

# Massachusetts Securities Division

REGISTRATION, INSPECTIONS, COMPLIANCE AND EXAMINATIONS SECTION

▲ DECEMBER 2018 NEWSLETTER ▲

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

## TOP EXAMINATION DEFICIENCIES

The Massachusetts Securities Division's Registration, Inspections, Compliance and Examinations ("RICE") Section reviewed the results of its 2016, 2017, and 2018 on-site examinations, and compiled the following list of investment advisers' most common deficiencies.

### 1. Form ADV Amendments (950 MASS. CODE REGS. 12.205(6)(a)1.)

*Common Exam Deficiencies:* (1) Failure to file annual amendment and (2) Failure to file other-than-annual amendments.

*Note:* Parts 1 and 2 of Form ADV are required to be updated on a yearly basis within 90 days of the end of the firm's fiscal year (regardless if any changes have occurred). In addition, certain Form ADV items require updating anytime there is a material change. The instructions to Form ADV identify the items that require an other-than-annual amendment and notes these items must be updated within 10 days of the material change. The Form ADV instructions are located on the SEC's website at: [www.sec.gov/about/forms/formadv.pdf](http://www.sec.gov/about/forms/formadv.pdf) and [www.sec.gov/about/forms/formadv-part2.pdf](http://www.sec.gov/about/forms/formadv-part2.pdf).

### 2. Client Contracts (950 MASS. CODE REGS. 12.205(9)(c)14.)

*Common Exam Deficiencies:* (1) Failure to have written contracts with clients, including clients not charged a fee and (2) Failure to include all required contract provisions specified in 950 MASS. CODE REGS. 12.205(9)(c)14 such as a non-assignability clause and whether or not the adviser will exercise discretion.



*Note:* Advisers must charge clients the exact fee or fee schedule stated in the advisory contract. If fees being charged are different, lower or higher, the advisory contract must be amended. In addition, if an adviser is providing advisory services to a family member, the adviser still needs a contract with the family member.

### 3. Custody (950 MASS. CODE REGS. 12.205(5)(b)(1))

*Common Exam Deficiencies:* (1) Failure to comply with independent audit requirements when the Adviser has actual custody and/or inadvertent custody and (2) Failure to send invoices to the client each time a fee is deducted.

*Note:* Actual custody can occur when the Adviser is a trustee or has general power of attorney. Inadvertent custody can occur when the Investment Adviser has client login credentials or standing letters of authorization. In either instance, Advisers must comply with the custody Regulation. Custody also includes direct fee deduction of advisory fees from client custodial accounts. However, the Regulations provide an exemption to the independent audit requirement if: (a) the adviser has written authorization from

the client to deduct advisory fees from the account held with the qualified custodian; and (b) the adviser sends 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.

Advisers cannot rely on the monthly or quarterly custodial statement the custodian sends to the adviser's clients. Finally, please review the Division's policy statement regarding custody available on the Division's website at: [www.sec.state.ma.us/sct/sctpdf/switchps.pdf](http://www.sec.state.ma.us/sct/sctpdf/switchps.pdf).

### 4. Business Continuity Plans (950 MASS. CODE REGS. 12.205(9)(b))

*Common Exam Deficiencies:* (1) Failure

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## TOP EXAMINATION DEFICIENCIES

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to have a business continuity plan and (2) Failure to include provisions in the business continuity plan to address both incapacity of key personnel and the loss of main offices or infrastructure.

*Note:* When naming your firm's emergency contact consider whether you may travel with this individual. The Division considers it a best practice for smaller firms to designate a person unlikely to travel with the investment adviser representative/key personnel.

### 5. Privacy Policy (950 MASS. CODE REGS. 12.205(9)(c)(13))

*Common Exam Deficiency:* Failure to include an "opt-in" provision in the Adviser's privacy policy.

*Note:* The Regulation prohibits Advisers from sharing non-public personal information with non-affiliated third parties unless the client specifically consents to the disclosure. Advisers must give its clients an "opt-in" option to share information with any unaffiliated third parties. The "opt-in" requires an Adviser to obtain from its clients a signed statement in which the person makes an affirmative declaration of permission to disclose such information. The Division's privacy policy statement is available on the Division's website at: [www.sec.state.ma.us/sct/sctgbla/gblaidx.htm](http://www.sec.state.ma.us/sct/sctgbla/gblaidx.htm).

### 6. Statement of Disciplinary History (950 MASS. CODE REGS. 12.205(8)(d))

*Common Exam Deficiency:* Failure to inform clients and potential clients that the Division can be contacted to obtain disciplinary history of the investment adviser and its representatives' individual disclosure history.

*Note:* The statement of disciplinary history can be included in the Adviser's brochure or other disclosure document(s) the Adviser may use. ▲

## SENIOR INVESTOR FINANCIAL EXPLOITATION

According to the National Council on Aging, approximately 1 in 10 Americans aged 60 and older have experienced some form of elder abuse.<sup>1</sup> It is estimated that only 1 in 14 cases of abuse are reported to authorities<sup>2</sup>, with as much as

Rank	Type of Scam	# of Complaints
1	IRS Impersonation Scams	381
2	Robocalls / Unsolicited Phone Calls	166
3	Sweepstakes / Jamaican Lottery Scam	111
4	"Can you hear me?" Scam	97
5	Grandparent Scam	87
6	Computer Scam	79
7	Romance Scam	64
8	Elder Financial Abuse	51
9	Identity Theft	40
10	Government Grant Scam	37

Figure 1. Top 10 Scams reported to Aging Committee Fraud Hotline from January 1, 2017, to December 31, 2017.

\$36.5 billion per year lost due to elder financial abuse and fraud<sup>3</sup>. On average, 10,000 baby boomers are retiring each day in the U.S.<sup>4</sup>, increasing the number of senior clients at risk for financial abuse.

The U.S. Senate Special Committee on Aging released its 2018 Fraud Book, which lists and

describes the top ten scams received by the Committee's Fraud Hotline during 2017<sup>5</sup>. The Fraud Book also reports the top scams by state and provides a listing of resources for seniors.

Two FINRA rules have been implemented for its members in order to protect senior investors from financial exploitation. These rules are FINRA Rule 2165: Financial Exploitation of Specified Adults and FINRA Rule 4512: Customer Account Information.



On May 24, 2018, the 2018 Economic Growth, Regulatory Relief, and Consumer Protection Act was signed into law. This Act incorporated the SeniorSafe Act which provides immunity from suit for disclosure of financial exploitation of senior citizens. In order for a financial institution and its employee or affiliate(s) to be immune from liability the employee or affiliate making the disclosure must satisfy two requirements. The disclosure must be (1) made in good faith, with reasonable care, and (2) that individual must have received appropriate training. Training may be provided by the financial institution or by a third party to qualified individuals<sup>6</sup> that either deal with senior citizens regularly or handle senior citizens' financial documents in connection with providing financial services. There are only three requirements for the training's content: (1) it must instruct trainees on how to identify suspected exploitation and report it, both internally and externally; (2) it must discuss the importance of privacy

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- 1 National Council on Aging. Retrieved from: <https://www.ncoa.org/public-policy-action/elder-justice/elder-abuse-facts/>
- 2 National Council on Aging. Retrieved from: <https://www.ncoa.org/public-policy-action/elder-justice/elder-abuse-facts/>
- 3 National Council on Aging. Retrieved from: <https://www.ncoa.org/public-policy-action/elder-justice/elder-abuse-facts/>
- 4 Adamy, Janet and Overberg, Paul. Growth in Retiring Baby Boomers Strains U.S. Entitlement Programs. The Wall Street Journal. June 21, 2018. Retrieved from: <https://www.wsj.com/articles/retiring-baby-boomers-leave-the-u-s-with-fewer-workers-to-support-the-elderly-1529553660>
- 5 U.S. Senate Special Committee on Aging, Fighting Fraud: Senate Aging Committee Identifies Top 10 Scams Targeting Our Nation's Seniors (2018) available at: <https://www.aging.senate.gov/imo/media/doc/Fraud%20Book%20April%202018.pdf>
- 6 Described as "officer or employee of, or registered representative, insurance producer, or investment adviser representative affiliated or associated with, the covered financial institution . . ."

## SENIOR INVESTOR FINANCIAL EXPLOITATION

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and respect for customer integrity; and (3) it must match the professional responsibilities of those in attendance.

*What Steps Can Investment Advisers Take to Protect Its Senior Clients?* (1) Implement policies and procedures in order to ensure potentially vulnerable client are not taken advantage of by addressing steps the investment adviser will take to report and/or address suspected exploitation; (2) Implement two part authentication by confirming the authenticity of client wire transfer requests received by electronic communication or a third party by telephone with the client; (3) Increase awareness of cognitive risks to senior clients, such as diminished decision-making capacity or memory loss; and (4) Obtain the name and contact information of a trusted contact person, such as a financial proxy, for each senior client.

*If Financial Exploitation is Suspected, What Can Investment Advisers Do?* (1) Discuss your concerns with the client's identified trusted contact; (2) Contact the Massachusetts Securities Division; and (3) Contact Elder Services and/or Local Law Enforcement.

*Note:* Obtaining a financial proxy from the client will alleviate privacy concerns should the adviser need to contact the specified individual. ▲

## SWEEP OF BROKERAGE FIRMS SELLING PRIVATE PLACEMENTS

In July 2018, after a report that broker-dealers employing agents with disciplinary history sell billions of dollars per year of private placements, the Division initiated a sweep of firms who sell private placements. The sweep includes ten Massachusetts-based brokerage firms. According to Secretary Galvin's statement:

*Private placements are risky investments that reward the salesperson handsomely with high commissions. Firms offering these to the public, especially seniors, have an obligation to see that they are sold to benefit the investor, not the broker. Individuals with a history of disciplinary actions magnify the risk of unsuitable sales in connection with private placements.*

The sweep seeks to gather information about various sales and supervisory practices in connection with selling private placements to Massachusetts customers. In conjunction with this sweep, the Division has focused on sales of GPB Holdings, II and GPB Automotive. ▲

## GPB CAPITAL HOLDINGS BROKER SWEEP

On April 30, 2018, GPB missed the deadline to file required annual audited financial statements for GPB Automotive and GPB Holdings, II. In a letter sent to broker-dealer executives, GPB stated that both funds would "temporarily" stop accepting new investments, in order to allow the funds to focus on rectifying their financials. In addition, the two funds have also stopped redeeming investor shares until the new audited financials are complete.

Due to the GPB funds failing to timely file their audited financials, the Division opened an investigation into the sales practices of firms selling shares of GPB Holdings, II and GPB Automotive. The Division served 63 subpoenas to all broker-dealers GPB reported as soliciting GPB Holdings, II or GPB Automotive in Massachusetts. In addition to assessing the number of Massachusetts investors exposed to these two funds, the sweep seeks to gather information regarding the sales, supervisory, due diligence, and approval process of the broker-dealer firms related to the sale of GPB products. ▲

## RECENT ENFORCEMENT ACTIONS

In August 2018, the Enforcement Section brought an administrative action against a California-based broker-dealer and its agent. The Administrative Complaint alleges that the agent recommended his customers, 30% of whom are Massachusetts investors, buy and then sell Unit Investment Trusts before their maturity date, resulting in losses for investors and more than \$750,000 in commissions for the broker-dealer and its agent. The Administrative Complaint seeks sanctions that include a cease and desist, a censure, payment of restitution to fairly compensate investors, an administrative fine, revocation of the agent's registration in Massachusetts, and a requirement that the broker-dealer hire an independent compliance consultant to review its supervisory procedures.



In September 2018, the Division entered into a Consent Order with a broker-dealer based, in part, on its failure to supervise the sale of Non-Traded REITs. The sale of REITs were facilitated by inflating clients' liquid net worth. Pursuant to the Consent Order, the broker-dealer will offer rescission to Massachusetts investors who purchased the Non-Traded REITs in violation of the broker-dealer's internal liquid net worth concentration limits. In addition, the broker-dealer will disgorge commissions paid by affected investors and pay a fine in the amount of \$50,000 to Massachusetts.

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## RECENT ENFORCEMENT ACTIONS

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In September 2018, the Division entered into a Consent Order with an investment adviser and its Massachusetts-based investment adviser representative for posting misleading information on the firm's website. The investment adviser permitted misrepresentations about the representative's disciplinary history to be publicly displayed on the representative's website for seven years. As a result of the Consent Order, the investment adviser and its representative agreed to: (1) ongoing monitoring of the investment adviser representative's website and Form U-4; (2) heightened supervision of the investment adviser representative; (3) hire an independent consultant to review internal policies and procedures regarding its representatives' advertisements and communications with retail investors; and (4) have the firm pay a fine of \$25,000 and the investment adviser representative pay a fine of \$10,000. ▲

## MSD LAUNCHES A NEW INVESTOR EDUCATION SECTION

The Massachusetts Securities Division recently launched a new Investor Education Section. The primary objective of the Investor Education Section is to educate and inform Massachusetts investors. This section will undertake public outreach in the form of speaking engagements and publication of materials for distribution. Some of the topics

presented on include red flags of financial fraud and abuse, common types of fraud and scams targeting seniors, and the fundamentals of securities and financial literacy. If you are aware of a group that would be interested in scheduling a presentation offered by the Investor Education Section, please contact the Division at 617-727-3548. ▲



## CYBERSECURITY BEST PRACTICE REMINDER

In November 2018, one of LPL Financial LLC's third-party vendors experienced a data breach exposing personal identifiable information ("PII") such as client names, addresses, social security numbers, and account numbers of LPL clients. LPL's third-party vendor, who provides data analytic services, discovered that an unauthorized person gained access to a third-party file-sharing system<sup>7</sup>.



This event shows how third-party vendors hired by and providing services to investment advisers can create vulnerabilities for the investment adviser and its clients. Investment advisers that

share client PII with third-parties should review their cybersecurity programs to account for potential data breaches.

*Note:* At the RICE Section's May 2, 2018 Cybersecurity Conference, investment advisers were urged to adopt cybersecurity programs to address vulnerabilities related to their businesses, including information-sharing with custodians and other third-party vendors.

For more information regarding cybersecurity and a recap of the Division's training on cybersecurity, please refer to the 2018 Mid-Year Newsletter. ▲

## UPCOMING INVESTMENT ADVISER TRAININGS

Starting in 2019, the RICE Section will begin conducting web-based trainings for state-registered investment advisers. The topics will cover areas of interest that investment advisers have identified through previous RICE conference surveys as well as current relevant issues that impact investment advisers. The first two webinars will be:

**Investment Adviser Books and Records** scheduled for winter 2019\*

**The Investment Adviser Examination Process** scheduled for spring 2019\*

\*Exact dates and times will be provided via email. Please ensure the email address on your ADV is up-to-date to receive these communications. ▲

<sup>7</sup> Neal, Ryan W. LPL Providing Credit Monitoring, Identity Protection to Investors Exposed by Data Breach. InvestmentNews. Nov. 14, 2018. Retrieved from: <https://www.investmentnews.com/article/20181114/FREE/181119948/lpl-providing-credit-monitoring-identity-protection-to-investors>