

Massachusetts Securities Division

REGISTRATION, INSPECTIONS, COMPLIANCE AND EXAMINATIONS SECTION

▲ 2019 MID-YEAR NEWSLETTER ▲

A Division of William Francis Galvin, Secretary of the Commonwealth

ADOPTION OF IA DISCLOSURE REGULATION (STAND-ALONE FEE TABLE)

The Division has finalized and has adopted a regulation to require investment advisers registered in Massachusetts to provide clients and prospective clients with a one-page, stand-alone fee table. The adopted regulation became effective on June 14, 2019, and the Division will

begin enforcing it as of January 1, 2020. The Division reviewed thirty-one written public comments between April 3 and May 3, 2019, and the Division appreciates the input of all registrants who took the time to provide comments. A fillable template is available on Division's

website, <https://www.sec.state.ma.us/sct/sctfeetable/feetableidx.htm> ▲

INVESTMENT ADVISER ALERT: MARIJUANA AND MARIJUANA-RELATED INVESTMENTS

Recent changes in several state laws have legalized marijuana cultivation and sales. Fraudsters often exploit “hot” industries in order to grab the attention of investors.



Investment Advisers are urged to be cautious when clients raise investment opportunities in marijuana or marijuana-related businesses. Significant considerations include the following:

- The sale of certain marijuana products became legal in Massachusetts in

November 2018. However, the sale of marijuana continues to be illegal under federal law.

- This is an emerging industry and businesses new to the industry may not be aware of the rules and regulations specific to the business. If you have questions regarding licensure, or business practices of marijuana-related businesses, you may contact Cannabis Control Commission at 617-701-8414, via email to CannabisCommission@mass.gov or their website at <https://mass-cannabis-control.com/>.
- Issuers of marijuana-related investments may be small first-time issuers and may not be familiar with the rules and regulations governing the securities industry generally and the rules and regulations governing private offerings specifically. Due diligence should be undertaken for any marijuana or marijuana-related investment opportunity.

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INVESTMENT ADVISER TRAININGS

On May 30, 2019 the RICE Section conducted its first web-based training on Books & Records requirements. The webinar attracted over 350 attendees. A recording is available on the Division's website, <https://www.sec.state.ma.us/sct/sctiatraining/iatrainingidx.htm>.

Please keep your contact information updated on your Form ADV to receive communications about future web-based trainings. ▲



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SAVE THE DATE

On **October 29, 2019**, the RICE Section will host an in-person Investment Adviser Training at the Best Western Hotel in Marlborough, Massachusetts. ▲

CHANGES TO THE DIVISION'S RICE SECTION WEBSITE

The RICE Section has updated the following on the Division's website:¹

- RICE Section Overview;
- Registration requirements and fees; and
- Frequently asked questions.

In addition, the following have been added to the website:

- Copies of prior newsletters;² and
- Recent investment adviser webinar on books and records requirements.³ ▲

1 <https://www.sec.state.ma.us/sct/sctlic/licidx.htm>

2 <https://sec.state.ma.us/sct/sctnewsletters/newslettersidx.htm>

3 <https://www.sec.state.ma.us/sct/sctiatraining/iatrainingidx.htm>

MARIJUANA AND MARIJUANA-RELATED INVESTMENTS

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Investment advisers are encouraged to share the enclosed Marijuana and Marijuana-Related Investment Brochure with their clients. In addition, investment advisers may always contact the Massachusetts Securities Division's toll free number at 1-800-269-5428 to confirm that a company or individual is properly registered or licensed to conduct the business in question in Massachusetts. The Brochure is available on the Division's website, <https://www.sec.state.ma.us/sct/sctinv/invidx.htm> ▲

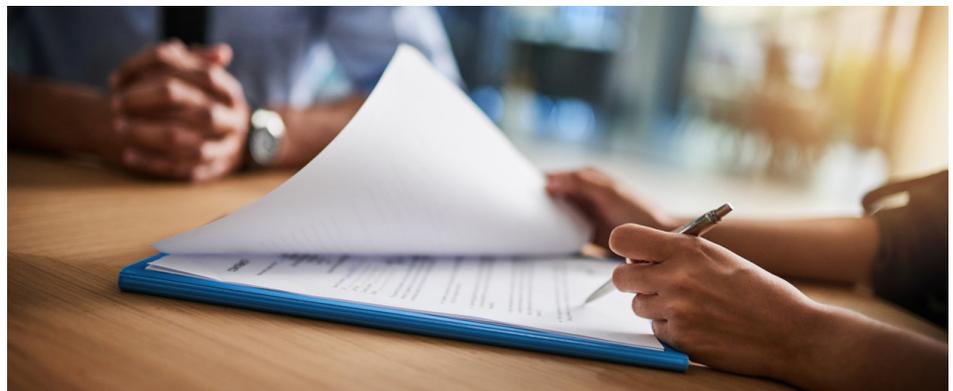
ENFORCEMENT SECTION CHARGES INVESTMENT ADVISER IN CONNECTION WITH CANNABIS PROJECTS

In April 2019, the Enforcement Section of the Massachusetts Securities Division filed charges against a state-registered investment adviser, its investment adviser representative, and several affiliated companies for allegedly engaging in fraudulent and dishonest and unethical conduct involving cannabis related investments. The complaint alleges that the representative repeatedly misled a client in order to fund the representative's personal marijuana projects. Furthermore, the representative omitted material information from offering documents provided to over 100 investors regarding a marijuana dispensary in Massachusetts.

The Enforcement Section alleges that the representative repeatedly sent a high net-worth client incomplete offering documents for the purpose of setting up investments in cannabis-related projects. The representative would often represent these projects as direct investments when in reality they were structured as limited partnerships with the representative as

the control person. The representative frequently masked his involvement with the limited partnerships by controlling them through various entities unknown to the investor. The representative then contracted with the investment adviser in order for the firm to provide management services to the limited partnership and receive a management fee that was not properly disclosed to the investor, who lost nearly \$3 million.

In addition, the Enforcement Section asserts: the representative misled investors in the project by omitting material information and failing to disclose critical risks to the investment, including the complex licensing process, leasing necessities, and required background checks; the representative omitted the existence and terms of a contract that directly impacted the investment as a whole; and as a result, the investment was unable to achieve its objectives. Investors have collectively lost access to \$8 million in funds. ▲



REGISTERING AN INVESTMENT ADVISER REPRESENTATIVE ("IAR")

In order for the RICE Section to review an IAR's application for registration, the following must be filed:

- A Form U4 filed through the IARD;
- Payment of a \$50 registration fee;
- Completion of exam requirements;¹ and
- A Criminal Offender Record Information ("CORI") Acknowledgment Form,² emailed to CORI@sec.state.ma.us. **Please note the CORI Acknowledgment Form must be notarized.* ▲

1 950 MASS. CODE REGS. 12.205(4).

2 CORI Acknowledgment Form is available at: <http://sec.state.ma.us/sct/sctcori/MSD-iCORI-Form.pdf>.

INVESTMENT ADVISER CONCERNS SURROUNDING TEXT MESSAGING AND SOCIAL MEDIA

Massachusetts-registered investment advisers have a duty to maintain a chronological correspondence file or log of all correspondence sent and received from clients or prospective clients.¹ This duty includes conversations that take place over text messaging and social media.

According to a 2018 Pew Research Center study, nearly 98% of households making more than \$75,000 use cell phones.² As the use

of cell phones by clients increases, it stands to reason that investment advisers will be texting with clients more often.

In fact, several investment advisory firms are developing specialized apps to enable their representatives to communicate with clients via text messaging.³ Investment advisers who are communicating with clients via text messaging and social media should implement procedures to ensure that client communications are retained, backed up, and archived.

Additionally, in 2011, the Massachusetts Securities Division conducted a survey⁴ of 576 Massachusetts registered investment advisers located in the state and determined that 44% of state-registered advisers utilized at least one form

of social media for business purposes. The most common social media sites were LinkedIn, Facebook and Twitter. These social media sites contain private messaging systems in which advisers can communicate directly with clients. As with text messaging, investment advisers should be mindful of the communications log requirement when utilizing these services, but also be cognizant of potential data privacy

concerns as well.⁵ See also, the SEC's December

2018 Risk Alert.⁶ Furthermore, an important factor for investment advisers to consider when using social media

is that information on a publicly-accessible social media account is generally considered advertising.⁷ Accordingly, social media use that is deemed to be advertising is subject to the same regulatory requirements as other forms of advertising. Most significantly this includes recordkeeping requirements and the prohibition on false or misleading statements.⁸ ▲



1 See 950 MASS. CODE REGS. 205(7)(a)(4).

2 Mathews, Jessica. Should you text clients? Financial Planning Magazine. January 15, 2019. Retrieved from: <https://www.financial-planning.com/news/should-financial-planners-text-with-their-clients>

3 Mathews, Jessica. Should you text clients? Financial Planning Magazine. January 15, 2019. Retrieved from: <https://www.financial-planning.com/news/should-financial-planners-text-with-their-clients>

4 Full results of this survey can be found at: <https://www.sec.state.ma.us/sct/sctmediasurvey/socialmedia.pdf>

5 See 201 MASS. CODE REGS. 17 and 950 MASS. CODE REGS. 12.205(9)(c)(13) for specific data privacy requirements.

6 Securities and Exchange Commission. Retrieved from: <https://www.sec.gov/files/OCIE%20Risk%20Alert%20-%20Electronic%20Messaging.pdf>

7 This is also true of social media accounts maintained by investment adviser representatives of the firm when the accounts are used at least in part to advertise investment advisory services.

8 See 950 MASS. CODE REGS. 12.205(7).

TEMPORARY OR PERMANENT INCAPACITATION OF AN INVESTMENT ADVISER

Part of an investment adviser's fiduciary obligation to its clients is to proactively take steps to protect clients from risks in the event the investment adviser is, or becomes, unable to service its clients.¹



To meet this obligation, many investment advisers have implemented business continuity plans that set out steps the investment adviser, or its designee, will take in the event of certain situations, such as a natural disaster or the loss of key personnel. However, investment advisers should also consider how their business will function, or how their clients will be protected, in the event of the adviser's temporary or permanent incapacitation. In particular, sole-practitioners and smaller investment advisory firms may need to determine whether their business continuity and succession plan is sufficient.

Investment advisers need to ask themselves questions, such as:

- What if I start showing signs of dementia? Who will recognize the signs? What can I do to protect my clients and my business?
- What if I am in the hospital for an extended period of time? How will my clients be protected during these periods?
- How do I refund fees charged in advance when I am unable to provide services?

Steps Investment Advisers can Take to Protect Its Clients: At a minimum, (1) Provide your clients with a person they can contact if they are unable to reach you or are concerned about your ability to provide advisory services, and (2) Advise your clients that they should contact the Division if they are concerned about your ability to provide advisory services. ▲

1 SEC Release No. IA-2204.

INVESTOR EDUCATION

In early 2019, the Massachusetts Securities Division launched two new Investor Education programs to provide training for law enforcement and medical personnel. The law enforcement training program, “Combatting Elder Financial Abuse and Securities Fraud,” seeks to help police officers and first responders identify and combat elder financial fraud, abuse, and exploitation. The training program highlights common



schemes and hallmarks of financial abuse that harm older adults and other vulnerable populations. The program also provides law enforcement officers with resources on how to recognize warning signs and how to report suspected problems to collaborating agencies such as the Massachusetts Securities Division.

Attorneys from the Massachusetts Securities Division traveled to several locations around Massachusetts to provide presentations to police officers. “It is important for my office to collaborate with law enforcement throughout the Commonwealth to combat elder financial abuse and securities fraud,” said Secretary Galvin.

Additionally, in March the Massachusetts Securities Division conducted a

webinar for 150 medical professionals in Massachusetts and around the United States. 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 medical professionals identify patients who may be at risk of financial abuse and refer them to agencies that could potentially provide assistance.

For more information regarding the training programs for law enforcement or medical personnel, please contact the Massachusetts Securities 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. ▲

RECENT ENFORCEMENT ACTIONS

In April 2019, the Division settled an administrative complaint against a broker-dealer and agent in connection with the firm’s failure to supervise an agent who recommended an unsuitable annuity exchange to a couple. The agent advised the couple to exchange an annuity product three years before its expiration date for another product with a much lower interest rate, resulting in more than \$43,000 in lost interest. Furthermore, the agent’s failure to file the correct paperwork for the exchange in a timely manner led to the couple being charged more than \$15,000 in penalties. The broker-dealer failed in its duty to supervise its agent while the agent made an unsuitable recommendation, and continued in their failure to supervise after they denied responsibility for the agent’s actions when the couple complained. Pursuant to the firm’s Consent Order, the firm will offer restitution to compensate the couple for the unsuitable annuity exchange, undergo a comprehensive review of its policies, and pay a fine in the amount of \$50,000. The agent’s Consent Order provides disgorgement of commissions earned from the annuity exchange, an agreement not to seek registration in Massachusetts for

a period of five (5) years, and payment of a fine in the amount of \$20,000. ▲

In February 2019, the Division filed an administrative complaint against a Massachusetts investment adviser representative who is alleged to have withdrawn nearly \$100,000 from a client’s account over a 13 year period. The IAR was charged with fraudulently misappropriating the investment funds of a North Shore retiree for his own personal use. Since 2006, the IAR had been diverting funds from the accounts of the client, who was preparing for retirement. The IAR concealed the scheme by convincing the inexperienced client to diversify the client’s investments and by presenting falsified documents showing that the diverted funds had generated substantial returns. In addition, the IAR employed stalling tactics to convince the client that the funds were not yet available for withdrawal when the client began preparing for retirement. Eventually, the IAR stopped responding to inquiries from the client, who had not been able to contact the IAR. ▲

In March 2019, the state filed charges against a Massachusetts-registered investment adviser and its two invest-

ment adviser representatives for allegedly engaging in fraudulent conduct, acting dishonestly and unethically, and failing to supervise.

The Division alleges that the investment adviser over-concentrated the majority of its clients in \$11 million worth of high risk energy-related investments, without consideration of its clients’ risk tolerance or investment needs. The investment adviser and one of its representatives overlooked the risk of the energy-related investments and clients’ assets experienced widespread losses. In addition, the complaint alleges that the investment adviser’s chief compliance officer failed to follow the firm’s policies and procedures when reviewing investment decisions in client accounts made by the IAR.

The Division seeks restitution to investors, a permanent cease and desist order, censure, revocation of the investment adviser registration, disgorgement of all proceeds received as a result of the alleged wrongdoing, and an administrative fine. The Division further seeks a permanent bar of the investment adviser representative’s registration and a temporary suspension of the chief compliance officer’s registration. ▲