

# Massachusetts Securities Division

REGISTRATION, INSPECTIONS, COMPLIANCE AND EXAMINATIONS SECTION

▲ DECEMBER 2019 NEWSLETTER ▲

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

## THE STAND-ALONE TABLE OF FEES FOR SERVICES REGULATION & BOOKS AND RECORDS EXAMINATION TRAINING

On October 29, 2019, the Registrations, Inspections, Compliance and Examinations (“RICE”) Section of the Massachusetts Securities Division of the Office of the Secretary of the Commonwealth (the “Division”) hosted the Stand-Alone Table of Fees for Services Regulation & Books and Records Examination Training. The conference featured two presentations. The first presentation discussed the new Table of Fees for Services (“Fee Table”), which will become effective January 1, 2020. The second presentation described the books and records examination process including a discussion of commonly identified deficiencies.



**Stand-Alone Table of Fees for Services Regulation Presentation:** Panelists included: Dylan White, Assistant Chief of RICE; Lauren Munschauer, Senior RICE Attorney; and Dr. Stephan Shipe, Assistant Teaching Professor of Finance at Wake Forest University. The presentation discussed the Division’s adoption

and enforcement of a new regulation that requires investment advisers registered in Massachusetts to provide clients and prospective clients with a one page, stand-alone Fee Table. The Division will begin enforcing this regulation as of January 1, 2020.

Dr. Stephan Shipe presented his research regarding the readability of investment adviser disclosure documents.

Dr. Shipe’s research demonstrates that many investment advisers’ disclosures have become increasingly difficult for the average person to read and comprehend. Fee disclosures are often hidden within a sea of narrative text. Investment advisers’ disclosure brochures often span twenty pages or more, and contain industry jargon that many investors may not fully understand. The Division spent two years developing the stand-alone Table of Fees for Services in order to combat this trend. After the end of the preliminary comment period, the Division formed a working group of Massachusetts-registered investment advisers, representatives

from industry trade groups whose members would be subject to the requirement, and Dr. Shipe. The Division solicited official comments on the proposal developed in the working group, and held a public hearing on May 2, 2019.

All investment advisers who are registered in Massachusetts, regardless of their principal place of business, must abide by this new regulation and each investment adviser must:

1. Prepare and maintain the Fee Table in a form approved by the Division. A fillable template is available on the Division’s website;<sup>1</sup>

<sup>1</sup> <https://www.sec.state.ma.us/sct/sctfeetable/feetable-adoption.htm>

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### TABLE OF FEES FOR SERVICES REGULATION REMINDER

Starting January 1, 2020, all Massachusetts-registered investment advisers must comply with the amended disclosure obligations, including the Fee Table.<sup>1</sup> The Fee Table must be provided to all prospective and current clients in conjunction with existing disclosure requirements and available on the investment adviser’s website, if applicable. ▲

<sup>1</sup> <https://www.sec.state.ma.us/sct/sctfeetable/feetable-adoption.htm>

# THE STAND-ALONE TABLE OF FEES FOR SERVICES REGULATION & BOOKS AND RECORDS EXAMINATION TRAINING

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2. Abide by the instructions in the Guide to Table of Fees for Services;<sup>2</sup>
3. Ensure that the Fee Table does not exceed one page;
4. Maintain the Fee Table as a stand-alone document, not an additional part of their Form ADV; and
5. If the investment adviser utilizes a website, ensure that a copy of the Fee Table is available and easily accessible on the website.



ensure that registrants are complying with recordkeeping<sup>4</sup> and other obligations to their clients. Through direct interaction with registrants, examiners are able to gain insight into current business practices and trends among investment advisers in the

Commonwealth and identify areas for further guidance from the Division.



Effective on January 1, 2020, investment advisers will deliver their completed Fee Table to their clients on the same timeline and in the same manner that they deliver their brochure. A copy of the amended regulation can be found on the Division's website.<sup>3</sup>

## Books and Records Examinations Presentation:

Panelists included: Emily Lee, RICE Attorney; Richard Etienne, RICE Examiner; and Matthew Taylor, Corporate Finance Attorney. The presentation explained the Division's authority and primary objectives for investment adviser examinations. The panelists also gave an overview of examination procedures and highlighted common deficiencies.

Examinations, which may be conducted either on-site or remotely, aim to

Deficiencies identified during the examination process as well as recommendations for best practices will be noted in a deficiency letter to the investment adviser. The investment adviser must respond to the letter within thirty days detailing how they have addressed each deficiency.

The panelists also highlighted certain common examination deficiencies.<sup>5</sup> One common deficiency discussed was incomplete client contracts. A valid and complete contract is required for every client, even those who are not charged an advisory fee.<sup>6</sup> Another common deficiency involves insufficient recordkeeping, particularly in regards to client communications.<sup>7</sup> Registrants often do not realize that the preservation of client communications extends to untraditional forms of communication including social media posts and text messages.

Finally, the panelists explained several ways in which investment advisers may unknowingly have custody over client assets. A common example is direct deduction of client fees without sending an invoice at the same time the fee is directly deducted. Other common practices which may result in the requirement to report custody include the possession of client log-in information, trusteeship, joint accounts, general power of attorney, and standing letters of authorization. More information regarding custody issues may be found in the Division's custody policy statement<sup>8</sup>. ▲

*Copies of the conference training materials are available upon request by calling the RICE Section at (617) 727-3548 or emailing [msd@sec.state.ma.us](mailto:msd@sec.state.ma.us)*

<sup>2</sup> <https://www.sec.state.ma.us/sct/sctfeetable/Guide-to-Table-of-Fees-for-Services.pdf>

<sup>3</sup> 950 MASS. CODE REGS. 12.205(8)(a)2., <https://www.sec.state.ma.us/sct/sctfeetable/950-CMR-12-205-8-as-amended-June-14-2019.pdf>

<sup>4</sup> Refer to 950 MASS. CODE REGS. 12.205(7). The Division conducted a webinar training on books and records requirements located at: <https://www.sec.state.ma.us/sct/sctiatraining/iatrainingidx.htm>.

<sup>5</sup> Refer to the December 2018 Newsletter for top examination deficiencies:

<https://www.sec.state.ma.us/sct/sctpdf/newsletters/Securities-newsletter-Dec-2018.pdf>

<sup>6</sup> The requirements for entering into or renewing an investment advisory contract can be found in 950 MASS. CODE REGS. 12.205(9)(c)14.

<sup>7</sup> The client communications requirements for Massachusetts-registered investment advisers are contained in 950 MASS. CODE REGS. 12.205(7)(a)4.

<sup>8</sup> <https://www.sec.state.ma.us/sct/sctpdf/switch-ps.pdf>

# FORMATION OF A FINTECH ADVISORY WORKING GROUP

On March 1, 2019, Secretary of the Commonwealth William F. Galvin announced that the Division had formed a FinTech Advisory Working Group. The FinTech Working Group is the first dedicated team established by a state securities regulator to provide support to, and receive advice from, FinTech industry participants.

## CUSTODY POLICY STATEMENT

In December 2019, the Division issued a policy statement to provide guidance on custody. The policy statement lays out certain arrangements that may result in an investment adviser having custody of client funds or securities, such as trusteeship, standing letters of authorization, deduction of fees from client accounts, and possessing client login credentials to a client's online accounts. In these situations, an investment adviser with custody may be required to obtain an independent verification of the funds or securities. However, the policy statement explains that in certain situations the Division will not take enforcement action against an investment adviser with custody for failing to obtain the independent verification of the client funds or securities.

The policy statement is intended to serve as guidance; it should not be taken as legal advice. Investment advisers must make their own determinations on whether they have custody of client funds or securities and, if they do, whether they are in compliance with MASS. GEN. LAWS ch. 110A of the Massachusetts Uniform Securities Act (the "Act") and the corresponding regulations promulgated thereunder at 950 MASS. CODE REGS. 10.00 et seq. (the "Regulations"). Refer to the custody policy statement, available on the Division's website,<sup>1</sup> for further details. ▲

<sup>1</sup> <https://www.sec.state.ma.us/sct/sctpdf/switch-ps.pdf>

"FinTech," which is shorthand for "financial technology," refers to the use of technology to streamline and improve financial services. FinTech is a broad term and refers to anything from the use of cellular phones for online banking to the use of cryptocurrency for transactions. FinTech companies themselves range in size and include start-ups and established companies.

The goal of the working group is to help FinTech businesses navigate regulatory requirements while meeting the Division's mandate to protect investors and to foster fair and efficient capital markets and confidence in the markets. The working group will strive to keep regulations in step with digital innovation by monitoring developments in FinTech and challenges encountered by FinTech-related businesses in the securities industry.

"This working group includes key

## UPDATED POLICY STATEMENT ON THE USE OF SOCIAL MEDIA BY INVESTMENT ADVISERS

In December 2019, the Division issued an updated policy statement to provide guidance on the use of social media by investment advisers. As the ways in which investment advisers use social media for business purposes evolves, it is important that investment advisers remain aware of the regulatory requirements that restrict or condition their use of social media. Investment advisers must keep in mind that the use of publicly-accessible social media is generally considered to be advertising and therefore is subject to the same requirements as other forms of advertising, such as record keeping requirements<sup>1</sup> and the prohibition on

<sup>1</sup> 950 MASS. CODE REGS. 12.205(7)



players from a broad spectrum of the FinTech community, ranging from innovation hubs to startups to financial institutions," said Secretary Galvin. "This collaboration will help advise securities regulators on meeting the novel demands of this rapidly growing space."

The FinTech Working Group members consist of staff members from the Division as well as experts from a variety of different institutions, such as academics, attorneys, and corporate executives. ▲

false or misleading statements<sup>2</sup>. The policy statement provides guidance to frequently asked questions, such as:

- Can an investment adviser use social media to discuss its business?
  - What are the advertising rules that apply to an adviser's social media use?
  - When is an adviser responsible for content posted on its social media accounts?
  - What are the social media restrictions regarding testimonials?
- What other advertising rules should be given particular attention before using social media?

The full policy statement is available on the Division's website<sup>3</sup>. ▲

<sup>2</sup> 950 MASS. CODE REGS. 12.205(9)(c)

<sup>3</sup> <https://www.sec.state.ma.us/sct/sctpdf/Guidance-on-the-Use-of-Social-Media-by-Investment-Advisers-19-12-09.pdf>

## INVESTOR EDUCATION

At the beginning of 2019, the Division launched several new outreach initiatives. As part of one of the initiatives for medical professionals, the Investor Education Section of the Division participated in a presentation at Boston University School of Medicine in early November. Known as the “Elder Investment Fraud and Financial Exploitation (EIFFE) Prevention Program,” the training, which was developed in connection with the Investor Protection Trust, seeks to help individuals in the medical field identify patients who may be at risk of financial abuse and provide options for referrals to agencies such as the Division.

Additionally, in October the Investor Education Section of the Division conducted a presentation at the Westwood Council on Aging on identifying and preventing financial fraud and abuse. The Division offers various types of investor education presentations for different segments of the population such as basic financial literacy for students and common red flags of financial fraud for older adults.

For more information regarding a presentation in your community, please contact the Division at 617-727-3548. Additionally, for copies of educational brochures or general investor education presentations, please make a request by phone or e-mail to [investor.education@sec.state.ma.us](mailto:investor.education@sec.state.ma.us). ▲



## RECENT ENFORCEMENT ACTIONS

In June 2019, the Enforcement Section charged eight interconnected property management companies and their founder with violations including issuing unregistered securities, engaging in business as a broker-dealer without appropriate registration, and employing unregistered broker-dealer agents. The complaint alleges that the companies raised at least \$47 million nation-wide through the issuance of promissory notes and limited partnerships in an attempt to emulate the returns of certificate of deposit accounts without being an FDIC insured institution.



This enforcement action was coordinated with securities regulators from New Hampshire, New Jersey, and Illinois. In September 2019, the U.S. Securities and Exchange Commission filed a complaint against the founder and companies, alleging fraud in the form of a Ponzi scheme.

The Enforcement Section filed a follow-up action against an individual who connected Massachusetts investors to the property management company and another company which had also been the subject of a prior enforcement action. The Enforcement Section alleges the unregistered individual offered or sold over \$5 million in securities to 33 Massachusetts investors. ▲

In July 2019, the Enforcement Section charged a Florida woman with acting as part of a scheme to defraud a Massachusetts investor in connection with a fictitious cryptocurrency exchange. The complaint alleges that after finding the fictitious cryptocurrency exchange through an online forum, the investor deposited \$20,000 into a bank account purported to be owned by the exchange. In reality, the Florida woman controlled the bank account. After making this deposit, the investor allegedly began to see fake profits in his account. Despite the investor's numerous attempts to withdraw his money, the Florida woman made a series of excuses and, eventually, stopped responding to his messages and calls. To date the investor has not been able to secure the return of his money. The administrative complaint seeks, among other things, to impose a fine, censure, and to require complete investor restitution. ▲

On September 24, 2019, the Enforcement Section filed a Consent Order following an investigation into an SEC-registered investment adviser and its Massachusetts-registered representatives. The Consent Order reflects violations of Section 102 of the Act.

The representatives recommended that their clients invest up to 5% of their portfolios in an OTC stock that the representatives themselves held, without disclosing that conflict. Further, the investment adviser's Form ADV falsely stated that its representatives do not invest in the same securities as their clients. Pursuant to the Consent Order, the investment adviser was censured, ordered to permanently cease and desist from further violations, and ordered to pay an administrative fine of \$225,000. The Consent Order was filed in conjunction with a similar order by the U.S. Securities and Exchange Commission. ▲

