

North Carolina Investment Adviser *Zooming Into Compliance*

Nov 2023 Edition

Workshop

PRESENTED BY:

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NORTH CAROLINA DEPARTMENT OF THE SECRETARY OF STATE –

SECURITIES DIVISION

WWW.SOSNC.GOV



Your Presenter



AXA ADVISORS



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

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 recent changes in the regulatory landscape
- 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

Securities Division

- **J. Anthony (Andy) Penry**, *Division Director and Deputy Securities Administrator*
- **Sherrell Forbes**, *Assistant Director*
- **Beth Aiken**, *Enforcement Attorney*
- **Allen Sipes**, *Special Agent*

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]

Internet Scams

- Have open conversations with your clients re: investments in crypto.
- Educate clients
- Experienced a loss?
 - Report to Securities Division
 - Contact CPA

www.sosnc.gov

For Securities Professionals

Investor Education Booklets



Internet Crime Complaint Center

- File a complaint
- Consumer Alerts
- Annual Reports
- Special section on Elder Fraud
- Link to contact local FBI office under
Brochures

www.ic3.gov

CRYPTO-Related Scams

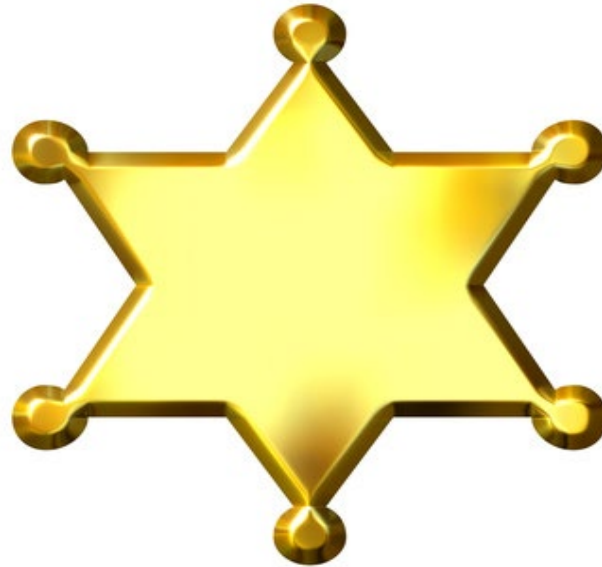
- www.NASAA.org
- FTC: ReportFraud.ftc.gov
- CFTC: CFTC.gov/complaint
- SEC: sec.gov/tcr
- IC3: ic3.gov/Home/FileComplaint



<https://www.nasaa.org/44848/informed-investor-advisory-cryptocurrencies/>

Complaint Form

[https://www.sosnc.gov/divisions/securities/file
a_complaint](https://www.sosnc.gov/divisions/securities/file_a_complaint)



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

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



Meet Olivia Kay

Sole prop d/b/a O. Kay Advisors

O. Kay Advisors is an “Assumed Name”

For a more organized home, make sure
everything has a place



Do You Have an Assumed Name?

- D/B/A required if not using your firm's legal name
- Assumed business names filed before 12/01/17 **expired on 12/01/22**
- Renew at local Register of Deeds Office to keep name on the statewide registry

[NCGS § 161-14.01]



SOS Vocabulary

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

VOCABULARY
Words Are Important!

[NCGS § 78C-2 Definitions]

Examination Process

- Restarted on-site examinations 3rd Q 2022
- Examiner will call to set up an appointment (if remote via telephone or WebEx)
- May include an initial records request
- Conduct a standard interview
- Often request additional records
- *Secure File Share*



[North Carolina General Statute § 78C-18]

Examination Process (con't)

- Once exam is complete, we send a deficiency letter via email and/or 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

www.nasaa.org



SEC as a Resource

- Division of Investment Management
 - *(Withdrawn No Action Letters)*
- Investor Alerts
- Division of Examinations *(Risk Alerts)*
- Forms and instructions
- 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
- Help Desk: **(240) 386-4848**



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



Sources for Statistics

NC Investment Advisers Act

- IARD filings for NC
- *as of 10/18/23*



All state-registered RIAs

- *NASAA 2023 IA Section Rpt*

Investment Advisers Act of 1940

- SEC Risk Alert *9/06/23*



State vs. SEC Statistics

NC Investment Advisers Act

- About 400
- \$9 billion *as of 10/18/23*



All state-registered RIAs

- 17,063 (*decrease of 308 fr 2022*)
- \$421 billion *as of 12/31/22*

Investment Advisers Act of 1940

- 14,800 *2022*; 15k *9/06/23*
- \$115 trillion in 2023



“Typical” NC vs. NASAA

NC Investment Advisers Act

- 0-2 employees = 90%
 - \$27 million average*
 - Asset mgt = 89%
- (*mean \$18 million)*



NASAA Jurisdictions

- 0-2 employees = 82%
- \$13 million average
- Asset management 84%



“Typical” NC vs. NASAA

NC Investment Advisers Act

- B/D rep = 7%
- Insurance = 35%



- Prep taxes = 15%

NASAA Jurisdictions

- B/D rep = 23%
- Insurance = 41%



Other NC Statistics 2023

- 85% are one-person firms
- 72% offer financial planning
- 89% report they provide ptf management
- 82% of IAs have discretionary authority
- <20% of IAs may be financial planners *only*



[ADV filings as of 10/18/23]

NASAA Coordinated Exams

2011-2023 (biennial review)

- Jurisdictions include Canadian provinces
- Examined 683 advisers in 2023
- 72% were one-person firms
- **Trending up:** Accounting firms registered as RIAs
- **Trending down:** affiliated w/broker-dealer

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

Top 3 Exam Deficiencies

NASAA 2022 and NC SOS 2023

- Registration
- Books and records
- Contracts
- Fees
- Advertising

[NASAA 2023 IA Section Annual Report, www.nasaa.org]

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
 - 3.5% of NC advisers

*[18 NCAC 06A.1702, .1703, .1707 and .1715]
[ADV filings as of 10/18/23]*



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]

Recent Regulatory Developments

- SEC Regulation Best Interest (Reg BI) and **proposed** changes to Custody Rule
- DOL changes to *Fiduciary Rule*
- NASAA Model Rule re: *continuing education*
- SEC *Marketing Rule*
- NASAA Model Rule re: *Policies & 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

History of SEC Custody Rule

- 2003: First release
- 2009: Current release
- 2017: Interpretation that SLOA is custody
- **Feb 2023**: Proposed changes to amend 206(4)-2 and add “*Safeguarding Rule*” 223-1
- 10/30/23: Comment period ends
- **11/01/23**: Lawmakers ask Fed Reserve, FDIC and OCC to review for “unintended outcomes.”



https://www.sec.gov/divisions/investment/custody_faq_030510

SEC Proposed Changes to the Custody Rule

- **IA-6240** announced in Feb press rls **2023-156**
 - Qualified custodian/Would include ALL assets
 - Expands custody to include discretion
 - Changes surprise exam (financial audit) req
 - Will affect Form ADV disclosures

This guidance is in flux, and the Division will notify you as needed

<https://www.sec.gov/news/pressreleases> and IA-6240

Road to the Dept of Labor Fiduciary Rule

- **2010:** Dodd-Frank Act
- **2016:** DOL issue its own fiduciary rule
- **2018:** DOL rule vacated by US Fifth Circuit Court of Appeals
- (2019: SEC Reg BI)
- **2020:** DOL adopts Rule 3.0
- **2022:** TX lawsuit filed



Recent Developments: DOL Fiduciary Rule

- **Feb 23:** FL lawsuit struck down expanded rule, DOL did not appeal
- **Jul 23:** TX vacated portions of the **PTE 2020-02**
- **Sep 23:** DOL files amended Rule
- **10/31/23:** DOL proposes “*Retirement Security Rule*” to update the definition of *investment advice fiduciary* under ERISA

[29 CFR 2510.3-21 and Release 23-2275-NAT]

www.napa-net.org National Association of Plan Advisors

Field Assistance Bulletin 2021-02 (1 of 2)

- Issued in response to ***Prohibited Transaction Exemption 2020-02***
- New ERISA policy effective 2/16/21
- Affects plan sponsors, participants and **IRAs**
- **Available to state-registered IAs**
- *Requires written acknowledgment and P&P*

<https://www.dol.gov/agencies/ebsa/employers-and-advisers/guidance/field-assistance-bulletins/2021-02> published 10/25/21

Field Assistance Bulletin 2021-02 (2 of 2)

This guidance is in flux and will not be enforced by the NC Securities Division

- *This Rule falls under to the Dept of Labor*
www.dol.gov
- **Consider retaining an ERISA attorney**

<https://www.dol.gov/sites/dolgov/files/ebsa/about-ebsa/our-activities/resource-center/faqs/new-fiduciary-advice-exemption.pdf> April 2021

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.



CE for IA Reps (“IAR CE”) (1 of 4)

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/>

CE for IA Reps (“IAR CE”) (2 of 4)

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/>

CE for IA Reps (“IAR CE”) (3 of 4)

Adopted for 1/01/24

Colorado, FL, Nevada, N. Dakota and Tennessee

Adopted for 1/01/23

**Arkansas, Kentucky, Michigan, Oklahoma, Oregon,
Wisconsin, DC and **South Carolina****

Adopted for 1/01/22

Mississippi/Maryland/Vermont



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

CE for IA Reps (“IAR CE”) (4 of 4)

Take action in 2024:

- a) If you are registered in a CE state, take CE
- b) Monitor the NASAA site to see if you will need to take CE in 2025
- c) Sign up for a FinPro account as needed

Failure to comply with CE does not affect your NC registration.

<https://www.finra.org/registration-exams-ce/finpro>



Exam Validity Extension Program

NC does not participate in EVEP!

8/30/23 NASAA launched for B/D representatives

10/31/23 NASAA launched for IARs

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 conflicts of interest 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

Interest rate

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

Wm Yeas

7/17/23



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

www.ncdor.gov



[348 N.C. 130]

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

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
- **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]

Duty of Loyalty: Conflicts of Interest

Significant conflicts of interest

- **Affiliates** *(11% have affiliated insurance agencies)*
- **Other business activities**
- **Compensation and incentives**
- **Valuation of illiquid positions**
- **Pooled Investment Vehicle** *(3%)*

[NCGS § 78C-8(a) and 18 NCAC 06A.1801 (a)(11), (22), (23)]



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

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

[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
- Not making disclosures at all

[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.*

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.*

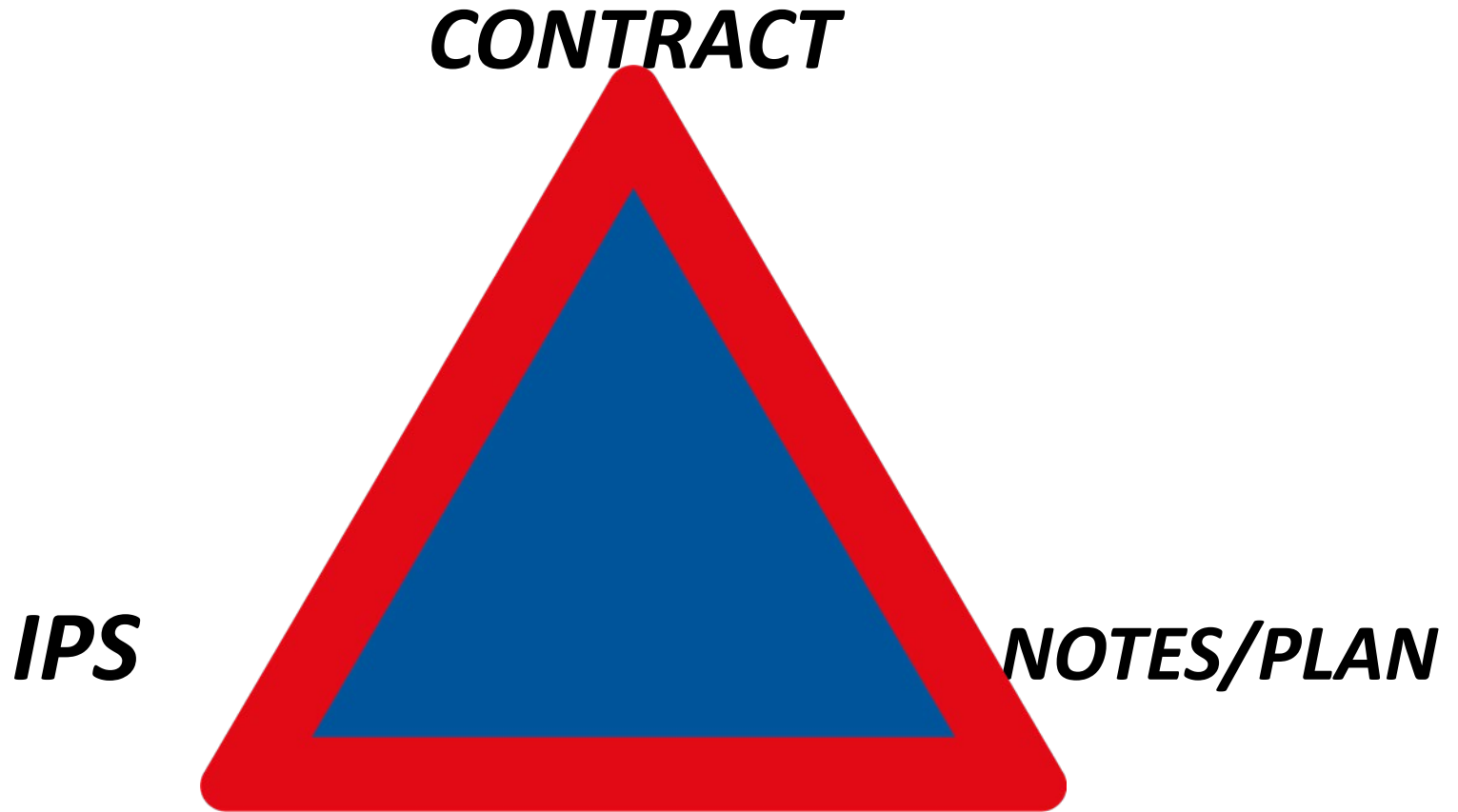
Duty to Explain Non-Disclosure!

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.

The Client Relationship



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. Mandatory arbitration clause not permitted;
2. **Be careful** with indemnification or hedge clauses;
3. Describe 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]



Did the Custodian Change?

- Custodian is a required disclosure in Form ADV Part 2A
- *Update by 3/31/24*
- *Deliver required amendment no later than 4/30/24*
- Update contact as needed

[18 NCAC 06A.1707 and .1801]

Miscellaneous Record-Keeping

- Archive texts
- Specific types of software not required (e.g., CRM or performance reporting)
- Retain all records for 2 years on-site, 5 years total

[18 NCAC 06A.1706]

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

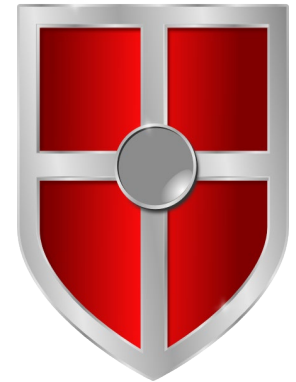
- Know your client
- Know your products
- Write it down



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. Look for misspellings!*
- ***Never act on email instructions alone!!***



[18 NCAC 06A.1801, www.sosnc.gov and www.nasaa.org Resources for Inv Advisers]

Business Email Compromise

\$50 billion scam (FBI I-060923-PSA 6/09/23)

- Use secondary channels to verify requests
- Initiate a new email
- **Verify, verify, verify**



Report cybercrime to the FBI field office and the Internet Crime Complaint Center at IC3.gov.

Confirm client disbursements via phone!!

[18 NCAC 06A.1801]

Let's Get Creative!

- Interesting investments
- Interesting fees



There's always something old!

Promissory Note: NO:

Under in terms of the Bills of Exchange Act 34 of 1944 as amended up to Bills of Exchange Amendment Act 56 of 1980; AND settlement in terms of High Court Rule 45B(2)

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

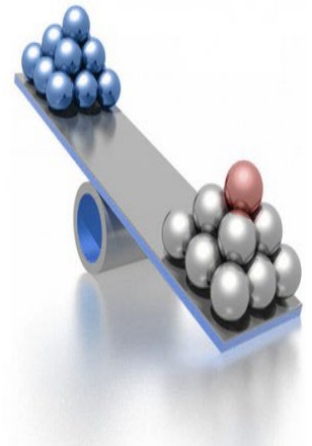
Understand the products you are selling

- 1) FINRA Regulatory Notice 09-31 and 22-08
- 2) FINRA Smart Beta (9/23/15)
- 3) SEC on Complex Exchange-Traded Products (10/04/21)
- 4) Single-stock leveraged ETFs (July 2022)
- 5) Inv Bulletin: Leveraged and Inverse ETFs (8/29/23)

<https://www.sec.gov/news/public-statement/gensler-statement-complex-exchange-traded-products-100421>

<https://www.sec.gov/news/statement/crenshaw-single-stock-etfs-20220711>

<https://www.sec.gov/investor/pubs/leveragedetfs-alert>



Cryptocurrency = Security?

- CFTC = *commodity*
- IRS = *taxable asset*
- SEC = 2018 said Bitcoin was not a security but they haven't seen any ICOs that are not
- 2017: Subject to Howey test

This guidance is in flux



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

<https://www.sec.gov/spotlight/cybersecurity-enforcement-actions>

Cryptocurrency Resources

SEC FinHub

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

Howey Coins Travel Network

<https://www.howeycoins.com>

8-10 *pending* Bitcoin ETFs

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

Enforcement Actions in NC

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

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



Beyond Plain Vanilla Investing

- More disclosure
- More due diligence
- Avoid misleading claims
- Check Risk Alerts



<https://www.nasaa.org/wp-content/uploads/2019/07/Opportunity-Zones-NASAA-SEC-Staff-Statement.pdf>

<https://www.sec.gov/files/esg-risk-alert.pdf>

Advisory Fees in NC

- **Asset management fees** range from less than 1% to 2%
- Are charged on *managed* assets
- **Financial planners** often charge hourly or by project
- Many advisers include financial planning in AUM fee
- Adviser must tell clients if s/he negotiates fees
- Disclose fees in both contract and ADV Part 2A

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



Types of Fees: NC vs. NASAA

NC Investment Advisers Act

- Asset mgt: 89%
- Fixed fees: 57%
- Hourly fees: 53%
- Other: 10%



NASAA IA Section Report 2023

- Asset mgt: 84%
- Fixed: 51%
- Hourly: 51%
- Other: 14%



Fees for “Assets under Advisement”

Example: **Advising on 401(k) held away**

- These are undefined terms requiring adequate recordkeeping
- Must be able to document review of the account
- Actions consistent with fiduciary?
- Best practice to charge hourly

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

Cash Equivalents Held Long-Term

Best practices include

- Documentation signed by client
- What exactly is your on-going analysis?
- Consider suspending the fee
- Actions consistent with fiduciary?
- Should this \$ be elsewhere?

[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)]

Problematic Billing

- Charge fees as described & calculate correctly
- If you prorate **w/d**, you must prorate **additions**
- Check fee calculations periodically
- Disclose non-standard quarters
- Billing failures may result in a Letter of Caution or **administrative action**



[18 NCAC 06A.1801 (a)(8) and .1706 Record-Keeping]

SEC Marketing Rule (1 of 2)

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



<https://www.sec.gov/rules/final/2020/ia-5653.pdf>

SEC Marketing Rule (2 of 2)

- **Applies to NC-registered advisers:** 18 NCAC 06A.1801 (a)(13)
- Does not replace prohibitions against ads tainted by fraud, puffery and bias.
- *“Facts and circumstances”*
- *“Fair and balanced”*
- Marketing Rule FAQs



<https://www.sec.gov/investment/marketing-faq>

<https://www.kitces.com/wp-content/uploads/2021/02/Key-Components-Of-The-New-SEC-Advertising-Rule.pdf>

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)]

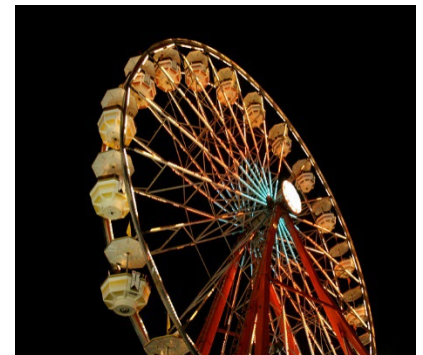


New Definition of Advertising

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 and IA-5653]

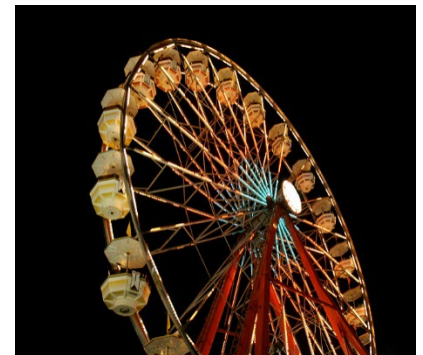


New Definition of Advertising

2. Any endorsement or testimonial for which an adviser provides direct or indirect compensation.

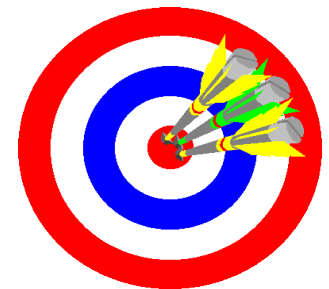
- *Endorsement = person other than a current client*
- *Testimonial = statements by current clients about the experience*
- *Solicitor replaced by “promoter”*

[Rule 206(4)-1 of the IAA of 1940 and IA-5653]



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 and IA-5653]

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]



Solicitor? Promoter? Sub- or Co-Adviser?

- Agreement between your firm and theirs
- Client knows where their \$ goes (disclosures)
- Client must have a contract with your firm
- Even if your client signs a contract with them
- Client must grant discretion
- Registration as IAR possible
- *Consult private counsel as needed*

[NCGS § 78C-2 (3)d Definitions, § 78C-16 (b2) Registration, SEC Rule 206(4)-1]

Performance Reports

- Use appropriate benchmarks
- Report all accounts (no cherry picking!)
- *“YTD return does **not** account for when DUM invested or at what price.” Huh?*
- Keep supporting documentation

[Rule 206(4)-1 of the IAA of 1940 and 18 NCAC 06A .1801 and .1706]



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 (1 of 2)

- Designation lapsed
 - Using designation conferred by former employer
 - No explanation of minimum qualifications for designation
 - False, fabricated and/or purchased designations
- <https://www.finra.org/investors/professional-designations>

DO NOT USE

Certified Retirement Financial Advisor (CRFA)

[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 Qualifications (2 of 2)

- Misuse of professional marks
- Implying everyone in the office holds the designation or certification

www.cfp.net

How to Use the CFP Marks



[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



[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

<https://www.sec.gov/news/press-release/2018-41>

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 IA-5653
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 and <https://www.sec.gov/investment/marketing-faq>]

Errors Using 3rd Party Rankings

- 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]

[SEC Investor Alert 11/08/22: IA Advertisements]

Free Lunch Seminars/Blogs

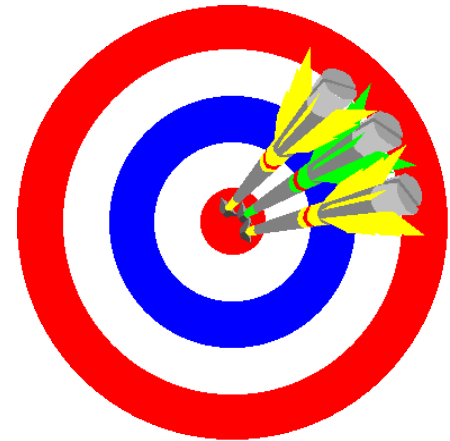
- Poor supervision of content & materials
- Attractive inducements/misleading statements
- Unsuitable investments
- Fraud

*[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



Written Policies and Procedures

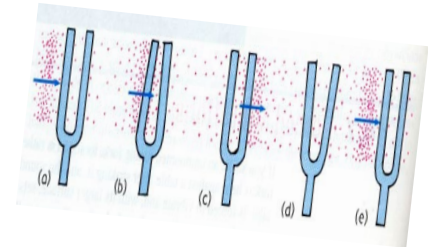


Written P&P Are Required!

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 Schwab...Calc fee in Excel...Check client accts for cash...Create a new invoice folder on the PC...Upload fees to Schwab...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
- *Don't forget LinkedIn!*

Outside Business Activities

- Concerns re: selling away
- “Pre-Approval Form”
- Need P&P for supervision
- Report OBA on Form U-4
- Monitor diligently



[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: 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



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

Common Deficiencies Re: Written Policies and Procedures

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



Annual Renewal

- Registration terminates 12/31 unless renewed
- Deadline at IARD is **always mid-December**
(12/11/23)



[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)]



Financial Statements

- Prepared in accordance with GAAP*
- Must be current (no less than Q)
- Required book and record
- Required annual reporting for advisers with discretion or custody
- Even if you have a bond
- File via email to secdiv@sosnc.gov

*[*18 NCAC 06A.1704, .1706 and .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

cash, inventory, property

=



Liabilities

*rent, wages, utilities,
taxes, loans*

+



Shareholders'
Equity

retained earnings

Annual Reporting: Balance Sheet

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



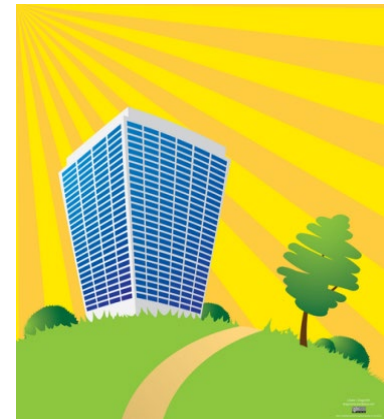
[18 NCAC 06A.1708]

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)]



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]



FIDUCIARY SUMMARY

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



WORKSHOP SUMMARY

- Know your fiduciary duties
- Know your practice



“Compliance”

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



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)*

<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 *("Woodbridge," March 2019)*

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

Elder Financial Abuse

- **NASAA Model Act (1/22/16)**

Updates available at www.nasaa.org/ServeOurSeniors

- **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
 - www.nasaa.org/trusted-contact
- Investor Hotline
 - 800-688-4507
- Report Elder Abuse
 - County Dept of Social Services
 - 800-662-7030 (NC DHHS)



Is your financial firm asking you for a **TRUSTED CONTACT?**

There are a number of very important reasons to give your financial firm the name of someone you trust, and FINRA, NASAA and the SEC urge you to consider the request.



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



Your trusted contact **CANNOT** make trades in your account



Your trusted contact **CANNOT** make decisions about your account



Being a trusted contact **DOES NOT** make them a power of attorney, legal guardian, trustee or executor

A trusted contact is someone who can help your financial firm help you, if needed. Add one today!

nasaa.org/trusted-contact