

# Massachusetts Securities Division

REGISTRATION, INSPECTIONS, COMPLIANCE AND EXAMINATIONS SECTION

▲ 2021 FALL NEWSLETTER ▲

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

## THE SEC AMENDS ITS DEFINITION OF “ACCREDITED INVESTOR”

In August 2020, the U.S. Securities and Exchange Commission (the “SEC”) adopted amendments to the definition of accredited investor under the Securities Act of 1933.<sup>1</sup> The SEC states that the definition was amended in order to identify more effectively both institutional and individual investors that have the requisite knowledge and expertise to participate in private capital markets. The amendment created several investor categories for individuals and entities.

### Accredited Investor Categories for Individuals:

- Individuals who hold either the Licensed General Securities Representative (Series 7) designation, the Licensed Investment Adviser Representative (Series 65) designation, or the Licensed Private Securities Offerings Representative (Series 82) designation in good standing can qualify as accredited investors. However, simply passing the requisite examination does not guarantee that an individual will qualify as an accredited investor. Individuals seeking accredited investor status under this category should consult the Financial Industry Regulatory Authority (“FINRA”) and applicable state rules in order to ensure that they meet any additional requirements. For example, an individual seeking to qualify as an accredited investor by passing the Series 65 ex-

amination would need to be registered as an IAR in his or her home state and would need to comply with all state-specific registration requirements;

- Individuals who meet the definition of a “knowledgeable employee” of a private fund as defined in Rule 3c-5(a) (4) of the Investment Company Act of 1940<sup>2</sup> can also qualify as an accredited investor. However, their status as a knowledgeable investor only qualifies them as an accredited investor with respect to

offerings made by the private fund they are associated with or an offering made by other private funds managed by the same employer; and

- Individuals may qualify as an accredited investor based on their status as a family client of a family office so long as the individual:
  1. Meets the definition of “family client” under Rule 202(a)(11)(G)-1 of the Investment Advisers Act of 1940;<sup>3</sup>
  2. Is a family client of a family office that itself qualifies as an accredited investor; and
  3. Has his or her investments directed by a person who has the requisite knowledge and experience with respect to financial and business matters that the family office is capable of evaluating the benefits and the risks of the prospective investment.



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### Accredited Investor Categories for Entities:

The amended definition states that the following entities may qualify as an accredited investor:

- Investment advisers registered with the SEC;
- State-registered investment advisers;
- Exempt reporting advisers;
- Rural business investment companies;
- Limited liability companies with more than \$5 million in assets;
- Certain family offices and family clients; and
- Entities owning investments in excess of \$5 million.

The amendments to the definition of an accredited investor took effect on December 8, 2020. Please remember to consult the SEC and state securities regulators with any questions regarding the amended definition. ▲

<sup>1</sup><https://www.sec.gov/corpfin/amendments-accredited-investor-definition-secg>

<sup>2</sup> 17 CFR § 270.3c-5(a)(4)

<sup>3</sup> 17 CGR § 275.202(a)(11)(G)-1(d)(4)

# FINRA AND NASAA ADDRESS LESSONS LEARNED FOLLOWING THE COVID-19 PANDEMIC

The COVID-19 pandemic forced many firms to make accommodations to their normal practices in order to effectively continue conducting business. Regulatory agencies had to adapt to these accommodations in order to ensure that firms were still in compliance with the rules and regulations and that investors continued to be protected. As offices begin to reopen and people begin returning to work, firms and regulators are now considering which new practices that arose as a result of the pandemic should continue to be utilized. FINRA<sup>1</sup> and the North American Securities Administrators Association (“NASAA”)<sup>2</sup> have provided commentary on whether these new practices should be allowed to continue in the securities industry.

## Online Qualification Examinations

In the interest of health and safety, FINRA and NASAA provided candidates seeking to take qualification examinations with access to an online testing service, as opposed to its regular practice of having candidates take the examinations in person at a testing center. FINRA has requested public comment as to whether it should continue to provide the online testing service. NASAA has advocated for keeping the online testing service available under limited circumstances, such as an accommodation for candidates who are unable to travel to a test-

<sup>1</sup> <https://www.finra.org/rules-guidance/notices/20-42>

<sup>2</sup> <https://www.nasaa.org/wp-content/uploads/2021/02/Comment-Letter-FINRA-RN-20-42-022321.pdf>

ing center. NASAA has reservations with continuing to make online examinations available beyond present business continuity needs and future accommodation needs. NASAA’s primary concern is that, despite taking steps to prevent cheating during the online examinations, in-person proctors have much more experience monitoring in-person testing than they do on-line testing, and they are more aware of the methods used by candidates to cheat when the tests are taken in person. As such, in-person testing provides less of an opportunity for candidates to cheat on their qualifications examinations. NASAA continues to weigh the benefits of online testing, including affordability and convenience, against the drawbacks, such as the potential threat of individuals cheating during the online examination and becoming registered despite being unqualified.

## Continuation of Remote Working

In addition, many firms are considering providing their employees with the option to telework even after offices reopen. NASAA has expressed its opposition to this continued practice for a number of reasons. First, many homes

have a weaker cybersecurity system when compared to the system in place at their offices, and many homes are not suitable locations in which to store physical copies of clients’ records. The continued use of telework also creates difficulties with respect to a firm’s proper supervision of its employees. Telework provides more



opportunities for employees to communicate with current and prospective clients outside of the firm’s established systems. Not only will firms face problems with supervising its own employees, they will also have no control over the other individuals who will be present in employees’ home offices. These shortcomings represent a serious security risk to clients’ non-public personal information and provide for the opportunity for misconduct to go undetected by firms.

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# NASAA ADOPTS MODEL RULE REQUIRING CONTINUING EDUCATION FOR INVESTMENT ADVISER REPRESENTATIVES

In November 2020, NASAA voted to approve a model rule that would require registered investment adviser representatives (“IARs”) to complete 12 hours of continuing education every 12 months. NASAA members adopted this model rule with the goal of ensuring that an IAR’s knowledge about the industry is maintained and expanded throughout

his/her career.

NASAA’s Continuing Education Program consists of two components:

1. An Ethics and Professional Responsibility Component, which is designed to ensure that IARs are aware of the duties and obligations that they owe to their clients; and

2. A Products and Practices Component, which is designed to ensure ongoing knowledge with respect to investment products, strategies and standards, and compliance practices in the investment advisory business.

IARs of both state-registered and federal covered investment advisers that are

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## MODEL RULE

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registered in a jurisdiction that has adopted the model rule will be subject to the requirements of NASAA's Continuing Education Program and will be required to meet the continuing education requirements of each jurisdiction in which they are registered. However, IARs registered in their home states will be considered to be in compliance with NASAA's Continuing Education model rule as long as they are in compliance with their home state's continuing education requirements and the requirements of their home state is at least as stringent as NASAA's Continuing Education Program requirements.



At this time, the Division has not adopted NASAA's Continuing Education model rule, but may elect to do so in the future and will notify investment advisers and their representatives in the event that it does so. For more information, refer to NASAA's FAQ regarding its Continuing Education model rule.<sup>1</sup> ▲

<sup>1</sup> <https://www.nasaa.org/industry-resources/investment-advisers/resources/iar-ce-faq/>



## ENFORCEMENT ACTIONS<sup>1</sup>

### **Nevada company and two affiliated individuals charged with deceptive sales practices and unregistered activity**

In December 2020, the Enforcement Section of the Division ("Enforcement Section") charged a Nevada-based company and two affiliated individuals with deceptive sales practices and unregistered activity. The Enforcement Section alleges that since 2012, the parties offered and sold unregistered and non-exempt promissory notes to Massachusetts investors in the total amount of \$2.48 million. The promissory notes guaranteed returns between nine and twelve percent. However, almost all monthly interest payments from the issuer have ceased and Massachusetts investors have not received any return of their principal. The promissory notes were also labeled "secured" despite the fact that the notes did not identify any collateral. In addition, the company and its two affiliated individuals have never been registered to offer or sell securities in Massachusetts. The Enforcement Section is seeking restitution to compensate Massachusetts investors for losses attributable to the alleged wrongdoing as well as a permanent bar on the company and the two individuals from registration in the securities industry in Massachusetts.

### **Brokerage firm and Massachusetts-based individual charged with unregistered activity and unethical business practices**

In July 2021, the Enforcement Section and the Registration, Inspections, Compliance and Examinations Section (together, the "Division") charged a Massachusetts based individual with engaging in unregistered activity (the "Unregistered Adviser") and a FINRA and Massachusetts-registered broker-dealer with failing to have adequate policies and procedures to monitor accounts on its platform for payments to known unregistered investment advisers and investment adviser representatives as well as enabling the Unregistered Adviser to receive payment for its unlawful services. The Division alleges that since 2015, the Unregistered Adviser provided investment advisory services to clients in Massachusetts whilst unregistered, unlawfully collecting over a hundred thousand dollars in advisory fees. The Division further alleges that, in addition to providing unregistered investment advice, the Unregistered Adviser made unsuitable recommendations to his clients, including recommending that his clients invest over 90% of their accounts into one industry sector and repeatedly misrepresenting the services he continues to provide to clients. The Division also alleges that the broker-dealer, which served as the custodian of the Unregistered Adviser's client accounts, allowed clients to pay investment advisory fees directly from their accounts to the Unregistered Adviser even after the broker-dealer removed the Unregistered Adviser from its platform. The Division alleges that the broker-dealer failed to have adequate supervisory procedures in place to prevent these unlawful payments to the Unregistered Adviser. The broker-dealer was aware that the Unregistered Adviser was unregistered and removed him from its platform for being unregistered, yet it still continued to allow its customers to pay their investment advisory fees to the Unregistered Adviser from their accounts with the broker-dealer. The Division alleges that the broker-dealer failed to have adequate supervisory policies and procedures in place to prevent these unlawful payments to the Unregistered Adviser. The Division is seeking, among other relief, (1) restitution for Massachusetts investors who suffered financial loss as a result of this conduct, (2) a permanent bar from registration for the Unregistered Adviser, and (3) for the broker-dealer to review and amend its policies and procedures related to payments made from the broker-dealer's customer accounts and the monitoring of customer accounts following the removal of a third-party adviser. ▲

<sup>1</sup> <https://www.sec.state.ma.us/sct/sctidx.htm>



## CORPORATE FINANCE SECTION UPDATES TO POLICIES ON REMOTE FILING

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As part of its continuing response to the COVID-19 pandemic, the Corporate Finance Section of the Securities Division has updated its filing procedures to accommodate filers that are working remotely.

As of June 2021, the Secretary of the Commonwealth has discontinued issuing Emergency Orders relating to remote filing procedures.

To provide continuity relating to remote filings, the Corporate Finance Section has issued Policy Statements to continue to accept filings via e-mail and payments via wire transfer. The Corporate Finance Section continues to accept electronic signatures and remote notarizations as well as manual signatures and in-person notarizations for Corporate Finance filings. See the Corporate Finance Statement of Policy on Filing Require-

ments and Remote Filings, dated May 28, 2021: <https://www.sec.state.ma.us/sct/sctefd/efdidx.htm>

The Corporate Finance Section continues to accept Rule 506 notice filings and UIT notice filings electronically via the NASAA Electronic Filing Depository (“EFD”). Filers also have the option to make hard-copy filings and pay filing fees by check. See the Corporate Finance Section’s May 28, 2021 notice for further information about filing via the NASAA EFD: <https://www.sec.state.ma.us/sct/covid-19/Emergency-Notice-for-Corporate-Finance-Filers.htm>

The Corporate Section recommends that filers regularly check the Securities Division’s website for Statements of Policy and Notices providing up-to-date information on securities registration, exemptions, and notice filings. ▲

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## USE OF MOBILE TRADING APPLICATIONS

There are a variety of mobile apps available today that allow individuals to invest their money using their smartphones.<sup>1</sup> These apps provide convenience when it comes to trading securities, as well as making it easier for people to stay informed about the status of their portfolios. Given these benefits, some investment advisers and financial planners may consider utilizing a mobile app in order to provide better services to their clients. If you are considering using a mobile app, please consider the following:

- Make sure to conduct your own independent research to find the mobile app that is best suited for both you and your clients;
- Review the types of services and products that are being made available on the app. Consider whether the available service will provide a material benefit to you and your clients;
- Look at the fees that the mobile app will charge and determine whether the types of service available warrant the increase cost; and
- Take care to ensure the mobile app has sufficient security features in place in order to protect your clients’ personal information. ▲

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<sup>1</sup> <https://www.nasaa.org/investor-education/millennial-money-mission/smartphone-investing-apps/>

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## LESSONS LEARNED

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Allowing employees to continue to telework also creates a challenge for regulators who conduct onsite inspections of firms and their branch offices. These on-site inspections are a crucial compliance tool to ensure that firms and their employees are following the law. Securities regulators would not be able to inspect every home office and would not be able to rely on the attestations of a firm and its employees that they are acting in compliance with relevant laws. Throughout the pandemic, many securities regulators have utilized remote examinations, but these can often fail to capture the extent of the compliance issues that are present. Given these facts, NASAA cautions against firms continuing to allow the majority of their employees to telework.

The impact of the COVID-19 pandemic on the workplace was sizeable, and time will tell which of these new practices will persist, as well as what new regulatory practices may arise as a result. ▲