

Massachusetts Securities Division

REGISTRATION, INSPECTIONS, COMPLIANCE AND EXAMINATIONS SECTION

▲ DECEMBER 2017 NEWSLETTER ▲

A Division of William Francis Galvin, Secretary of the Commonwealth

AN OVERVIEW OF MASSACHUSETTS SECURITIES LAWS AND REGULATIONS

Investment advisers and investment adviser representatives are required to abide by Massachusetts securities laws. These laws are found in two places: 1) the Massachusetts General Laws (Mass. Gen. Laws), and 2) the Code of Massachusetts Regulations (Mass. Code Regs.). Specifically, statutory requirements are located at Mass. Gen. Laws c. 110A (malegislature.gov/Laws/GeneralLaws/PartI/TitleXV/Chapter110A), and regulatory requirements can be found at 950 Mass. Code Regs. 12.205 (www.mass.gov/courts/docs/lawlib/900-999cmr/950cmr12.pdf). Chapter 110A of the Massachusetts General Laws is commonly referred to as the “Act” and the accompanying regulations are referred to as the “Regulations.”

In general, the Act provides the framework for prohibited conduct, registration and notice filing requirements for firms and representatives, registration and notice filing requirements for securities, and provides definitions for important terms contained throughout the Act and Regulations. The Regulations exist to provide additional details of the Act, and often provides more specific requirements, or exclusions to provisions found in the Act. Below are non-exhaustive key provisions of the Act and Regulations that can affect an investment adviser’s day to day business.

Registration Requirements

The Act discusses the registration requirements and procedures for investment advisers and investment adviser representatives in Sections 201 and 202, respectively. Section 202 also discusses fees associated with registration. Registration requirements for Massachusetts investment advisers are further explained in the Regulations, specifically Section



12.205. For example, Section 12.205(2) (a) lists the components of an application to become an investment adviser in the Commonwealth. Similarly, Section 12.205(2)(d) discusses the registration of investment adviser representatives, including the Criminal Offender Record Checks (CORI) requirement, the Uniform Application For Securities Industry Registration Or Transfer (Form U4) requirement, exam qualifications and the filing fee.

Discretion / Custody Requirements

Investment advisers should review the requirements associated with having discretion and/or custody over client funds. This information can be found in the Regulations, specifically Section 12.205(5). Here, investment advisers can find that Massachusetts incorporates the federal definition of “custody” under the Investment Advisers Act of 1940. Section 12.205(5) of the Regulations also explains that investment advisers who have discretionary authority of funds must, among other things, “send[] the qualified custodian and client an invoice or statement of the amount of the fee to be deducted from the client’s account

each time a fee is directly deducted” in order to be exempt from the audit requirements associated with having custody.

Note: If an investment adviser reports that it does not have discretion, it must ensure that it is in compliance with the applicable regulations and the Division’s policy statement on discretion, located at www.sec.state.ma.us/sct/sctprs/prsrel/relpol10.htm.

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See also, the Division's policy statement on custody for trustee relationships available at www.sec.state.ma.us/sct/sctpdf/switch-ps.pdf. In addition, an investment adviser will be deemed to have custody if it has a client's log-in information or password credentials for any financial institution.

Books and Records / Record Keeping Requirements

In addition, investment advisers can find within the Act and Regulations various books and record keeping requirements. Section 203 of the Act describes the general record keeping requirement, and states, in pertinent part, "[e]very registered broker-dealer and investment adviser shall make and keep accounts, correspondence, memoranda, papers, books, and other records as the secretary prescribes by rule or order, [...] All records so required, with respect to an investment adviser, shall be preserved for such period as the secretary prescribes by rule or order." Section 12.205(7) of the Regulations further details the books and record keeping requirements. For example, Section 12.205(7)(b) requires books and records to be kept "in a form permitting easy access for reasonable periodic, special, or other examinations by representatives of the [Massachusetts Securities] Division. Furthermore, Section 12.205(7)(c) mandates that such books and records must be "maintained and preserved for a period of not less

than five years, the first two years in an appropriate office of the investment adviser. All items must be arranged or indexed to permit prompt retrieval of any particular record." An investment adviser's adherence to the books and records requirements must be demonstrated in the event of an examination.

Note: While the books and records regulation indicates that information must be preserved for at least five years, the regulation does not mandate the form in which documents are retained, i.e. electronically maintained or hard copy documents.



Prohibited Practices

Finally, investment advisers should review certain prohibited practices, such as those found in Section 12.205(9) of the Regulations. This section, titled "Fraudulent Practices / Dishonest or Unethical

Practices" contains a non-exhaustive list of practices that violate Section 204(a)(2)(G) of the Act. Some examples of practices prohibited by Section 12.205 include: recommending unsuitable products; placing a buy or sell order without authority; exercising discretion without having written discretionary authority; borrowing or loaning money or securities to clients; misrepresenting qualifications of the adviser; charging an unreasonable advisory fee; failing to disclose conflicts; not utilizing a written advisory contract that specifies the fees and services to be provided. The above described certain prohibited practices and investment advisers must carefully review the entirety of the Act and Regulations to understand what practices are prohibited.

Note: Section 12.205(9)(c)(14) requires that an investment adviser must have investment advisory contracts with its clients. In interpreting this provision, the Division uses the definition of "client" from the Glossary of Terms to Form ADV, which includes clients from which the firm receives no compensation. Thus, an investment adviser needs to execute a written contract with a client even if the client is not charged advisory fees. Failure to have contracts with all clients may result in disciplinary action.

Conclusion

Investment advisers must adhere to all provisions in the Acts and Regulations in order to meet their fiduciary duty to clients. ▲

CHANGES TO FORM ADV

Every registered investment adviser must file its annual Form ADV amendments within ninety days of the end of its fiscal year as required by 950 Mass. Code Regs. 12.205(6)(a)1. Such an amendment is made by updating Form ADV Parts 1 and 2 via the IARD.

The U.S. Securities and Exchange Commission ("SEC") has updated some questions in the Form ADV and investment advisers must comply with the new Form ADV starting on October 1, 2017. For many state-registered investment advisers that have a December 31, 2017 fiscal year end, these firms would need

to be in compliance with the changes no later than March 2018. The following Form ADV questions may be particularly relevant to state-registered investment advisers.

Adviser's Physical Office Locations

Form ADV Part 1A, Item 1.F. has been revised to request the total number of offices in which the adviser conducts business and information about each location. In the updated Form ADV, the adviser will disclose the number of employees performing advisory functions in

each office location and report the types of securities-related activities that are conducted in each office.

Social Media

Form ADV Part 1A, Item 1.I. has been amended to ask whether the adviser has one or more accounts on social media platforms, such as Twitter, Facebook or LinkedIn. The information requested is limited to websites where the adviser controls the content and manages the social media account. The address of each of the adviser's social media pages shall be provided in Schedule D of Section 1.I.

Chief Compliance Officer

Form ADV Part 1A, Item 1.J. has been amended to require disclosure of whether the chief compliance officer is employed anywhere other than with the investment adviser.

Wrap Fee Programs

Form ADV Part 1A, Item 5.I and Section 5.I of Schedule D has been amended to require an investment adviser to disclose its assets under management as the sponsor or portfolio manager of a wrap fee program. It also requires disclosure of the SEC File Number and CRD number for the sponsors of the wrap fee program.

Separately Managed Accounts

Form ADV Part 1A has added Item 5.K. and a corresponding section of Schedule D. The amendments will require advisers to provide certain aggregate information about separately managed accounts that they advise, including disclosure of the amounts invested into each type of asset category. The adopting release for the Form ADV defines separately managed accounts as advisory accounts other than those that are pooled investment vehicles.

In August 2017, SEC issued guidance to address concerns of Form ADV

filers making an unanticipated other-than-annual amendment, available at www.sec.gov/divisions/investment/imannouncements/im-info-2017-06.pdf. After October 1, 2017, in filing an other-than-annual amendment, an investment adviser may not be able to complete the new sections of Form ADV Part 1A, Item 5.K and related Schedule D if the investment adviser's books and records did not capture the required data necessary to complete this response. In response to this concern, the SEC advised that Form ADV filers who need to file an other-than-annual amendment could respond to Item 5.K with "0" as a placeholder with a correlating explanation in the Miscellaneous



section of Schedule D to identify the "0" placeholder was entered. Therefore, *only* for any other-than-annual amendment made after October 1, 2017 and prior to the investment adviser's next annual Form ADV amendment, the Division

will accept this placeholder for Item 5.K.

Advisory Business

Form ADV Part 1A, Item 5 has been amended to require investment advisers to report (1) the number of clients for whom the adviser provides advisory services; (2) the amount of assets under management attributable for each type of client; (3) the number of clients for whom the adviser provides advisory services, but does not have those assets under management; and (4) the amount of assets under management attributable to clients that are non-United States persons.

Audited Financial Statements

Form ADV Part 1A, Item 7 has been amended to require advisers who receive an annual audit or annual surprise examination to provide the auditing firm's Public Company Accounting Oversight Board (PCAOB) assigned number.

This article is not a comprehensive list of each Form ADV change and the full text is available in the Federal Register at www.gpo.gov/fdsys/pkg/FR-2016-09-01/pdf/2016-20832.pdf. A redlined copy of the Form ADV changes is available at www.sec.gov/rules/final/2016/ia-4509-form-adv-summary-of-changes.pdf. ▲

REGISTRATION RENEWAL REQUIREMENTS

As required by Massachusetts law, all investment advisers, notice filers and exempt reporting advisers are required to renew their registration annually via the IARD and investment adviser representatives must renew electronically via the CRD. Failure to do so could result in a "Failure to Renew" status on the CRD, a fine, a reportable order, and potential enforcement issues for conducting unregistered advisory activity. Below are steps for state-registered investment advisers who will continue to conduct business in 2018.

1. **Look for reminders from the Massachusetts Securities Division**
The Division sends out reminders via email to remind registrants of the upcoming renewal deadline. Please

ensure your email address is current on your Form ADV to receive these reminders.

2. **Check the IARD renewal calendar**
Information regarding renewals for registrations, notice-filings and exempt reporting filings can be found at www.iard.com. Click on "Renewal Program" in the left margin for the renewal instructions.
3. **Fund the renewal account**
The deadline for full payment to be posted to the firm's renewal account is **December 18, 2017**. Please ensure that accounts are sufficiently funded to pay registration fees for both the firm and its affiliated investment adviser representatives.

Again, remember to fund the renewal account, not the daily account.

4. **Contact FINRA with any questions**
If you have any questions regarding payment on the CRD or IARD for registration renewals, notice-filings and exempt reporting filings, please contact FINRA at 240-386-4848.
5. **Termination of Advisory Services**
If your advisory firm plans to cease providing services, you must file a Form ADV-W by December 31, 2017 on the IARD website. ▲

RECENT ENFORCEMENT ACTIONS

Complaint Filed against Investment Adviser

In October, the Division filed charges against a state-registered investment adviser for allegedly engaging in fraudulent conduct, acting dishonestly and unethically, and breaching its fiduciary duties. The complaint alleges the investment adviser and its sole principal made false and misleading statements to investors and assessed performance fees to non-qualified advisory clients.

The Division alleges that the investment adviser set up venture capital funds for the sole purpose of raising capital for two Massachusetts start-up companies and raised capital partly by soliciting its own advisory clients. The complaint alleges that the principal misled potential investors to encourage them into investing and continued to mislead investors to convince them to continue investing when the companies were unable to repay them.

The Division seeks a permanent cease and desist order, censure, revocation of investment adviser registration, disgorgement of all proceeds received as a result of the alleged wrongdoing, restitution to investors, and an administrative fine.

Permanent Ban on Investment Adviser

In September, a Massachusetts-registered investment adviser and its sole investment adviser representative agreed to be permanently banned by Consent Order from conducting advisory business in Massachusetts.

The investment adviser, located in Massachusetts, made false statements on its Form ADV by not disclosing on Form ADV that the firm's principal was also the general partner and sponsor of four pooled investment vehicles. The investment adviser did not disclose the conflicts of interests resulting from the pooled investment vehicles. The investment adviser's principal solicited advisory clients to invest into his pooled investment vehicles, which invested in penny stocks and offered unregistered securities. ▲



DEPARTMENT OF LABOR EXTENDS TRANSITION PERIOD FOR FIDUCIARY RULE EXEMPTIONS

On November 27, 2017, the U.S. Department of Labor formally announced an 18-month extension of the Transition Period for the Fiduciary Rule's Best Interest Contract Exemption and the Principal Transactions Exemption. The effective date has been extended from January 1, 2018 to July 1, 2019. During the extension period, the Department of Labor will consider public comments and possible changes and alternatives to the currently proposed exemptions. The Department of Labor's news release for this matter is located at www.dol.gov/newsroom/releases/ebsa/ebsa20171127-0. ▲



THE RICE SECTION CONFERENCE SERIES

Cybersecurity & Data Privacy Training

SAVE THE DATE

When: Wednesday, March 14, 2018

Time: 9:00 a.m. – 12:00 p.m. Complimentary continental breakfast

Where: Best Western, Marlborough, Massachusetts

No Admission Charge

The Registration, Inspections, Compliance and Examinations (RICE) Section of the Massachusetts Securities Division will host a complimentary training to educate registrants on cybersecurity and data privacy. The training will include outside speakers from government agencies as well as the private sector and will be geared towards small and mid-sized state-registered investment adviser firms. As cyber-attacks and data breaches become increasingly common, investment advisers must be prepared to protect client information.

Space is limited. Additional information to follow. Registration will begin in mid-January.

