [the SEC] preempt the states by administrative regulation when it flies in the face of what Congress specified." Montana has also filed a separate lawsuit against the SEC making similar allegations.

#### 4 Compliance with 950 CMR 12.205(9)(c)14. (Client Contracts)

950 CMR 12.205(9)(c)14. reads as follows, in pertinent part:

*(c) The following practices are a non-exclusive list of practices by an adviser which shall be deemed "dishonest or unethical conduct or practices in the securities business" for purposes of M.G.L. c. 110A, § 204(a)(2)(G):*

...

*14. Entering into, extending or renewing any investment advisory contract, other than a contract for impersonal advisory services, unless such contract is in writing and discloses, in substance, the services to be provided, the term of the contract, the advisory fee or the formula for computing the fee, the amount or the manner of calculation of the amount of the prepaid fee to be returned in the event of contract termination or nonperformance, whether the contract grants discretionary power to the adviser or its representatives and that no assignment of such contract shall be made by the adviser without the consent of the client.*

Common issues complying with this regulation seen in 2014 examinations have included firms not having written client contracts with selected clients, and firms' failure to use a non-assignability clause in standard written contracts.



### Business Continuity and Succession Planning Survey

The Division will be sending a Survey Regarding Business Continuity and Succession Planning for Massachusetts-Registered Investment Advisers in the near future. Each firm should complete and return this survey to the Division following the instructions provided in the survey's cover letter. Your firm's participation is appreciated.

#### 5 Best Practices: Business Continuity Plans

Although Massachusetts does not currently maintain explicit regulations concerning business continuity plans, RICE Section examiners encountered numerous situations in which small firms, often with only one principal, did not have a business continuity plan in the event the firm could no longer conduct business. Massachusetts investment advisers would find it prudent to consider this issue to better protect firm and client interests.

To that end, on April 13, 2015, the North American Securities Administrators Association ("NASAA") adopted a Model Rule on Business Continuity and Succession Planning. Massachusetts has not explicitly adopted this rule in its law or regulations, but the associated guidance issued alongside the rule provides excellent assistance in how to structure and evaluate the issues surrounding their firm's business continuity plan. The RICE Section is currently gathering data and information on how best to address this topic, but in the meantime, investment advisers can view NASAA's model rule with its related guidance at <http://www.nasaa.org/> . ▲

## Position Benefits, LLC/Woodbridge Mortgage Investment Funds

On May 4, 2015, Secretary Galvin charged a Plymouth firm, Position Benefits, LLC (“Position Benefits”), with acting in an unregistered capacity as both an investment adviser and broker-dealer, and charged Charles N. Nilosek with acting as an unregistered investment adviser representative and broker-dealer agent. The Division also alleges that Position Benefits and Nilosek sold risky, unregistered securities, mainly to seniors, in the form of security interests in commercial mortgages. The Division’s complaint alleges that Position Benefits and Nilosek utilized extensive television and radio advertising and programming, as well as a substantial internet and social media presence, to hold themselves out to the public as an investment adviser when their ultimate purpose was to offer investment products in mortgage investment funds.

In a related matter, Secretary Galvin also reached a settlement with Woodbridge Mortgage Investment Funds 1, 2 and 3 (collectively “Woodbridge”): three Sherman Oaks, California mortgage investment funds providing commercial mortgages known as Secure Bridge Loans. As a part of the settlement, Woodbridge agreed to stop offering and selling the Secure Bridge Loans in the Commonwealth until they are registered as securities or are considered exempt from Massachusetts securities registration requirements. Woodbridge also agreed to pay a \$250,000 civil penalty; to return money to 144 Massachusetts residents who invested in Secure Bridge Loans between January 2012 and the present; and to accept a Division censure.

## Investment Adviser Registration Renewal

As a reminder, Massachusetts regulations require all Massachusetts investment advisers to renew their registration annually. While the Division sends out annual notifications of this requirement near the end of each calendar year, we encourage every investment adviser to verify its firm’s account on FINRA’s CRD website. Please ensure that accounts are sufficiently funded to pay for 2016 registration fees for both the firm and the affiliated investment adviser representatives. Thank you.



## Save the Date: Meet the RICE Section Conference

The Division will be hosting a second Meet the RICE Section Conference on October 14, 2015 at the Best Western, Marlborough, Massachusetts. Details regarding the conference content will be provided at a later date, but the Division anticipates that limited seats will be distributed on a first-come, first-serve basis. Please keep your firm’s CRD contact information updated so that the Division can communicate with your firm when more information is available. Thank you. ▲

