

Massachusetts Securities Division

REGISTRATION, INSPECTIONS, COMPLIANCE AND EXAMINATIONS SECTION

▲ 2016 MID-YEAR NEWSLETTER ▲

A Division of William Francis Galvin, Secretary of the Commonwealth

THE DEPARTMENT OF LABOR FIDUCIARY RULE

On April 6, 2016, the Department of Labor (“DOL”) released its final version of a regulation imposing heightened standards for the provision of investment advice in retirement accounts, requiring financial professionals servicing individual retirement accounts, 401(k) accounts, and other similar vehicles to act in their clients’ best interests while doing so. The amendments seek to limit conflicts of interest with regard to brokers’ provision of retirement advice to clients, and were reached after years of planning and in the face of substantial opposition by a large portion of the financial services industry. The DOL regulation, which is notable in that it applies based on to whom advice is provided rather than being based on advice regarding any specific investment product, was shaped in part through thousands of comment letters, including a letter of support from Secretary Galvin.

Despite being subject to a fiduciary duty due to their current role and registration

status, the new DOL regulation will significantly affect Massachusetts-registered investment advisers. The fiduciary duty required by the Employee Retirement Income Security Act of 1974 (“ERISA”), the law over which the DOL maintains jurisdiction, is a more heightened fiduciary standard than that developed by



case law stemming from the Investment Advisers Act of 1940, which governs the standard undertakings of Massachusetts-registered investment advisers. As such, Massachusetts-registered investment advisers will be subject to additional responsibilities and obligations in the course of providing investment

advisory services and retirement advice to Massachusetts clients in connection with individual retirement accounts, 401(k) accounts, and other similar vehicles.

The fiduciary requirement under the DOL regulation will become applicable as of April 10, 2017, while certain aspects of the policies and procedures

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that firms will need to adopt will not need to be in place until the end of 2017. The Division is currently in the process of reviewing the DOL regulation and assessing the specific impacts to practices managed by Massachusetts-registered investment advisers, and intends to provide informational sessions for its registrants regarding the DOL regulation by the end of this calendar year. ▲

RICE SECTION CONFERENCE

Following up on its March 2015 conference held in Boston, on October 14, 2015, the Massachusetts Securities Division of the Office of the Secretary of the Commonwealth’s (“Division”) Registration, Inspections, Compliance and Examinations (“RICE”) Section hosted a second Meet the RICE Section Conference at the Best Western Royal Plaza Hotel and Trade Center in Marlborough, Massachusetts. As a part of a series of educational outreach programs conducted by the Division, the three-



hour conference allowed Massachusetts-registered investment advisers and investment adviser representatives to attend a discussion with RICE attorneys and staff as well as federal regulators and law enforcement regarding topics currently impacting advisers. The conference drew over 200 attendees, primarily consisting of individuals affiliated with Massachusetts-registered investment advisers while a small portion of attendees came from federally registered invest-

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ment advisers or other compliance-related organizations. The conference focused on three specific areas: Trending Topics, Common Examination Findings and Cybersecurity.

The Trending Topics panel discussed a number of items that would present new challenges to Massachusetts-registered investment advisers, including (1) business continuity and succession planning; (2) the Securities and Exchange Commission's ("SEC") proposed amendments to the Form ADV; (3) proposed FINCEN Anti-Money Laundering ("AML") regulations for investment advisers; (4) robo-advisers; and (5) the Department of Labor's ("DOL") fiduciary rule.

RICE attorneys also led a panel discussion on Common Examination Findings. Conference attendees got an overview of the RICE Section's examinations program, which is generally designed to assist registrants in protecting clients by ensuring registrants' compliance with Massachusetts laws and regulations pertaining to investment advisers. In the Common Examination Findings panel, RICE attorneys discussed the top ten examination deficiencies identified during Massachusetts investment adviser examinations between June 30, 2014 and June 30, 2015. According to feedback from attendees, this presentation was a crowd favorite as most found this information to be very useful in helping investment advisers comply with Massachusetts laws and regulations.

The final panel discussed cybersecurity from the perspective of federal regulators and law enforcement. Kevin M. Kelcourse, Associate Director for the Office of Compliance Inspections and Examinations at the SEC's Boston Regional Office and John Keelan, Supervisory Special Agent, Securities and Corporate Crimes, Federal Bureau of Investigation, led this discussion. This panel provided considerable insight regarding the high-level security concerns faced by federal officials in the area of cybersecurity, re-emphasizing that Massachusetts-registered investment advisers should continue to be diligent when it comes to protecting sensitive client information in the course of fulfilling the fiduciary duties owed to their clients. ▲



INVESTMENT ADVISER EXAMINATION PRIORITIES

The Massachusetts Securities Division's Registration, Inspections, Compliance and Examinations Section (hereinafter the "RICE Section") conducts regular and continuing investment adviser examinations of its registrants in order to protect Massachusetts investors. In addition to continuing to conduct for-cause examinations in response to client complaints and industry developments, the RICE Section will also focus on a number of key areas in the upcoming calendar year in the course of its standard examinations. These areas of focus include the following:

Retirement Plans/Pension Funds

RICE Section examiners will focus on retirement accounts held by investment adviser clients, as well as investment advisers that provide advice specifically to individual retirement accounts (IRAs), retirement plans and pension funds. This focus is especially significant considering



the Department of Labor's April 2016 amendments to the fiduciary standard to be applied to individuals who advise retirement accounts, as the new standard will also affect Massachusetts-registered investment advisers. Specifically, RICE Section examinations will analyze the assets held within those accounts to determine their suitability for the client in order to ensure that clients are placed in appropriate investment vehicles. Examples of issues that the RICE Section may examine could include the transfer of assets between tax-advantaged accounts, as well as products held in retirement accounts that may cause an investment adviser to have a material conflict of interest with its client.

Product Recommendations

The RICE Section will also continue to examine the products Massachusetts-registered investment advisers recommend to clients. Topics under this umbrella include examining whether investment advisers' use of popular investment vehicles, such as exchange-traded funds, comports with the investment adviser's obligation to provide suitable recommendations and to disclose the pertinent risks of particular products with the client. The RICE Section will continue to emphasize that investment advisers' fiduciary duties to their clients mean that they should know the products being recommended to those clients, and

whether such recommendations makes sense in light of the clients' individual circumstances.

Senior Clients



Examinations will also focus on issues primarily pertaining to senior clients. Examples of types of these issues include looking at an investment adviser's policies and procedures regarding heightened supervisory oversight for senior clients, as well as for clients with a mental impairment or other form of diminished capacity. RICE Section examiners will continue to encourage investment advisers to be mindful of their fiduciary obligation to act in a senior client's best interest and to be proactive in establishing systems to help address those best interests.

Custody

The RICE Section will also continue to focus on investment advisers that maintain custody over client assets. The ability to access and withdraw client assets remains the most straightforward way by which fraud can be perpetrated against Massachusetts investors, and as such, the RICE Section will examine investment advisers to (1) determine whether state-registered investment advisers have custody of client assets, and (2) ensure that those advisers maintaining custody are fulfilling the regulatory obligations they incur as a result of their authority.

The RICE Section encourages Massachusetts-registered investment advisers to contact the Division with suggestions as to how best accomplish the Division's goal of protecting Massachusetts investors through its examination program. Please notify the RICE Section at MSD@sec.state.ma.us. ▲

ROBO-ADVISERS AND STATE INVESTMENT ADVISER REGISTRATION POLICY STATEMENT

On April 1, 2016, the Massachusetts Securities Division issued a policy statement regarding the ability of robo-advisers to register with the Commonwealth of Massachusetts as investment advisers.

As robo-advisers have emerged in the marketplace as alternatives to traditional investment advisers, the Division is tasked with ensuring that all investment advisers meet the fiduciary obligations they assume when they provide investment advice for compensation. In conjunction with that responsibility, the Division's policy statement touches upon the issues the Division will examine in considering whether a robo-adviser can

register with the Commonwealth, and is intended to provide guidance to potential robo-adviser applicants.

Shortly after issuing the policy statement, the Division e-mailed a copy of the statement to all state-registered investment advisers in the Commonwealth. The Division encourages all investment advisers to become familiar with this guidance. A copy of the policy statement can be found on the Division's website at <http://www.sec.state.ma.us/sct/sctpdf/Policy-Statement--Robo-Advisers-and-State-Investment-Adviser-Registration.pdf>. ▲

FREQUENTLY ASKED QUESTIONS

When do I need to file my annual Form ADV amendments?

Every registered investment adviser must file its annual Form ADV amendments within ninety days of the end of its fiscal year. Such an amendment is made by updating Form ADV Parts 1 and 2 via the Investment Adviser Registration Depository (IARD). As required by 950 CMR 12.205(6)(a)1., please refer to the Instructions to Form ADV for further guidance.

Do I need to file my annual Form ADV amendments if nothing has changed from the previous filing?

Yes. Filing annual amendments to an investment adviser's Form ADV is an annual obligation for all investment advisers regardless of whether or not there have been material changes. Such filing should also reflect any non-material changes made by the investment adviser.

As required by 950 CMR 12.205(6)(a)1., please refer to the Instructions to Form ADV for further guidance.

I filed a Form U4 application seeking registration for one of my investment adviser representatives, but the person's status still shows as "pending." Is there anything else I need to do?

An investment adviser representative's registration status can remain "pending" for a number of reasons. However, in most cases, an investment adviser representative's application may stay in a pending status if our office has not received the Criminal Offender Records Information ("CORI") Acknowledgment Form, as required by 950 CMR 12.205(2)(d)1.d. The Division does not deem an investment adviser representative's application complete until this form has been received by our office. The form is located on the Division's website at <http://www.sec.state.ma.us/sct/sctcori/MSD-iCORI-Form.pdf>. The firm should e-mail completed forms to the Division's dedicated e-mail address for receiving such forms: CORI@sec.state.ma.us. ▲

