North Carolina
Investment Adviser
Compliance in the Time of COVID,
2nd Edition
Workshop

THIS PRESENTATION IS BEING RECORDED FOR EDUCATION AND TRAINING PURPOSES

NORTH CAROLINA DEPARTMENT OF THE SECRETARY OF STATE – SECURITIES DIVISION
WWW.SOSNC.GOV
North Carolina
Investment Adviser
Compliance in the Time of COVID,
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2nd Edition
Disclaimer (1 of 2)

- This webinar 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 or SEC as appropriate.
- Rules and statutes may be paraphrased, abbreviated or incomplete.
  - NCAC = NC Administrative Code
  - NCGS = NC General Statutes §

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
- Practice management & Trends
- Advertising, Contracts & Fees
- Professional conduct
- Filing reminders
Workshop Goals

- Help you to establish best practices
- Topics modified from our day-long IA Best Practices Workshop
- Discuss impact of 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 the following:
  - 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 (con’t)

- 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]
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

[NCGS § 78C-2 Definitions]
COVID Examination Process

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

[North Carolina General Statute § 78C-18]
COVID Examination Process (con’t)

- Once exam is complete, we send a deficiency letter via email (sometimes cc: certified mail)
- Respond in writing to the deficiency letter, usually within 10 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
“Compliance Consultant”
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
• Resources for continuing education
• Forms and instructions

Lots of info at [www.nasaa.org](http://www.nasaa.org)
SEC as a Resource

• Division of Investment Management
• Investor Alerts
• Division of Examinations  (formerly Office of Compliance Inspections & Examinations)
• 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*
State vs. SEC Statistics

NC Investment Advisers Act
• About 400
• $9 billion as of 11/02/21

All state-registered RIAs
• 17,454
• $366 billion as of 12/31/20

Investment Advisers Act of 1940
• 13,494
• $97 trillion as of 5/25/20
“Typical” State vs. SEC IA

NC Investment Advisers Act
• 0-2 employees = 90%
• $25 million

All state-registered RIAs
• 0-2 employees = 81%
• Asset management = 84%

Investment Advisers Act of 1940
• 8 employees
• $341 million RAUM
NASAA Coordinated Exams

2011-2021 (biennial review)

- Jurisdictions include Canadian provinces
- Examined 1,206 advisers in 2021
- 68% were one-person firms
- 63% managed >$30 million
- Trending down: PIV managers
- Trending down: affiliated w/BD

[All NASAA Coordinated Exams available at www.nasaa.org]
NC Statistics 2021

- 75% are one-person firms
- 90% are one- or two-person firms
- 3% advise PIV
- 8% offer financial planning but not AUM
- 88% of NC IAs have discretionary authority

[ADV filings as of 11/02/21]
Form Filings Review

- Form ADV Part 1
- Form ADV Part 2A: Firm Brochure
- Form ADV Part 2B: Brochure Supplement

[18 NCAC 06A.1702, .1703, .1707 and .1715]
Form Filings Review (con’t)

➢ Form U-4
  • Disclosures for OBA
  • Judgments/Liens/Bankruptcies
  • Criminal charges
  • Disciplinary actions
  • Update regularly

➢ Form U-5

[18 NCAC 06A.1702, .1703, .1707 and .1715]
Form Filings Review (con’t)

- Form ADV Part 2A: Appendix 1 Wrap Fee Brochure
  - If the IA sponsors a wrap fee program
  - 5% of NC advisers

[18 NCAC 06A.1702, .1703, .1707 and .1715]
[ADV filings as of 11/02/21]
Upcoming Changes to ADV Part 1

- Due to new SEC Marketing Rule
  - Performance reports/advertising
  - Testimonials/endorsements
  - Third-party ratings
  - Hypothetical performance
  - Compensation practices

[SEC Rule 206(4)-1]
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]
Polling Question 1
Recent Regulatory Developments

- SEC Regulation Best Interest (Reg BI)
- DOL Fiduciary Rule
- NASAA Model Rule re: continuing education
- SEC Marketing Rule
- NASAA Model Rule re: Policies and Procedures
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

Challenged Sept 2019, upheld 6/26/20 by 2nd Circuit Court of Appeals
Road to the Dept of Labor Fiduciary Rule

- **2010**: Dodd-Frank Act
- **2015**: DOL proposes its own regulations
- **2018**: DOL rule vacated by US Fifth Circuit Court of Appeals
- (2019: SEC Reg BI)
- **2020**: DOL adopts Rule 3.0
Dept of Labor Fiduciary Rule

Field Assistance Bulletin 2021-02 (1 of 2)

• New ERISA policy became effective 2/16/21
• Affects plan sponsors, participants and IRAs
• Full enforcement expected 2/01/22
• “Impartial Conduct Standards”

Dept of Labor Fiduciary Rule

Field Assistance Bulletin 2021-02 (2 of 2)

• **Prohibited Transaction Exemption** available to state-registered investment advisers

• **Requires written acknowledgment and P&P**

• **Rollovers exempted through 6/30/22**

• **Consider retaining an ERISA attorney**

How Model Rules Work

1. NASAA proposes a rule.
2. NASAA receives feedback from jurisdictions, industry and the general public.
3. NASAA membership adopts the Model Rule.
4. Individual states decide whether to adopt it or not.
5. NC has adopted the NASAA Model Rule on Senior Designations.
6. NC often uses other NASAA Model Rules as “best practice” guidelines.
Unlike most financial services professionals, investment adviser representatives did not have a continuing education requirement.

- CE year is a calendar year (Jan-Dec)
- Will be reported on CRD

https://www.nasaa.org/industry-resources/investment-advisers/investment-adviser-representative-continuing-education/
Mississippi adopted for 1/01/22

12 credits total of NASAA-approved content

– 6 credits in Products and Practices
– 6 credits in Ethics and Professional Responsibility

Applies to all IAs registered in the adopting state, not just the ones who live there!

https://www.nasaa.org/industry-resources/investment-advisers/investment-adviser-representative-continuing-education/
NASAA CE Model Rule (3 of 3)

Other states will adopt for 1/01/23

**Take action in 2022:**

a) If you are registered in Mississippi, take CE in 2022

b) Monitor the NASAA site to see if you will need to take CE in 2022 or 2023

https://www.nasaa.org/industry-resources/investment-advisers/investment-adviser-representative-continuing-education/member-adoption/
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

7/17/22
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)]
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

[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


https://home.treasury.gov/policy-issues/coronavirus
COVID-Related Scams

• Related to vaccines, tests
• Retail investors looking for their own returns
• Social isolation

SEC Resources & NASAA Investor Advisory
https://www.nasaa.org/category/investor-education/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

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
• Recognize that some conflicts cannot be mitigated by disclosure

[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
- Legal and disciplinary actions
- Judgments/liens

[18 NCAC 06A.1801 (a)(11), (22), (23) and .1707]
Conflicts of Interest in NC

Also an insurance agent 62%
Also a registered rep 11%
Also prepares tax returns 15%

[ADV filings as of 11/02/21]
Duty of Loyalty: Conflicts of Interest

Significant conflicts of interest

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

Conflicts of Interest and Risk Governance, 10/22/12
Duty of Loyalty: Conflicts of Interest

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


[18 NCAC 06A.1801 (a)(11), (22), (23)]
**Duty of Loyalty: Full & Fair Disclosure**

- Avoid 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)]
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.
COVID, PPP* Loans and Reporting

- Show PPP loan(s) on the RIA’s financial statements. *Confer w/CPA as needed.*
- Track the receipt and forgiveness of this special loan. Retain documentation.
- Disclosure to clients required if the loan represents a financial condition reasonably likely to impair the ability of the IA to meet contractual commitments to clients.

*Paycheck Protection Program

[18 NCAC 06A.1706 (a)(6) and .1801 (a)(17)(A) and (B)]
Q: If a registered person or a business they control obtains a PPP loan and the loan or part of the loan is forgiven, must the registered person report that forgiveness in response to Question 14K on Form U4 as a “compromise with a creditor?”

A: No, provided the PPP loan or part of the loan is forgiven consistent with the original terms of the loan. For purposes of Form U4 Question 14K, a compromise with one or more creditors “generally involves an agreement between a borrower and a creditor in which a creditor agrees to accept less than the full amount owed in full satisfaction of an outstanding debt, unless such an agreement is included in the original terms of the loan.” Because a PPP loan contemplates forgiveness of some or all of the loan as part of the original terms of the loan, such forgiveness will not involve a new agreement by the creditor, but will be an event consistent with the loan’s original terms. In those circumstances, the forgiveness of a PPP loan will not be a “compromise with creditors” for purposes of Form U4 Question 14K. **Any forgiveness beyond the original terms of the loan would be considered a “compromise with creditors.”**

[https://www.finra.org/rules-guidance/key-topics/covid-19/faq#indiv](https://www.finra.org/rules-guidance/key-topics/covid-19/faq#indiv)

[18 NCAC 06A.1706 (a)(6) and 1801 (a)(17)(A) and (B)]
Polling Question 2
The Client Relationship

CONTRACT

IPS

NOTES/PLAN
**Investment Advisory Contract**

**Required elements:** (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)]
**Investment Advisory Contract**

**Problematic elements:** (including for financial planning)

1. **No** mandatory arbitration clause;
2. **Be careful** with indemnification or hedge clauses;
3. Describes accurately the adviser’s business;
4. Electronic signatures conform with the NC Uniform Electronic Transactions Act.

**Is this contract consistent with your fiduciary duty?**

[18 NCAC 06A.1801 (a), (a)(16) and NCGS § 78C-38 and § 66-311]
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.
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.
FIDUCIARY STATE OF MIND

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

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

• Know your client
• Know your products
• Write it down
Cybersecurity

Stay updated on available resources

• Avoid public wi-fi.
• Keep hardware and software updated.
• Use anti-virus and anti-malware.
• Use strong passwords and two-factor identification.
• Check links before you click.
• Never act on email instructions alone!!

[18 NCAC 06A.1801 and www.sosnc.gov ]
Business Email Compromise

$1.8 billion lost in 2020  (FBI Internet Crime Report 2020)

- Australian hedge fund lost $8.7 million after Fake Zoom invite loaded malicious software.
- Hedge fund paid $1.2 million in fake invoices.
- When fund admin phoned to verify a transaction, firm principal did not take the call but followed up via email...which had been compromised.

Confirm disbursements via phone!!

[18 NCAC 06A.1801]

https://www.nacha.org/content/business-email-compromise
Let’s Get Creative!

- Interesting investments
- Interesting fees
There’s always something old!
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 Statement on Complex Exchange-Traded Products (10/04/21)
Recent Actions re: Leveraged ETFs

- **Wells Fargo**  
  SEC 2/24/20...$35 million  

- **Morgan Stanley**  
  SEC 2/14/17...$8 million  

- **Demitrios Hallas**  
  SEC 9/29/17: Disgorgement, civil penalties, interest $550k+  
Cryptocurrency = Security?

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

Cryptocurrency = Security? (con’t)

SEC = 3/07/19

• Howey test, not static
• FinHub

https://www.sec.gov/finhub

Howey Coins Travel Network
https://www.howeycoins.com

https://www.sec.gov/ICO
Recent Crypto Developments

• Crypto exchanges
• Blockchain tokens
• BitConnect ($2 billion)
• SEC rejects Bitcoin ETF
• SEC halts registration of digital tokens (11/10/21)

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

Special Purpose Acquisition Companies

A company w/no operations offers securities for cash thru an IPO

$125 mil penalty to SEC
12/22/21

Non-Fungible Tokens (NFT)

Associated with art, gaming and collectibles

*Everydays: The First 5000 Days* by Beeple sold for $69.3 mil

ESG* and DEI Investing

• Disclosure
• Due diligence
• Misleading claims

*environmental
*social
*governance

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
• Many AUM advisers include financial planning
• Adviser must tell clients if s/he negotiates fees

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

- **Example**: Advising on 401(k) held away
  - Must be able to document review of the account
  - Best practice to charge less than the standard fee

- **Example**: Cash equivalents held long-term
  - Documentation signed by client
  - What is your on-going analysis?
  - Suspend fee/Reallocate?

[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%
• Fees to manage a product on which the adviser earned a commission
• Advisory fees charged w/out any due diligence

What exactly are you doing to earn this fee?
Consistent with your fiduciary duty?

[18 NCAC 06A.1801 (a)(10)]
Polling Question 3
SEC Marketing Rule (1 of 2)

• SEC first promulgated the Advertising Rule in 1961
• New Marketing Rule effective 5/04/21, compliance begins 11/04/22
  • Combines Rule 206(4)-1 and 206(4)-3
  • Significant changes for performance advertising
  • Redefines solicitation practices
  • SEC will withdraw No-Action letters

SEC Marketing Rule (2 of 2)

• Applies to NC-registered advisers.
• Does **not** replace prohibitions against ads tainted by fraud, puffery and bias.
• More guidance expected from SEC in Fall 2022.
• “Facts and circumstances”
• “Fair and balanced”

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)]
New Definition of Advertising

1. Any direct or indirect communication made to more than one person that offers the adviser’s services with regard to securities to prospective clients or offers new services to existing clients.

- Excludes ADV
- Excludes extemporaneous, live, oral communications
- Includes prepared remarks, slides, written materials
- Includes investors in a private fund
- Includes social media

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

2. Any endorsement or testimonial for which an adviser provides direct or indirect compensation.
   • **Endorsement** = *person other than a current client*
   • **Testimonial** = *statements by current clients about the experience*
   • **Solicitor replaced by “promoter”**

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

1. Any untrue statement of a material fact or material omissions.
2. Any material statement of fact the adviser cannot substantiate.
3. Info that would cause an untrue or misleading implication or inference concerning a material fact.
4. Discussing potential benefits without fair and balanced treatment of material risks or limitations.
5. Reference to specific investment advice in a manner that is not fair and balanced.
6. Performance results or present performance in a manner that is not fair and balanced.
7. Any content that is materially misleading.

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

- Emails, texts, IM
- Video, film, podcasts, blogs
- Digital audio or video files
- Billboards/Radio/TV ads
- Business card/stationery
- Website
- Social media

[SEC Rule 206(4)-1]
Testimonials

- Require five disclosures *within the testimonial* about the source, compensation and conflicts of interest
- Written agreement between the adviser and the compensated person
- Includes cash and non-cash compensation

[Rule 206(4)-1 of the IAA of 1940]
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 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)]
Holmes Stripped of Control of Company for Defrauding Investors

- Exaggerated or made false statements about the company’s technology, business and financial performance in investor presentations, product demonstrations and media articles
- $700 million fraud
- Convicted 1/03/22 on 4 of 11 fraud counts

Like/Share/Endorse on 3rd Party Site

- Do not “adopt or entangle” yourself by selectively deleting negative reviews or altering their content
- Yelp/Google

[SEC Rule 206(4)-1 and SEC Risk Alert Volume VI, Issue 6, 9/14/17]
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

- Ranking provided by unrelated person who ranks in the ordinary course of its business.
- Adviser must perform due diligence to avoid a predetermined result from the survey.
- “Clear and prominent” disclosures *within the four corners of the advertisement*:
  1. Date of ranking/Period of time on which it was based;
  2. Identity of third-party that created the rating;
  3. That compensation has been provided to the adviser when obtaining or using the third-party rating.

*[SEC Rule 206(4)-1]*
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]
Free Lunch Seminars/Blogs

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

[Protecting Senior Investors: Rept of Examinations of Securities Firms Providing “Free Lunch” Seminars, SEC/NASAA/FINRA, September 2007]
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)]
Most Common NC Advertising Deficiencies

- Exaggerations
- Misrepresentations
- Guarantees
- Puffery
IA Advertising Must Be True
Polling Question 4
Written Policies and Procedures
Written P&P Are Required!

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)]
Don’t have “DUM” Procedures

DUM billing procedure:
I send an invoice every month to clients. I keep a copy of it.

Better procedure describes each step:
On the first day of the new Q run the Balances report from TDA...Calc fee in Excel...Check client accts for cash...Create a new invoice folder on the PC...Upload fees to TDA...Send invoice to clients via email

[18 NCAC 06A.1808 (d), Sample TOC and Compliance Grid]
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.

[SEC Rule 206(4)-2 Custody]
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 (agenda)

[18 NCAC 06A.1808]
Your IA Rep’s Website

- The website of your IA rep is **YOURS**
- Review for statements of fact, not opinion
- Backup digital advertising
- Report websites on ADV 1

[18 NCAC 06A.1808]
Outside Business Activities

- Usually insurance
- “Pre-Approval Form”
- Need P&P re: actual supervision
- Report OBA on Form U-4

[18 NCAC 06A.1703 and .1808]
Supervision of Non-Registered Employees

Non-registered employees cannot:

- Make recommendations or render advice regarding securities
- Accept trading instructions directly from a client, even if the trade is unsolicited
- Circumvent the custodian’s controls by executing trades under the ID of a registered person

[NCGS § 78C-16 Registration]
Business Continuity

• Part of your written policies and procedures
  - Disaster plan
  - Succession plan

[18 NCAC 06A.1801 (a)]
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)]
Written Procedures

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

[18 NCAC 06A.1808 (d), Sample TOC, Compliance Grid]
NASAA Model Rule for IA Written P&P

- Policies and Procedures *NAASA adopted 11/24/20*
- Business Continuity and Succession Plan
- Privacy
- Cybersecurity
- Compliance Grid
- *Sample TOC*
- 3 case studies

[18 NCAC 06A.1808 (d), Sample TOC, NASAA Model Rule w/Compliance Grid]
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)

- SEC Guidance

[NASAA Model Act to Protect Vulnerable Adults from Financial Exploitation]
[SEC Guidance on Privacy Laws and Reporting Financial Abuse of Older Adults]
Is your financial firm asking you for a TRUSTED CONTACT?

WHAT IS IT?
A "trusted contact" is a person you authorize your financial firm to contact in limited circumstances.

WHO SHOULD HAVE ONE?
We suggest a trusted contact for anyone who has an investment account.

How would having a trusted contact help me?
Maybe your investment professional needs to get in touch with you but can't when:

- You are traveling
- There is a natural disaster
- There is a concern about fraud
- You are having a health issue

<table>
<thead>
<tr>
<th>Your trusted contact</th>
<th>Can't make trades in your account</th>
<th>Your trusted contact</th>
<th>Can't make decisions about your account</th>
<th>Being a trusted contact</th>
<th>Does not make them a power of attorney, legal guardian, trustee or executor</th>
</tr>
</thead>
</table>

A trusted contact is someone who can help your financial firm help you, if needed. Add one today! 
nasaa.org/trusted-contact
Elder Financial Abuse (continued)

• Know your client
  – www.nasaa.org/trusted-contact

• 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 always mid-December

[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

March 31

[18 NCAC 06A.1708]
What is a balance sheet?

What Does a Company Balance Sheet Tell You?

A balance sheet shows what a company owns and owes and how much shareholders have invested.

THE BALANCE SHEET FORMULA

Assets  =  Liabilities  +  Shareholders’ Equity

Assets: cash, inventory, property

Liabilities: rent, wages, utilities, taxes, loans

Shareholders’ Equity: retained earnings
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 reptd on annual ADV amendment

Investment Advisers Act of 1940
• Must return to State when RAUM fall to $90 million as reptd 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)]
Polling Question 5
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?
See something, say something

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


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

See something, say something

SOS Complaint Form

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

Remember: The Securities Division cannot provide legal advice to you or consumers!
“Compliance”

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