

GUIDANCE DOCUMENT

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INVESTMENT ADVISER USE OF SERVICES TO MANAGE, TRADE, AND BILL ON ASSETS IN HELD AWAY ACCOUNTS

It has come to the Nebraska Department of Banking and Finance's ("Department") attention that some Nebraska state-registered investment advisers are using the services of unregistered third-party digital platforms to actively manage, trade, and bill on assets in held away accounts. The Department is concerned that adviser use of these platforms may violate the Securities Act of Nebraska ("the Act") and associated rules and regulations found in the Nebraska Administrative Code. The purpose of this investment adviser alert is to communicate the basis of the Department's concerns and to reiterate aspects of compliance for advisers to consider in using these platforms.

Data Privacy, Cybersecurity, and Improper Use of Customer Credentials

At least one of the unregistered third-party platforms being used by advisers to access held away accounts uses a customer's username and password to access held away accounts. It appears that the platform does so without the knowledge or consent of the custodians responsible for safeguarding the held away assets. Impersonating customers in this manner may void customer account protections with the custodian and may interfere with or disrupt the custodian's AML (Anti-Money Laundering) and BSA (Bank Secrecy Act) compliance and surveillance systems. This platform moreover collects a significant amount of private customer data (including the customer's age, time horizon, risk tolerance, net worth, and investment preferences and strategies) to provide its services. As an unregistered entity, there is no financial regulator reviewing the platform's policies, procedures, or practices for compliance with federal and state data privacy, cybersecurity, or safeguarding laws.

In Nebraska, it is a fraudulent, dishonest, and unethical practice to access a client's account by using the client's own unique identifying information, such as username and password. *See* 48 NAC 12.006.28. The securities rules also prohibit an investment advisor from "engaging in conduct or any act, **indirectly or through or by any other person**, which would be unlawful for such person to do directly under the provisions of the Act or any rule or regulation thereunder. *See* 48 NAC 12.006.24.

Inadvertent Custody

The Department understands that at least one of the unregistered third-party platforms has marketed its service as allowing advisers to manage held away accounts without custody. Please note that marketing statements are not determinative about whether custody in fact exists. An adviser has custody if it is "holding directly or indirectly, client funds or securities, or having any authority to obtain possession of or the ability to appropriate client funds or securities." *See* 48 NAC 07.012.04B. Advisers should independently review and understand their ability and authorization to access client funds. Such a review should examine the powers of attorney, agreements between the customer and the third-party platform, and any agreements between the

customer and the custodian of each held away account that is accessed by the third-party platform. Custody occurs where advisers are authorized to withdraw client funds or securities maintained with a custodian, or where the adviser has a general power of attorney. *See* 48 NAC 07.012.04B1b. This includes situations where the adviser has the authority to deduct advisory fees or other expenses directly from a client's account. *See* 48 NAC 07.012.02C. Advisers should ensure that none of the agreements confer upon the adviser or the third-party platform the authority to access or withdraw client funds or securities from a held away account.

In addition, it appears that at least one third-party platform might add the investment adviser or investment adviser representative as a supplemental or authorized user on the customer's custodial account to navigate account authentication procedures during log-in. In that circumstance, it would be important to know what rights the supplemental or authorized users are given by each custodian, most notably whether supplemental or authorized users have the ability (whether used or not) to withdraw funds or securities from the account.

Investment advisers with custody of customer assets must affirmatively disclose this and are subject to heightened safeguarding requirements found in 48 NAC 07.012.

Fees

At least one of the unregistered third-party platforms that investment advisers are using to access held away accounts is charging the adviser a fee, believed to be between 25 to 30 basis points, based on the value of the assets in the held away accounts. Some investment advisers are charging their customers a fee for managing these held away assets – ranging from simply passing the platform fees on to customers, to charging the full advisory fee that they apply to other managed assets.

In Nebraska, investment advisers are prohibited from charging an unreasonable advisory fee. *See* 48 NAC 12.006.10. The Department questions whether it is reasonable for an investment adviser to charge an AUM fee for “managing” an account that is held away where the adviser has no authority or control over the securities that are available in the plan and where the account is automatically rebalanced by the custodian based on the customer's stated risk tolerance and investment strategy. Advisers should consider the adverse impact that an annual AUM fee has in eroding returns on held away assets to ensure the advisers, as fiduciaries, are acting in the best interests of their customers.

Compliance By Third-Party Platform

The Department is engaging with one unregistered third-party digital platform to learn more about its services and ascertain its compliance with the Act. While that review remains ongoing, the Department urges all state-registered investments to confirm their own compliance with the aforementioned rules in engaging the services of third-party platforms.