

North Carolina Investment Adviser *Compliance in the Time of Covid* Workshop

PRESENTED BY:

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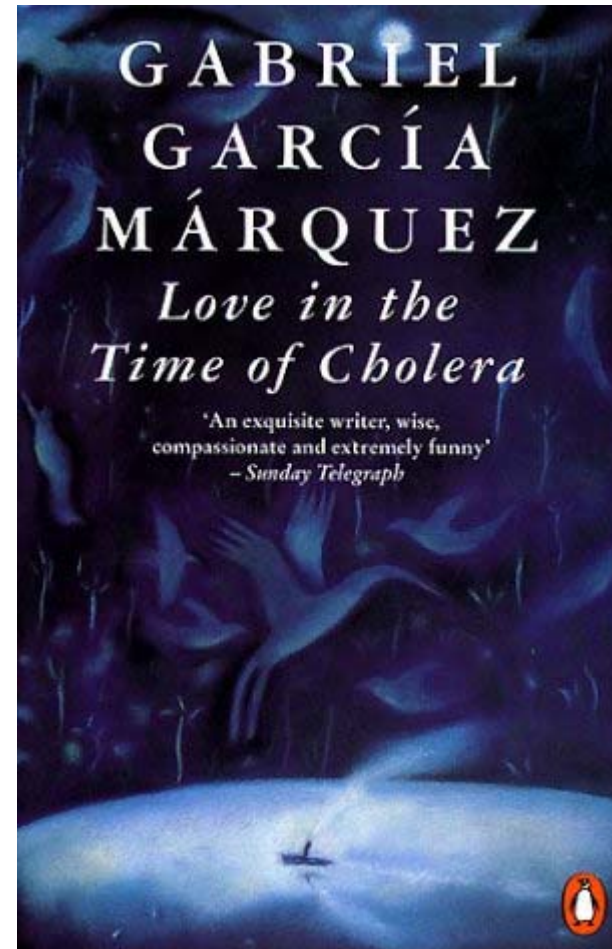
**NORTH CAROLINA DEPARTMENT OF THE SECRETARY OF STATE –
SECURITIES DIVISION**



WWW.SOSNC.GOV



Compliance in the Time of Covid



Your Presenter



AXA ADVISORS



THE UNIVERSITY
of **NORTH CAROLINA**
at **CHAPEL HILL**

Disclaimer (1 of 2)

- This workshop is presented as an educational experience. *This is not legal advice!*
- North Carolina registered investment advisers are subject to all relevant laws, regulations, rules and orders whether or not they are included in this presentation.
- The views expressed are those of the presenter.
- Presenter believes all information is truthful and accurate; however, mistakes can occur.

Disclaimer (2 of 2)

- All slides contain a citation, attribution or authority from the NC Investment Advisers Act.
- Rules and statutes may be paraphrased, abbreviated or incomplete.
 - NCAC = NC Administrative Code
 - NCGS = NC General Statutes § 78C-18
- https://www.sosnc.gov/home/administrative_rules
- <https://www.ncleg.net/gascripts/Statutes/StatutesTOC.pl?Chapter=0078C>

Workshop Topics

Organized around ***fiduciary duty and the client relationship:***

- Duty of care/due diligence
- Duty of loyalty/disclosures
- Fees
- Advertising
- Supervision
- Filing reminders



Workshop Goals

- Help you to establish best practices
- Topics modified from our day-long *IA Best Practices* Workshop
- Discuss trends related to Covid
- Q&A via chat
- Available resources



NC Dept of the Secretary of State

- Securities Division
- Business Registration Division
- Notary
- Lobbying
- Charities
- Trademarks
- Land Records
- Authentications

www.sosnc.gov



General Overview of the Division

- The Securities Division registers and regulates
 - IAs with regulatory assets under management of \$100 million or less
approximately 400 in North Carolina
 - Investment adviser representatives
 - Broker-dealers and securities salesmen



[NC Investment Advisers Act, NC Securities Act, NC Commodities Act, NC PACES Act]

General Overview of the Division (cont)

➤ Other areas

- Securities-related investigations
- Securities product registration
- Investor education

➤ ***Goal of the Division is to protect consumers and support legitimate businesses of North Carolina.***



[NC Investment Advisers Act, NC Securities Act, NC Commodities Act, NC PACES Act]

Division Examination Program

All Workshop content derived from *actual* books and records examinations!

NCGS* § 78C-18(e) states IA records *“are subject at any time or from time to time to such reasonable periodic, special, or other examinations by representatives of the Administrator.”*



*[*North Carolina General Statutes]*

Covid Examination Process

- Examiner will call to set up an appointment via telephone or WebEx
- May include an initial records request
- Standard interview
- May request additional records
- Secure *File Share*



[North Carolina General Statute § 78C-18]

Covid Examination Process (cont)

- Once exam is complete, we send a deficiency letter via email (sometimes cc: certified mail)
- Respond in writing to the deficiency letter, usually within 30 business days
- Provide any additional records via *File Share*
- Once all deficiencies have been satisfactorily cured, Division closes exam



[North Carolina General Statute § 78C-18]

“Compliance”

- *A set of effective controls for operations*
 - Latin “com”: *with/together/in association*
- **Resources** for your compliance include SOS, NASAA, SEC and IARD



North American Securities Administrators Association



- Organized in 1919
- NASAA is a voluntary association whose membership consists of 67 state, provincial, and territorial securities administrators in the 50 states, the District of Columbia, Puerto Rico, the U.S. Virgin Islands, Canada, and Mexico
- Oldest international organization devoted to investor protection



NASAA as a Resource

- Consumer publications
- Model Rules
- Forms and instructions

Lots of info at www.nasaa.org



NASAA Coordinated Sweeps

2011-2019 *(biennial review)*

- Jurisdictions include Canadian provinces
- Examined 1,300 advisers in 2019
- One-person firms
- Manage <\$30 million
- Trending down: PIV managers
- Trending down: affiliated w/BD



[All NASAA sweeps available at www.nasaa.org]

SEC as a Resource

- Division of Investment Management (IM)
- Investor Alerts
- Office of Compliance Inspections & Examinations (OCIE)
- Forms and instructions
- Lots of info at www.sec.gov



IARD

- “Investment Adviser Registration Depository”
- Used to facilitate registration, regulatory review, and public disclosure information of investment adviser firms
- Developed and operated by FINRA
- Sponsored by the SEC and NASAA



IARD Assistance

➤ Help available at www.iard.com

Call **(240) 386-4848** for IARD help



FINRA does not regulate IAs!

NC Investment Advisers Act

- *Less than \$100 million in RAUM*



Investment Advisers Act of 1940

- \$100 million or more in RAUM



Statistics

NC Investment Advisers Act

- About 400
- \$9 billion as of 8/31/20



All state-registered RIAs

- 17,268
- \$334 billion as of 12/31/18

Investment Advisers Act of 1940

- 13,299
- \$84 trillion as of 12/31/18



Meet IA Ray

Durham Unlimited Management, Inc.

DUM is RIA and Ray is the Investment Adviser Rep



SOS Vocabulary

- Registrant
- IA
- Deficiencies
- Form filings
- Examinations/exams/audits

VOCABULARY
Words Are Important!

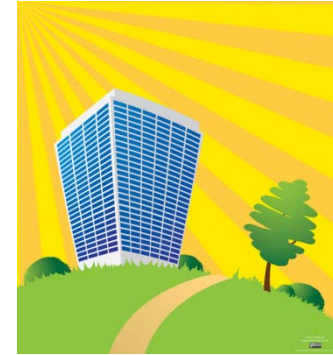
[NCGS § 78C-2 Definitions]

Form Filings Review

- Form ADV Part 1



- Form ADV Part 2A: Firm Brochure



- Form ADV Part 2A: Appendix 1



- Form ADV Part 2B: Brochure Supplement

- Form U-4



- Form U-5



[18 NCAC 06A.1702, .1703, .1707 and .1715]

SEC “Regulation Best Interest”

- Adopted 6/05/19 for *broker-dealer* firms and *SEC-registered* IAs
- Effective **6/30/20**

ADV Part 3

***NOT required
in NC***



<https://www.natlawreview.com/article/regulation-bi-challenged-second-circuit>

Dept of Labor Fiduciary Rule



Find the FIDUCIARY!

- a) Insurance agent selling term life or indexed annuity
- b) Registered rep selling mutual fund in a joint brokerage account
- c) IA rep providing financial planning for a fee
- d) IA rep providing asset management services
- e) Registered rep selling a REIT
- f) All of the above
- g) C and D only
- h) B, C and D



The Advisory Relationship

- A ***fiduciary duty*** to act in the best interest of the client, placing the client's interest ahead of your own.
- This is a ***fundamental*** and ***legal*** obligation based on trust and confidence.
- **Principles-based** approach
- **Broad-brush** approach



[18 NCAC 06A.1801 (a)]

Two Basic FIDUCIARY Duties

Duty of Care

- ***Provide advice in the best interest of the client***
- ***Seek best execution of a client's transactions***
- ***Provide advice & monitoring over the course of the relationship***

[18 NCAC 06A.1801 and SEC release IA-5248]

Two Basic FIDUCIARY Duties

Duty of Loyalty

- ***Eliminate or make full and fair disclosure of conflicts of interest***
- ***Client must provide informed consent to the conflict***

[18 NCAC 06A.1801 and SEC release IA-5248]

Your Advisory Business

If it's not written down



It didn't happen



Duty of Care

Have a reasonable basis for investment advice and fees charged

- Financial situation; level of sophistication; investment experience; financial goals:

Investment Policy Statement



[18 NCAC 06A.1801 (a)(1), (8), (10), (22)]

Investment Policy Statement

Investment objective

Liquidity/Income needs

Time horizon

Risk tolerance

Asset allocation

Constraints/preferences

Inflation rate

Diversification

Investment strategy

Portfolio or plan review

Performance measurement



****Consider adding client signature and date***

Uny 5

7/17/20**20** vs. 7/17/20

Duty of Care: Updates

Updating the investment profile

- Events have occurred rendering inaccurate or incomplete the Investment Profile upon which the adviser bases its advice
- Events can be personal (retirement, divorce)
- Events can be current

[18 NCAC 06A.1801 (a)(1), (8), (10), (22)]



Duty of Care: Providing advice

- *Bailey v. State of NC*
 - Five years of service as of 8/12/89, then NC retirement **exempt** from state income taxes
 - Also affects Federal retirees
- www.ncdor.gov



[348 N.C. 130]

[*Davis v. Michigan Dept of Treasury*, 489 U.S. 803]

Duty of Care: Providing advice

CARES Act *signed into law 3/27/20*

Coronavirus Aid, Relief and Economic Security Act

- Retirement account early w/d penalty waived if certain conditions met
- Minimum distributions suspended for 2020

[\[https://home.treasury.gov/policy-issues/cares\]](https://home.treasury.gov/policy-issues/cares)



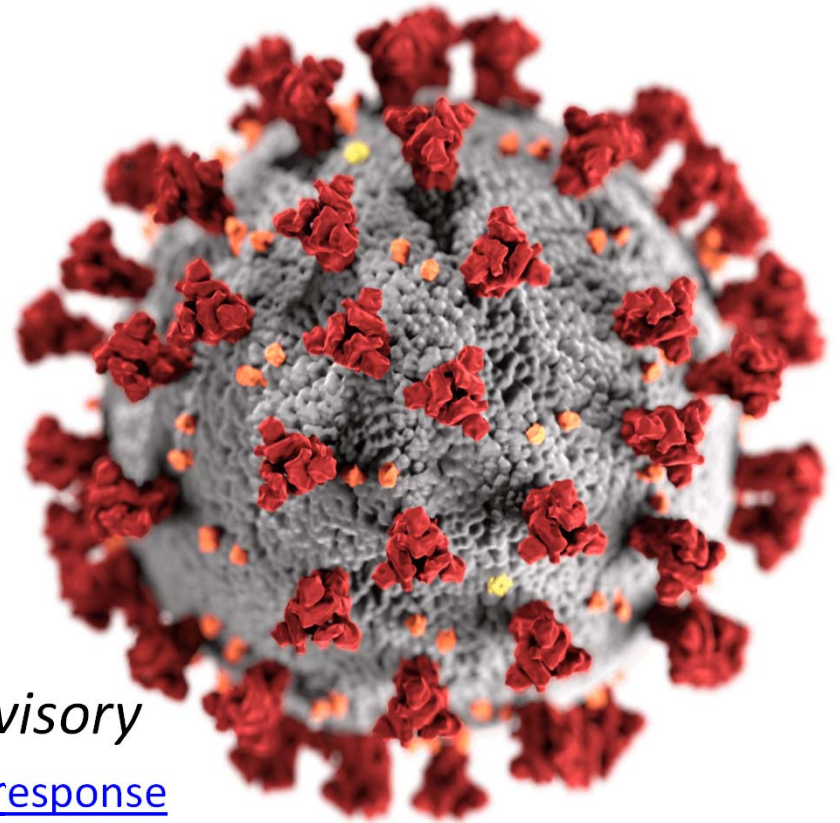
Covid-Related Scams

Related to vaccines,
blood tests, scanners,
and PPE fueled by
retail investors looking
for their own returns.

SEC Resources & NASAA Investor Advisory

<https://www.sec.gov/sec-coronavirus-covid-19-response>

<https://www.nasaa.org/55064/covid-19-related-early-withdrawals-from-retirement-accounts/?qoid=investor-advisories>



Duty of Care: Best Execution

➤ Class A shares with 12b-1 fees?

Are there less expensive institutional shares of the same mutual fund available?

➤ Commission-free trades for RIA clients

\$35 vs. \$12.95 vs. \$5.95 vs. free

<https://www.finra.org/rules-guidance/guidance/targeted-examination-letters/zero-commissions> February 2020

Duty of Care: Recommendations

Have a reasonable belief the advice is in the best interest of the client

- Options/futures/derivatives
- Leveraged or inverse ETFs
- Due diligence on the investment

[18 NCAC 06A.1801 (a)(1), (8), (10), (22)]



Duty of Care: Due Diligence

- Record your **specific actions** when “reviewing” financial plans or outside assets
- Always **document** your actions and any research: use notebook, Word, CRM. *Ex:* make notes during phone conference w/managers
- Include printouts/PDFs
- Align “Risk Tolerance” and IPS



[18 NCAC 06A.1801 (a)(1) and (10) and SEC Risk Alert, Vol IV, Issue 1, 1/28/14]

Duty of Loyalty

- Act in best interest of the client
- Avoid using client's assets to benefit adviser
- Avoid conflicts of interest when possible
- Disclose conflicts that occur



[18 NCAC 06A.1801 (a)(11), (22), (23)]

Duty of Loyalty: Conflicts of Interest

High priority conflicts of interest

- Affiliates
- Portfolio management
- Compensation and incentives
- Valuation of illiquid positions

Conflicts of Interest and Risk Governance, 10/22/12

<https://www.sec.gov/news/speech/2012-spch103112cvdhtm>



Conflicts of Interest in NC

Also an insurance agent 39%

Also a registered rep ~10%

Also prepares tax returns ~14%

[ADV filings as of 6/26/19]

Duty of Loyalty: Conflicts of Interest

- Using the IA firm to steer clients to insurance products
- Compensation > 2%
- Excessive fp fee for what the client receives as a financial plan

<https://www.sec.gov/litigation/complaints/2019/comp-pr2019-274.pdf>

[18 NCAC 06A.1801 (a)(11), (22), (23)]



Duty of Loyalty: Disclosures

- Full and fair disclosure of all material facts
 - Material = facts a reasonable investor must know in order to make an informed decision
- Clear and detailed enough for the client to give informed consent
- Describe how you will mitigate conflicts
- Legal and disciplinary actions



[18 NCAC 06A.1801 (a)(11), (22), (23) and .1707]

Make Complete Disclosures

- *“Clients are under no obligation to purchase insurance products from the adviser.”*
- *Insurance services offered through XYZ Agency. Investment advisory services offered through XYZ Asset Management, LLC.*
- *Durham Unlimited Management, LLC, doing business as Asset Selection Services.*
- *Joe Doe, a sole proprietor d/b/a Doe Capital Assets.*



Duty of Loyalty: Full & Fair Disclosure

- Self-serving explanations of disclosure history
- “May” have a conflict when in fact the conflict is real
- Partial truths, exaggerations, misleading impressions
- Not adhere to governing documents
- Not following client instructions

[18 NCAC 06A.1801 (a)(11), (22), (23)]



FIDUCIARY STATE OF MIND

- Act honestly with utmost good faith
- Treat clients fairly
- Reflected in your advertising
- Reflected in form filings
- **Fiduciary relationship changes over time**

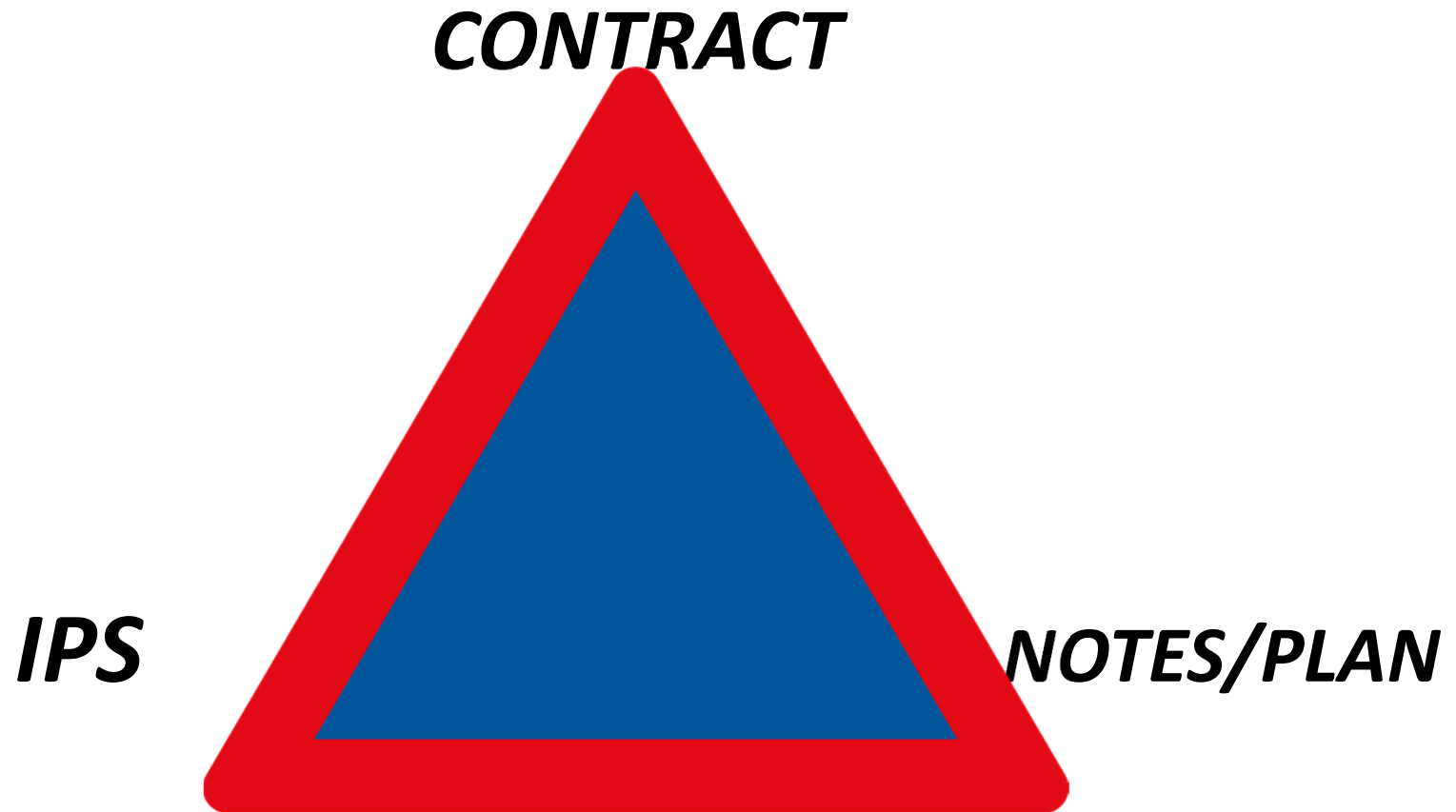
[18 NCAC 06A.1801 (a)(11), (22), (23)]

FIDUCIARY SUMMARY

- Know your client
- Know your products
- Write it down
- *Relationship*



The Client Relationship



The Client Relationship

Investment Advisory Contract (including for financial planning)

1. Services provided; term of the contract;
2. Fee or fee formula;
3. Refund of any pre-paid fee;
4. Non-assignment clause;
5. Whether the contract grants discretionary authority;
6. Right to terminate w/in five days;
7. Acknowledgments (ADV 2, Privacy, electronic delivery)
8. Matches description in Form ADV Part 2

[18 NCAC 06A.1801 (a)(16) and .1707 (b)(2)(B)]



Suitability of Investments

- Recommending to a client to whom investment supervisory, management or consulting services are provided the purchase, sale or exchange of any security without reasonable grounds to believe that the recommendation is suitable for the client...

[18 NCAC 06A.1801 (a)(1)]



Suitability of Investments *(continued)*

- ...on the basis of information furnished by the client after reasonable inquiry concerning the client's investment objectives, financial situation and needs, and any other information known or acquired by the investment adviser...

[18 NCAC 06A.1801 (a)(1)]



Suitability of Investments *(continued)*

- ...after reasonable examination of such of the client's financial records as may be provided to the investment adviser.

[18 NCAC 06A.1801 (a)(1)]



See something, say something

Former employees testified they **lied to clients** and **forged documents** under the owner's direction. *(June 2019)*

<https://www.justice.gov/usao-ednc/pr/raleigh-investment-advisor-convicted-twenty-counts-investment-fraud>

Court Orders **\$1 Billion** Judgment Against Operators of Ponzi Scheme *(March 2019)*

<https://www.sec.gov/news/press-release/2019-3>

See something, say something

Special Agent in Charge ***Shawn Pruett***

919-814-5534

spruett@sosnc.gov



There's always something old!

Promissory Note: NO:

Issued in terms of the Bills of Exchange Act 34 of 1944 as amended up to Bills of Exchange Amendment Act 56 of 1988, (AND Settlements in terms of High Court Rule 40(2)(a))

This Promissory NOTE was issued at:

_____ (Place)

Date: _____

AMOUNT: _____ (in numbers)

AMOUNT: _____

_____ (written)

This certifies that

I, _____ ID Number: _____

Hereby promise to pay _____ (HOLDER) the full amount specified, on this NOTE, for value received.

Terms & Conditions

The payment will be made in monthly instalments of R 500 (five hundred rand) per month, on the 7th (seventh) day of every consecutive month until the obligation has been fulfilled. The payment can be obtained by the HOLDER at _____. I hereby give permission to the HOLDER and/or the HOLDER-IN-DUE-COURSE of this Promissory Note, to use this NOTE in any way necessary as a negotiable instrument to be financially traded on; whereas such trade shall terminate the obligation herein.

Date _____ Signature _____

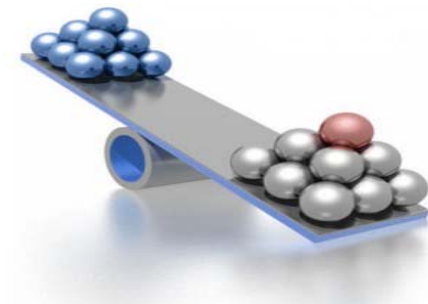
There's always something new!



Due Diligence & Leveraged ETFs

Understand the products you are selling

- 1) *Leveraged and Inverse ETFs: Specialized Products with Extra Risk for Buy-and-Hold Investors (8/18/09)*
- 2) FINRA Regulatory Notice 09-31
- 3) FINRA Smart Beta (9/23/15)
- 4) Custodian info
- 5) SEC proposed sales practice rules (11/25/19)
- 6) United States Oil Fund, LP (USO) from \$106 to \$16
(52 week range as of 9/15/20)



Recent Actions re: Leveraged ETFs

- ***Wells Fargo*** SEC 2/24/20...\$ 35 million
<https://www.sec.gov/news/press-release/2020-43>
- ***Morgan Stanley*** SEC 2/14/17...\$ 8 million
<https://www.sec.gov/news/pressrelease/2017-46.html>
- ***Demitrios Hallas*** SEC 9/29/17: Disgorgement, civil penalties, interest \$550k+
<https://www.sec.gov/litigation/litreleases/2017/lr23955.htm>

Cryptocurrency = Security?

- CFTC = commodity
- IRS = taxable asset
- SEC = 2018 said
Bitcoin not, but
have not seen any ICOs
that are **not** securities



[<https://www.sec.gov/news/speech/speech-hinman-061418>]

Cryptocurrency = Security? *(cont)*

SEC = 3/07/19

- Howey test, not static
- FinHub

<https://www.sec.gov/finhub>

Howey Coins Travel Network

<https://www.howeycoins.com>

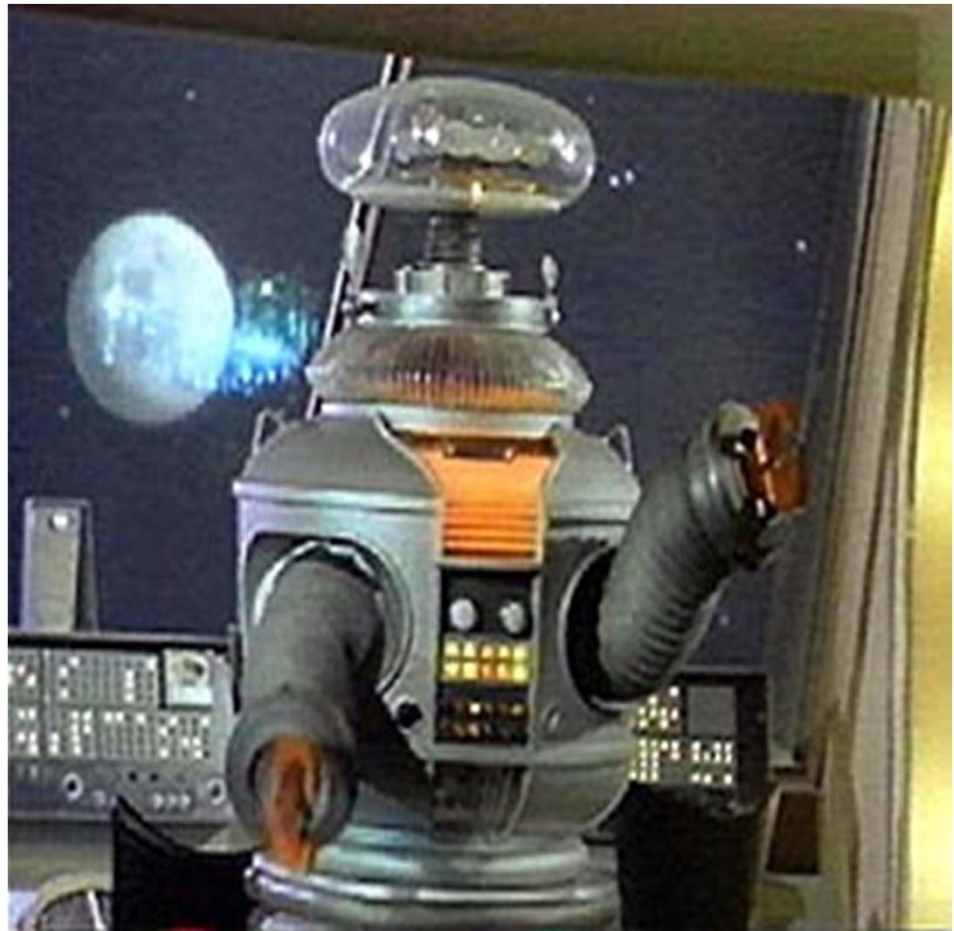


<https://coincenter.org/files/2019-03/clayton-token-response.pdf>

Enforcement Actions in NC

https://www.sosnc.gov/divisions/securities/admin_action

- *Adozia*
- *Bitconnect*
- *Power Mining Pool*
- Listed by year
- People, firms
- Products



Opportunity Zones

Distressed urban or rural communities receive special tax treatment



[NASAA Advisory on Opportunity Zone Investments, www.nasaa.org]

Anti-Fraud Provisions

Unlawful for any person who receives, directly or indirectly, any consideration from another person for advising the other person as to the value of securities

- (1) to employ any device, scheme or artifice to defraud the other person; or
- (2) to engage in any act, practice or course of business which operates as a fraud or deceit upon the other person.

[North Carolina General Statute § 78C-8(a)]



NC Rules



➤ 18 NCAC 06A.1801 (f):

Compliance with this Rule shall not relieve any investment adviser from the obligations of any other disclosure requirement under the Act, the rules thereunder or under any other federal or state.

➤ 18 NCAC 06A.1801 (a):

The conduct set forth in this Rule is not exclusive. It also includes employing any device, scheme or artifice to defraud or engaging in any act, practice or course of business which operates as a fraud or deceit.

NC Rules & ADV Instructions

➤ Instructions for Form ADV Part 2:

“Registrant is under a continuing obligation to disclose conflicts of interest even if the information is not specifically required by ADV Part 2.”

➤ 18 NCAC 06A.1707 (g): *Nothing in this Rule shall relieve any investment adviser from any obligation pursuant to any provision of the Act or the rules and regulations thereunder or other federal or state law to disclose any information to its clients or prospects not specifically required by this Rule.*



Duty to Explain Non-Disclosure!

➤ 18 NCAC 06A.1706 (a)(15):

A memorandum describing any legal or disciplinary event listed in Schedule D of Form ADV or in any Form U-4 relating to any representative and presumed to be material, if the event involved the investment adviser or any of its representatives or supervised persons and is not disclosed to clients and prospects on Form ADV Part 2.

The memorandum must explain why the adviser determined that the presumption of materiality is overcome and must discuss the factors described in those items.



“Compliance Consultant”



Misleading Filings

“It is unlawful to make, in any document filed with the Administrator, any statement which is at the time false or misleading in any material respect.”

- **Your responsibility to instruct, monitor and proofread!**



[NCGS § 78C-9]

Advisory Fees in NC

- **Asset management fees** range from less than 1% to 2%
- Are charged on *managed* assets
- **Financial planners** charge hourly or by project
- Adviser must tell clients if s/he negotiates fees

***Only ~ 7%** of NC RIAs are solely financial planners*



[18 NCAC 06A.1801 (a)(10) and ADV filings as of 6/26/19]

Other Management Fees

- Example: Advising on 401(k) held away
 - Must be able to document review of the account
 - IAs often charge less than the standard fee
- Example: Cash equivalents held long-term
 - Documentation signed by client
 - IAs often suspend fee

*****FIDUCIARY*****

[18 NCAC 06A.1801 (a)(10)]



Excessive Fees

Advisers may not charge an advisory fee that is unreasonable in light of the following:

- type of services provided
- the experience and expertise of the adviser
- the sophistication and bargaining power of the client
- whether the adviser has disclosed that lower fees for comparable services may be available from other sources



[18 NCAC 06A.1801 (a)(10)]

Problematic Fees

- Retainer fee for “access to a planner”
- Minimum fees for smaller accounts that exceed 3%
- “On boarding” fee

What exactly are you doing to earn this fee?

Often these creative fees are excessive.

[18 NCAC 06A.1801 (a)(10)]



What is Advertising?

- Publishing, circulating or distributing any advertisement which does not comply with Rule 206(4)-1 under the Investment Advisers Act of 1940.

[18 NCAC 06A.1801 (a)(13)]



Advertising

- Advertisement shall include any notice, circular, letter or other written communication addressed to more than one person, or any notice or other announcement in any publication or by radio or television, which offers any of the following:

[Rule 206(4)-1 of the IAA of 1940]



Advertising *(continued)*

- (1) any analysis, report or publication concerning securities, or which is to be used in making any determination as to when to buy or sell any security, or which security to buy or sell, *or*
- (2) any graph, chart, formula or other device to be used in making any determination as to when to buy or sell any security, or which security to buy or sell, *or*
- (3) any other investment advisory service with regard to securities.

[Rule 206(4)-1 of the IAA of 1940]



Examples of Advertising

- Business card, stationery, ADV Part 2
- Website and blogs
- Newsletter
- Social media
 - Facebook
 - LinkedIn
 - Twitter



More Examples of Advertising

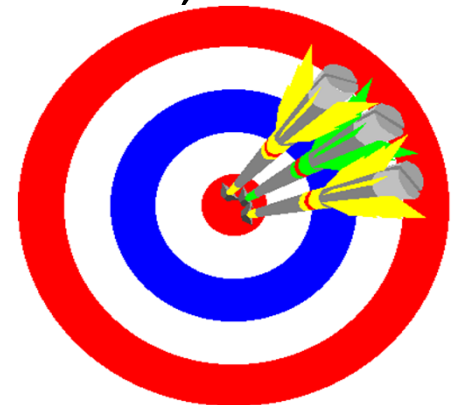
- Free Lunch/Dinner Seminars
- Distribution of an article concerning Registrant
- Letter that goes to more than one person
- Sponsor golf hole or Little League team
- Radio/TV adverts
- Pens, cups, other swag
- T-shirt with logo



Prohibited Advertising

1. Testimonials.
2. Reference to past investment recommendations unless specific disclosures appear and all recommendations are furnished for minimum of past year.
3. Rely on a graph, chart, formula, or other device to determine investment strategy unless the ad discloses specific details and the limitations.
4. Stating that certain adviser services are free, unless they are, in fact, free.
5. Contains any untrue statement of a material fact, or which is otherwise false or misleading.

[Rule 206(4)-1 of the IAA of 1940]



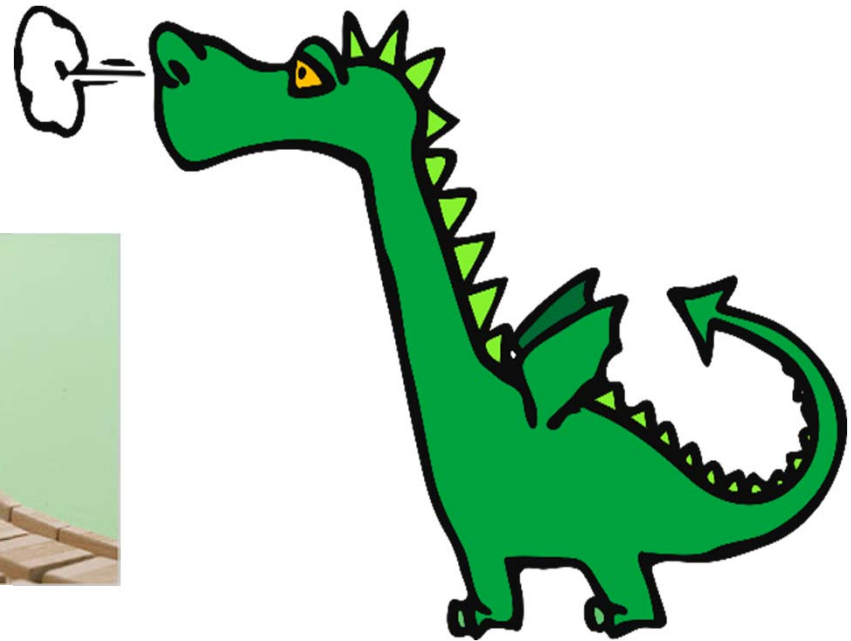
SEC Advertising Rule

- SEC first promulgated the rule in 1961
- Proposed updates Nov 2019, *possible* implementation in 2020
- IAA, FPA, NAPFA all commented:
- *Increased compliance costs*
- *Ads tainted by puffery and bias*
- *No compelling insight to change*
- <https://www.investmentnews.com/adviser-trade-associations-tell-sec-rework-proposal-modernize-advertising-rule-188203>



Most Common NC Advertising Deficiencies

- Testimonials
- Exaggerations/Misrepresentations
- Guarantees
- Puffery

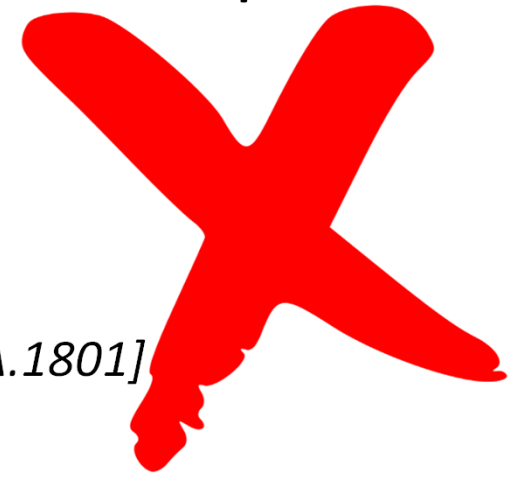


Testimonials

- Statements by clients attesting to service or experience
- Statements by you or your staff attesting to the service or experience of your clients
- Appearing on websites, social media, reprints of third-party articles
- Express or implied

[SEC Risk Alert Volume VI, Issue 6, 9/14/17 and 18 NCAC 06A.1801]

[For insurance agents: 11 NCAC 12.0426]



Examples of Testimonials

- *Investment strategies used by DUM and the expertise of IA Ray are superior to other firms in the area.*
- *Become one of our satisfied clients.*
- *Unlike most advisers, we care about our clients*



False or Misleading Advertising

- Misrepresenting the qualifications of the adviser or an employee, or
- Omitting a material fact regarding qualifications, services or fees to make them not misleading.



[18 NCAC 06A.1801 (a)(8)]

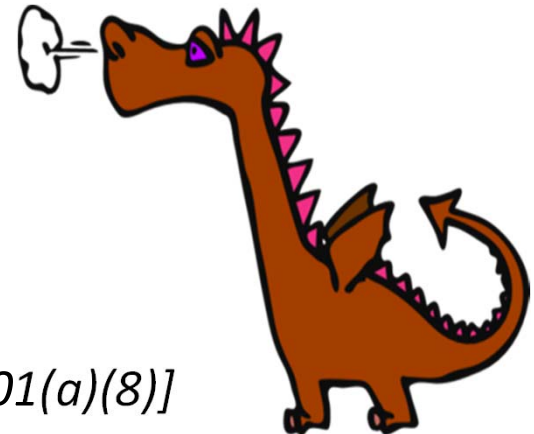
Misleading Qualifications

- Designation lapsed
- Using designation conferred by former employer
- No explanation of minimum qualifications for designation
- False, fabricated and/or purchased designations
- Misuse of professional marks
- Implying everyone in the office holds the designation or certification

<https://www.finra.org/investors/professional-designations>
www.cfp.net

[SEC Risk Alert Volume VI, Issue 6, 9/14/17]

[Rule 206(4)-1 of the IAA of 1940 and 18 NCAC 06A.1801(a)(8)]



“Misleading” Examples

- Exaggerated and unwarranted statements
- **Contain generalizations, promissory language, hyperbole**
- Claims inconsistent with ADV and U-4
- Statements that cannot be proven with objective evidence:

Premier, unique, unprecedented, foremost, revolutionary, expert, proven results, peace of mind, clients sleep well at night



[Rule 206(4)-1 of the IAA of 1940 and 18 NCAC 06A.1801(a)(8)]

Missing or Improper Attribution

- **Missing “As Seen On” links**
- Stale or absent citations
- Misrepresentations of risk/return
- Providing a report prepared by someone else without disclosing that fact
- Missing disclosures



*17 SEC 058
[18 NCAC 06A.1801 (a)(8), (9) and (13)]*

BEST ADVISER SEVEN YRS IN A ROW!!!

Durham Unlimited Management, Inc., was voted “Best Adviser in the Triangle” seven years in a row.



Using 3rd Party Rankings/Awards

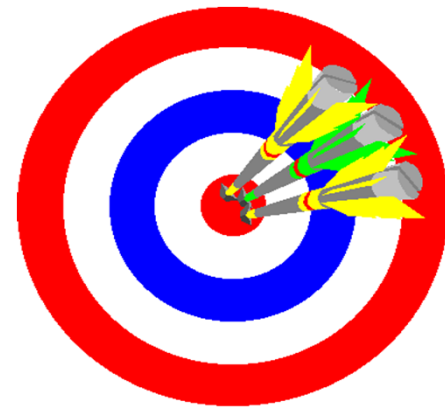
- Failed to disclose material facts
- Submitted false info in application for award
- Referenced stale rankings
- Failed to disclose relevant selection criteria, including the fact that advisers paid a fee to participate in the survey



[SEC Risk Alert Volume VI, Issue 6, 9/14/17]

Providing Guarantees

- Guaranteeing a client that a specific result will be achieved (gain or no loss) as a result of the advice rendered.



[18 NCAC 06A.1801 (a)(12)]

Free Lunch Seminars/Blogs

- Poor supervision of content & materials
- Attractive inducements/misleading statements
- Unsuitable investments
- Testimonials
- Fraud

*[Protecting Senior Investors: Rept of Examinations
of Securities Firms Providing “Free Lunch” Seminars,
SEC/NASAA/FINRA, September 2007]*



Find compliant ads!

Ads may not contain which of these?

- a) Testimonials from clients or staff
- b) Guarantees
- c) Exaggerations
- d) Misleading statements
- e) Omission of material facts
- f) Untrue statements
- g) Inaccurate performance
- h) All of the above



IA Advertising Must Be True



Written Procedures

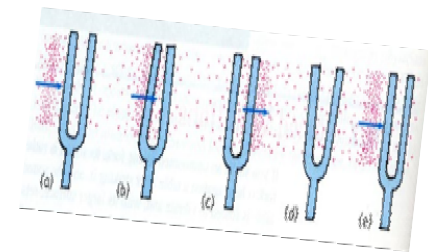


Written Procedures *(continued)*

Establish, maintain and enforce written procedures which must include but are not limited to:

- 1) Review of new accounts
- 2) Frequent examination of accounts to detect and prevent irregularities and abuses
- 3) Prompt review of transactions and correspondence pertaining to solicitation or execution of transactions
- 4) Prompt review in handling all client complaints

[18 NCAC 06A.1808 (d)]



Written Procedures *(continued)*

DUM billing procedure:

I send an invoice every month to clients. I keep a copy of it for my records.

Better procedure describes each step:

On the first day of the new Q run the Balances report from TDA...Check client accts for cash...Create a new invoice folder on the PC...Upload fees to TDA...Send invoice to clients

[18 NCAC 06A.1808 (d) and Sample TOC in Workbook]



Written Procedures *(continued)*

- ☐ What is the policy or procedure?
- ☐ Who does it?
- ☐ How often is it done?
- ☐ How is it documented?
- ☐ Explain each step of what you do!



[18 NCAC 06A.1808 (d) and Sample TOC in Workbook]

Written Procedures *(continued)*

- Living, breathing document that should be continually updated to reflect changes in Registrant's business, rules, regulations and personnel
- Consider revision date by page
- Keep a copy in each business office



[18 NCAC 06A.1808 (d) and Sample Table of Contents]

Trade Errors

Keep a separate Trade Error file.

- Can also keep copy in client file.
- Write a brief Memo contemporaneously with the error.



[18 NCAC 06A.1706(a)(3) and (12)]

Check Log

- If you receive checks from clients and forward them to the custodian, keep a check log
- Check in/Check out/Dates/Delivery confirmation

Do not hold checks for more than three days.

[NEED CITE]



Supervision of IA Representatives

Registrant shall be responsible for the acts, practices and conduct of its IA representatives:

- Designate a supervisor
- Exercise diligent supervision over the advisory activity of IA representatives
- Periodically inspect each office to insure written procedures are being enforced

[18 NCAC 06A.1808]



Supervision of IA Reps *(continued)*

- Who can be a supervisor?
 - IA (in case of sole proprietor or single member)
 - Partner, officer, office manager or any qualified investment adviser representative
- Visit off-site IARs every couple of years
 - Agenda/Notes

[18 NCAC 06A.1808]



Advertising/Supervision/P&P

- Update content regularly
- The website of your IAR is YOURS
- Review for statements of fact, not opinion
- Backup digital advertising
- Report websites on ADV 1



Supervision of Non-Registered Employees

- Non-registered employees cannot:
 - Make recommendations or render advice regarding securities
 - Solicit clients on behalf of the Registrant
 - Accept trading instructions directly from a client, even if the trade is unsolicited.

[NCGS § 78C-16 Registration]



Supervision of Non-Registered Employees (cont)

- Non-registered employees cannot:
 - Effect transactions in client accounts as if they were registered
 - Circumvent the controls of the custodian regarding proper execution by registered persons (e.g., use a *registered* person's "code," "ID number" or other identifier)

[NCGS § 78C-16 Registration]

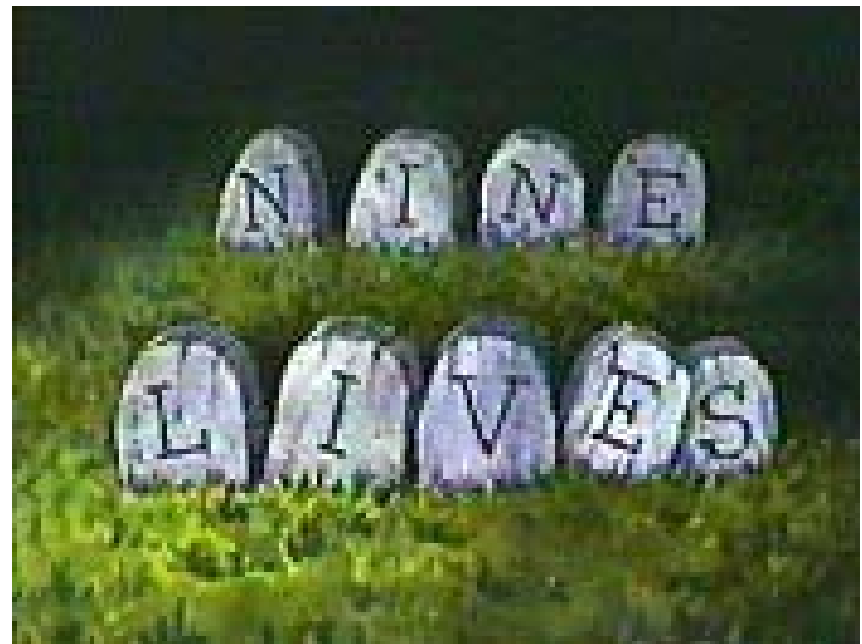
Business Continuity

- *Business Continuity & Succession Planning & IA BCP Rule and Guidance*

– adopted by NASAA on 4/13/15

- Part of your P&P
 - ☐ Disaster plan
 - ☐ Succession plan

[18 NCAC 06A.1801 (a) and Workbook]



Business Continuity: Disaster

- Utility outages
- Natural disasters
- Loss of personnel



[18 NCAC 06A.1801 (a) and .1808]

Business Continuity: Succession

Retirement *or* wind down the business in the event of death, disability or incapacity

- ☐ Can clients manage their own affairs?
- ☐ Illiquid, volatile, hedged positions?
- ☐ Do I need a buy/sell agreement?



[18 NCAC 06A.1801 (a)]

Expected NASAA Model Rule Soon

- ☐ Policies and Procedures
- ☐ Business Continuity
- ☐ Privacy
- ☐ Cybersecurity
- ☐ Compliance Grid
- ☐ Sample TOC
- ☐ 3 case studies



Common Written Procedures Deficiencies

- ☐ Non-existent
- ☐ Not written
- ☐ Incomplete
- ☐ Not current
- ☐ Not specific to actual business
- ☐ Not followed
- ☐ Not enforced



Elder Financial Abuse

- NASAA Model Act (1/22/16)

Updates available at ServeOurSeniors.org

- Senior Safe Act (2019)

<https://www.sec.gov/news/press-release/2019-75>

- SEC Guidance



[NASAA Model Act to Protect Vulnerable Adults from Financial Exploitation]

[SEC Guidance on Privacy Laws and Reporting Financial Abuse of Older Adults]

Elder Financial Abuse *(continued)*

- Know your client
 - *Do you have an emergency contact I can call?*
- Investor Hotline
 - 800-688-4507
- Report Elder Abuse
 - County Dept of Social Services
 - 800-662-7030 (NC DHHS)



Annual Renewal

- Registration terminates 12/31 unless renewed
- Deadline at IARD is **December 14, 2020**



[NCGS § 78C-16 (c) and 17 Registration and <https://www.iard.com/renewal-program>

Annual Renewal *(continued)*

- No longer a “registered” investment adviser
- All IA representatives also terminate 12/31
- Must re-register with a lapse
- Creates possibility of unregistered activity

[NCGS § 78C-16 (c) and 17 Registration]



Annual Renewal Includes ADV!

Form ADV Part 1 and 2 via IARD

- An application for renewal is not considered filed for purposes of 78C-17 until the required fee and all submissions have been received by the Administrator.



[18 NCAC 06A.1702 (e)]



Annual Reporting: Balance Sheet

For advisers with discretion or custody
due w/in 90 days of fiscal year end



[18 NCAC 06A.1708]



Annual Reporting: Balance Sheet

- Filed via paper or email to the Division at secdiv@sosnc.gov
- Filing required even if you have a bond!

Discretion: Attestation
Custody: Audited

[18 NCAC 06A.1708]



Mid-Dec and Mid-March



Withdrawal Process

- Withdrawal of Registrant: **Form ADV-W**
 - Must maintain books and records for 5 years
 - Report location on ADV-W
- Do not assume that by letting a registration lapse for FTR that the Registrant has withdrawn
 - Division will contact you!



[18 NCAC 06A.1710 and .1706(f)]

Which Regulator?

NC Investment Advisers Act

- Can stay with State until RAUM are **\$110 million** *as repta on annual ADV amendment*



Investment Advisers Act of 1940

- Must return to State when RAUM fall to **\$90 million** *as repta on annual ADV amendment*



Withdrawal Process: NC to SEC

- Must file within **90 days** after Registrant files its annual updating amendment disclosing regulatory AUM of \$110 million or more
- File ADV-W (partial withdrawal) to transition from NC to SEC

[Form ADV Instructions for Part 1A, Item 2]



Withdrawal Process: SEC to NC

- Files its annual updating amendment disclosing regulatory AUM of less than \$90 million
- File **ADV-W** to withdraw from SEC registration within **180 days** of your fiscal year end
- Remain subject to SEC and NC



[Form ADV Instructions for Part 1A, Item 2 & SEC Rule 203A-1(b)(2)]



Enforcement Referrals

- Unregistered activity
- Fraud
- Repeat or willful violations
- Failure to supervise IARs
- Failing to cooperate, not responding



[North Carolina General Statute § 78C-18]

Enforcement Actions

- Conference at the Division
- Letter of Caution
- Consent Order*
- Registration suspension or revocation*

You have the right to be represented by an attorney

** Reportable administrative action*

[North Carolina General Statute § 78C-19]



What do you see or hear?



“Compliance”

- Conformity, cooperation, controls
- Original sense: *Fulfill, accomplish*
- ***Complete the evaluation!***





LINKS AND WEBSITES TO REFERENCE

Disclaimer: The following are links to resources which state-registered investment advisers may find useful. These references are provided for informational purposes only. The NC Department of the Secretary of State shall under no circumstances be liable for any actions taken or omissions made in reliance on any information contained on these sites, or for any other consequences of any such reliance.

REGULATORY COMMUNITY

- 1) NC Department of the Secretary of State www.sosnc.gov
 Securities Division <https://www.sosnc.gov/Sec/>
 Business Registration Division (f/k/a Corporations) https://www.sosnc.gov/divisions/business_registration
 Securities Division general email secdiv@sosnc.gov
- 2) Securities and Exchange Commission www.sec.gov
- 3) North American Securities Administrators Association (NASAA) www.nasaa.org
- 4) NASAA initiative for investors and industry re: seniors www.ServeOurSeniors.org
- 5) National Adult Protective Services Association www.napsa-now.org
- 6) Investment Adviser Registration Depository www.iard.com
 IARD Renewal Calendar <https://www.iard.com/renewal-program>
- 7) NC Department of Revenue www.ncdor.com
- 8) Federal Trade Commission www.ftc.gov
- 9) US Department of Labor www.dol.gov

BAILEY DECISION re: RETIREMENT

<https://www.ncdor.gov/bailey-decision-concerning-federal-state-and-local-retirement-benefits>

CRYPTOCURRENCY and OPPORTUNITY ZONES

- 10) NC administrative actions: https://www.sosnc.gov/divisions/securities/admin_action

- 11) SEC public statement 2011: <https://www.sec.gov/news/public-statement/statement-clayton-2017-12-11>
- 12) No-Action 2018 re: holdings: <https://www.sec.gov/divisions/investment/noaction/2018/cryptocurrency-011818.htm>
- 13) Digital asset transactions: <https://www.sec.gov/news/speech/speech-hinman-061418>
- 14) FinHub: <https://www.sec.gov/finhub>
- 15) Howey Coins Travel Network: <https://www.howeycoins.com>
- 16) Howey test: <https://coincenter.org/files/2019-03/clayton-token-response.pdf>

PRIVACY AND FINANCIAL ABUSE

- 17) Interagency Guidance re: Financial Abuse: <https://www.sec.gov/news/press/2013/elder-abuse-guidance.pdf>
- 18) FINRA Rule 2165 Financial Exploitation of Adults: <http://www.finra.org/industry/notices/17-11>

LIST OF PROFESSIONAL DESIGNATIONS

<https://www.finra.org/investors/professional-designations>

SECURITIES AND EXCHANGE COMMISSION (SEC)

19) Division of Investment Management

- SLOA as custody: <https://www.sec.gov/investment/im-guidance-2017-01.pdf>
- SLOA No Action Itr: <https://www.sec.gov/divisions/investment/noaction/2017/investment-adviser-association-022117-206-4.htm>
- SEC FAQs re: custody: https://www.sec.gov/divisions/investment/custody_faq_030510.htm
- All No Action Itrs: <https://www.sec.gov/divisions/investment/im-noaction.shtml>

20) Investor Alerts <https://www.sec.gov/investor/alerts>

Leveraged/Inverse ETFs: <https://www.sec.gov/investor/pubs/leveragedetfs-alert.htm>

21) Office of Compliance Inspections and Examinations

- Risk Alert: **Advertising (2/2017)** <https://www.sec.gov/ocie/Article/risk-alert-5-most-frequent-ia-compliance-topics.pdf>
- Risk Alert: **Advertising (9/2017)** <https://www.sec.gov/ocie/Article/risk-alert-advertising.pdf>
- Risk Alert: **Due diligence** <https://www.sec.gov/about/offices/ocie/adviser-due-diligence-alternative-investments.pdf>

22) Investor Publications

Mutual Funds/ETFs:
<https://www.sec.gov/reportspubs/investor-publications/investorpubsinwsmfhtm.html>

- 23) Electronic Media <https://www.sec.gov/rules/interp/34-42728.htm>
- 24) Testimonials/Social Media <https://www.sec.gov/investment/im-guidance-2014-04.pdf>
- 25) Fiduciary duty <https://www.sec.gov/news/speech/2012-spch103112cvdhtm>
- 26) Fiduciary duty <https://www.sec.gov/rules/interp/2019/ia-5248.pdf>
- 27) COVID-19 scams <https://www.sec.gov/sec-coronavirus-covid-19-response>
- 28) Speech to Compliance Pros <https://www.sec.gov/news/speech/2012-spch103112cvdhtm>
- 29) Springer Inv Management <https://www.sec.gov/litigation/complaints/2019/comp-pr2019-274.pdf>
- 30) Sales Practices/Derivatives <https://www.sec.gov/news/press-release/2019-242>
- 31) Clover Capital No Action letter:
<https://www.sec.gov/divisions/investment/noaction/clovercapital102886.htm>
- 32) Facebook/Cambridge Analytica: <https://www.sec.gov/litigation/complaints/2019/comp-pr2019-140.pdf>

SENIOR-SPECIFIC RESOURCES

- 33) NASAA initiative for investors and industry re: seniors www.ServeOurSeniors.org
- 34) National Adult Protective Services Association www.napsa-now.org
- 35) Senior Safe Act Press Release 5/23/19 with other links <https://www.sec.gov/news/press-release/2019-75>
- 36) Senior Safe Act Fact Sheet <http://www.nasaa.org/wp-content/uploads/2019/05/Senior-Safe-Act-Fact-Sheet.pdf>

529 PLANS

- 37) SEC Investor Publications: An Introduction to 529 Plans with other links:
<https://www.sec.gov/reportspubs/investor-publications/investorpubsintro529htm.html>
- 38) FINRA Fees and Expenses Comparison Tool for 529 Plans:
https://tools.finra.org/529_calculator/main

COVID SPECIFIC INFO

- 39) COVID-19 scams-SEC <https://www.sec.gov/sec-coronavirus-covid-19-response>
- 40) Early w/d re COVID/NASAA <https://www.nasaa.org/55064/covid-19-related-early-withdrawals-from-retirement-accounts/?qoid=investor-advisories>
- 41) US Treasury <https://home.treasury.gov/policy-issues/cares>

DISCIPLINARY ACTIONS

- 42) Ladenburg Thalmann Asset Management Inc. (*F-Squared*)
<https://www.sec.gov/litigation/admin/2016/ia-4501.pdf>
- 43) Demitrios Hallas 6/23/14, FINRA ID 2012031943701
<https://www.sec.gov/litigation/litreleases/2017/lr23955.htm>

- 44) Morgan Stanley 2/14/17 <https://www.sec.gov/news/pressrelease/2017-46.html>
- 45) Edward T. McFarlane 5/18/17, FINRA ID 2016050393901
https://www.finra.org/sites/default/files/fda_documents/2016050393901_FDA_VA702183.pdf
- 46) Raymond Lucia, Sr (*Buckets O' Money*), 9/03/15, SEC Release 34-75837
<https://www.sec.gov/litigation/opinions/2015/34-75837.pdf>
- 47) Wells Fargo 2/24/20 <https://www.sec.gov/news/press-release/2020-43>
- 48) FINRA Disciplinary Actions Online
<https://www.finra.org/industry/finra-disciplinary-actions-online>
- 49) Securities Division administrative actions organized by year
https://www.sosnc.gov/divisions/securities/admin_action

GOVERNING LAW

- 50) North Carolina Investment Advisers Act: https://www.sosnc.gov/home/administrative_rules
- 51) North Carolina Administrative Code:
<https://www.ncleg.net/gascripts/Statutes/StatutesTOC.pl?Chapter=0078C>

CYBERSECURITY

- 52) North Carolina Secretary of State Securities Division Cybersecurity Initiative:
https://www.sosnc.gov/divisions/securities/cyber_security
- 53) National Institute of Standards and Technology (NIST) Framework for Improving Critical Infrastructure Cybersecurity: <https://www.nist.gov/cyberframework>
- 54) North American Securities Administrators' (NASAA) "Cybersecurity Checklist for Investment Advisers (2017)": <https://www.nasaa.org/industry-resources/investment-advisers/nasaa-cybersecurity-checklist/>
- 55) Financial Industry Regulatory Authority's (FINRA) "Checklist for a Small Firm's Cybersecurity Program": <https://www.finra.org/rules-guidance/key-topics/cybersecurity#checklist>
- 56) US Securities and Exchange Commission's (SEC) "Spotlight on Cybersecurity, the SEC and You: <https://www.sec.gov/spotlight/cybersecurity>
- 57) International Organization of Securities Commissions' (IOSCO) "Cyber Task Force Final Report":
<https://www.iosco.org/library/pubdocs/pdf/IOSCOPD633.pdf>