

Testimony regarding Rule No. S-2016-01
Vermont Securities Regulations (Revised 2021) (V.S.R.)

William R. Carrigan, CFE

Deputy Commissioner, Securities Division, Department of Financial Regulation

Senate Committee on Finance, January 12, 2022

Thank you for the opportunity to present DFR's view relating to the questions posed to this Committee by the Legislative Committee on Administrative Rules. Specifically, I will address the two areas of concern raised in the letter, which involve a couple of aspects of our regulation. First, contained in our recently amended Regulation, is the requirement for a Code of Ethics to be established and maintained by state-registered investment advisors (V.S.R. § 7-6(a)(3)) Second is the pre-existing requirement for state-registered investment advisors to establish and maintain written policies and procedures reasonably designed to ensure protection of vulnerable adults from financial exploitation (V.S.R. § 8-4(h)).

Before diving into the details, however, I want to eliminate any confusion that might arise from the LCAR letter: violations of either of the regulatory provisions above are subject to DFR's jurisdiction and, if warranted, enforcement.

V.S.R. § 8-4(h)

Section 8-4(h), regarding the protection of vulnerable adults from financial exploitation, was added in the 2016 amendment of our Securities Regulation and was a North American Securities Administrators Association ("NASAA") Model Rule. This Regulation has been in place, and functioning as it was intended, since 2016. This NASAA Model Rule has also been adopted by over 30 other states. We receive written reports from firms when it appears that there may a potential situation involving the financial exploitation of a vulnerable adult. Firms are also required to report to the Adult Protective Services in Vermont as part of this mandatory reporting requirement. We have received a handful of these reports since 2016 and investigated each incident as appropriate.

Further, the Department has regularly required specific information from all registered advisors on this topic. As part of the annual Investment Advisor Questionnaire process, we require information from advisors about different areas of their business. This questionnaire is the equivalent of a "desk exam" and a full and truthful response by the firms is mandatory. In 2019 and 2020 we specifically posed questions to our registered firms asking if they had established written supervisory procedures regarding the financial exploitation of vulnerable adults. We also asked as to whether they had identified any incidents of potential financial exploitation which they had not reported to the Division. We have not received any responses that have indicated that there are firms that do not have these procedures in place. Also, we have received no responses from firms that have indicated that they had experienced an incident of potential financial exploitation of a vulnerable adult that had not been provided to the Division as

required. Nor has the Division received any consumer complaints or other information that would lead us to believe that changes are necessary in our oversight on this topic.

V.S.R. § 7-6(a)(3)

The recent amendment of our Securities Regulation contained a requirement that state-registered investment advisor firms “establish, maintain, and enforce a written code of ethics that, at a minimum, includes:

- (i) A standard (or standards) of business conduct that the investment adviser requires of its supervised persons, which must reflect the investment adviser’s fiduciary obligations and those of its supervised persons;
- (ii) Provisions requiring the investment adviser’s supervised persons to comply with applicable State and Federal securities laws;
- (iii) Provisions requiring all of the investment adviser’s access persons to report, and the investment adviser to review, their personal securities transactions and holdings periodically;
- (iv) Provisions requiring supervised persons to report any violations of the investment adviser’s code of ethics promptly to its chief compliance officer or, provided the investment adviser’s chief compliance officer also receives reports of all violations, to other persons designated in the investment adviser’s code of ethics; and
- (v) Provisions requiring the investment adviser to provide each of its supervised persons with a copy of the investment adviser’s code of ethics and any amendments, and requiring the investment adviser’s supervised persons to provide it with a written acknowledgment of their receipt of the code and any amendments.

Violations of these requirements are subject to oversight and enforcement by the Department under existing law. 9 V.S.A. § 5603.

It is worth noting that Vermont is the first state in our region that is imposing this requirement on its state-registered investment advisor firms.¹ Neither New Hampshire, Maine, Massachusetts, or Rhode Island currently has a requirement for a firm to have a written Code of Ethics.

As a Division, our oversight of compliance with these requirements will be regular and thorough. Initially, when a firm applies to the Division to become a state-registered investment advisor firm, there are certain physical documents that are required to be submitted as part of the application process. The Code of Ethics is being added to the list of required documents and is also subject to review by a Division examiner prior to the firm being approved to do business in Vermont. We also intend to add a question to our annual investment advisor questionnaire (which will be sent to state-registered investment advisor firms in late spring) which asks if the firm has a written Code of Ethics; they will also be required to provide a copy of that document.

¹ There is an existing requirement for investment advisor firms that are under the jurisdiction of the SEC (those firms with over \$100M in assets under management) to have a written Code of Ethics that is similar to what is required in our Regulation.

We will also be requiring firms to disclose any notices of Code violations as outlined in § 7-6(a)(3)(iv) of the Regulation shown above. We would also require further documentation related to the violation.

When the Division conducts any examination of a state-registered investment advisor firm, whether on-site or remotely, the firm will be required to provide the Division with a copy of the firm's Code of Ethics. We feel that the level of oversight just described is more than adequate, and further would note that the Department has the resources to take corrective actions if necessary.

Thank you for the opportunity to provide this testimony and please do not hesitate if there are other questions.

William R. Carrigan, CFE, Deputy Commissioner

(802) 828-4858: William.carrigan@vermont.gov