

Ten Common Violations of the North Carolina Investment Adviser's Act

Noted below are ten common violations found during routine examinations of North Carolina registered investment advisers. Take a look at these violations and ask yourself: “*How can I improve?*”

1. **Failing to file the required Form ADV Part 1 annual amendment within 90 days of the end of fiscal year (March 31st if on a calendar year).** It is common for Registrants to forget to file their required annual amendment. Maybe nothing has changed and you don't think the Form ADV needs to be amended. Even if there are no changes, the Registrant is required to amend both its Form ADV Part 1 and Part 2 every year.
2. **Inaccurate or incomplete Forms ADV Part 1 and 2.** To gain a better understanding of how to complete the Forms, read the instructions and use resources available at www.sec.gov and www.iard.com. Complete the Forms based on the perspective of the Registrant, not yours (unless you're a sole proprietor). Update the information routinely, and ensure it is accurate and up-to-date. Make sure the procedures described in both Parts match!
3. **No contract, inadequate or incomplete contract.** Not having a contract is considered a dishonest and unethical business practice. Ensure the Registrant and clients properly execute a contract. What good is a contract unless it is properly signed and dated? Ensure you have all the elements required for a contract in North Carolina. Contracts may not contain hedge clauses or mandatory arbitration clauses. Keep a copy or duplicate original in a client file.
4. **Failing to maintain net worth requirements.** The net worth required must be maintained at all times: \$10,000 for advisers with discretionary authority, and \$35,000 for those with custody. Refer to the Rule [Title 18 NCAC 06A.1704 (c)] for the specific definition of “net worth” as some items allowed by GAAP are excluded from the calculation. If you do not want to maintain the required net worth, then purchase a \$35,000 surety bond. The bond amount of \$35,000 is the same for Registrants with either discretion or custody.

5. Failing to maintain current client suitability information. Know your clients and document their investment information such as goals, risk tolerance, time horizon and needs. Update this information periodically. Having this information “in your head” is not adequate. As a good business practice, use an investment policy statement that defines the client’s objectives.

6. Non-compliance with privacy requirements. Investment advisers are defined as a financial institution by the Gramm-Leach-Bliley Act and are required to adhere to the privacy laws. Develop a privacy statement for the Registrant as well as a privacy policy that is included in the written procedures. The statement must detail the types of information the adviser is collecting and the safeguards taken. If the adviser shares or sells the information, the customer must be able to opt out.

Provide the privacy statement when first meeting with your client, then deliver it annually as long as the person remains a client. Document how this was done. Advisers often use an acknowledgement sheet or section of the contract for documenting the initial delivery.

7. Failing to maintain applicable books and records. Review the record keeping requirements to see which books and records must be maintained. The Registrant should be able to provide any required record upon request. The record may be electronic as long as the Registrant can provide it at time of request.

8. Failing to maintain written procedures (compliance manual). Registrants must keep written procedures describing Registrant’s policies. Each topic should describe the policy, its implementation and who is responsible for overseeing it. Review the procedures regularly, and document the review with an acknowledgement sheet.

9. Failure to calculate and/or document fees accurately. Disclose fees in the Form ADV Part 2 and in the contract. Calculate the fees as described. Calculate the fees accurately. Full disclosure ensures there are no misunderstandings with your clients.

10. Non-compliance with advertising rules. Make accurate and truthful representations of your business and experience. Do not exaggerate performance or qualifications. Remember that when advertising to public, you are also advertising to Division personnel. Misleading advertising is considered a dishonest and unethical business practice.

Frequently Asked Questions

Disclaimer: *This information is provided for educational purposes only and should not be viewed as providing legal advice or legal interpretation of any North Carolina statute or rule. Specific questions should be directed to a licensed private attorney specializing in securities law.*

Do I register as an investment adviser with the Securities and Exchange Commission or with the state of North Carolina?

Investment advisers that have regulatory assets under management of less than \$100 million register with the State. Investment advisers that have regulatory assets under management over \$100 million register with the SEC. If an SEC adviser has less than \$90 million in regulatory assets under management when it files its annual amendment, the adviser must withdraw from the SEC and register with the state.

If the investment adviser does not manage asset but provides financial planning only, s/he must register with the State.

About the IARD (Investment Advisory Registration Depository)

The IARD is a national computer database operated by the Financial Industry Regulatory Authority (FINRA) and is used by the states and the Securities and Exchange Commission for registration purposes. All applications for investment adviser registration must be filed on the IARD.

How do I register as a registered investment adviser?

Complete the application via Form ADV in accordance with the form instructions on the Investment Adviser Registration Depository (www.iard.com). The application shall include the following:

1. Proof of compliance with the examination requirements
2. Copy of the Registrant's current balance sheet
3. Evidence of compliance with minimum financial requirements
4. Copy of surety bond if applicable
5. A \$300 fee
6. Any other information the Administrator may from time to time require relevant to the applicant's qualifications

What is a Form ADV?

The Form ADV is used to register as an investment adviser or to renew the registration of an investment adviser. Form ADV is divided into two parts. The first part (Part 1) discloses specific information about an adviser that is important to regulators (for example, name, number of employees, form of the organization, nature of the business). The second part (Part 2) acts as a disclosure document for clients of the business and includes information about services provided and fees charged. These two parts are filed electronically with the Investment Adviser Registration Depository (IARD). Instructions on how to complete the forms are available from www.iard.com.

I want to register as an investment adviser representative of a registered investment advisory firm. Do I need to take an exam?

Maybe. You must either pass the Uniform Investment Adviser Law Examination (Series 65 exam) or both the General Securities Representative Examination (Series 7 exam) *and* the Uniform Combined State Law Examination (Series 66 exam). The exam requirement may be waived if you currently hold one of the following designations:

1. Certified Financial Planner (CFP)
2. Chartered Financial Consultant (ChFC)
3. Personal Financial Specialist (PFS)
4. Chartered Financial Analyst (CFA)
5. Chartered Investment Counselor (CIC)

How long does it take to get approved as a registered investment adviser?

If the application is complete and no denial order is in effect and no proceeding is pending, then registration becomes effective at noon of the 30th day after an application is filed. The Division may specify an earlier effective date. Do not assume the registration is effective the same day you submit the registration request. Many applicants do not submit a complete application!

How long is the registration good for?

The registration of an investment adviser expires on December 31 of each year unless renewed. A renewal must be filed annually by early December to ensure registration does not lapse January 1st. If the registration lapses, the registrations of all the investment adviser representatives also lapse.

How do I renew my investment adviser registration?

Application for annual renewal of registration shall be filed with the Investment Adviser Registration Depository (IARD) along with the fee of \$300. The renewal fee for each investment adviser representative is \$75. Other documents may be required if applicable upon the request of the Administrator.

How do I update information concerning the registered investment adviser?

In addition to the required annual amendment, you must update the Form ADV within 30 days of a material change.

My firm is registered as an investment adviser in another state. When do I register in North Carolina?

If you or your firm are registered as an investment adviser in a state other than North Carolina as your principal place of business, and you have no place of business in North Carolina, you may obtain no more than five clients without being registered in NC. (Check with other states to determine their requirements.)

How do I withdraw my registration as investment adviser or investment adviser Representative?

The Investment Adviser is required to file a Form ADV-W with the IARD. The Investment Adviser Representative is required to file on Form U-5 with the IARD. Merely letting your registration expire is unacceptable.

Do I need a written contract?

Yes, it is dishonest and unethical business practice to conduct advisory business without a written contract. The written contract must disclose in substance the services to be provided; the term of the contract; the advisory fee or the formula for computing the fee; and the amount or the manner of calculation of the amount of the prepaid fee to be returned in the event of contract termination or non-performance (refund policy). The contract must also state if the client is granting discretionary authority to the Registrant. Finally, the contract must state that no assignment of the contract shall be made by the adviser without the consent of the other party of the contract.

What books and records does the Division require me to maintain?

For a complete list read Title 18 North Carolina Administrative Code 06A.1706. Some of the records include the following:

- Financial records including net-worth statements, income and expense statements and general ledgers, check books, bills, and bank statements
- Originals of all written communications and copies of all communications sent
- All advertising
- List of all accounts with discretionary power
- All contracts or written agreements
- A record of every transaction in a security in which the investment adviser has influence or control
- Many more!

How long do I keep my required books and records?

Maintain all books and records in an easily accessible place for a period of not less than five years from the end of the fiscal year during which the last entry was made on such record. The first two years the Registrant must keep books and records in the principal office of the Registrant.

A Registrant that ceases to conduct its business shall arrange for and be responsible for the preservation of the books and records required for five years.

What format should I keep my books and records in?

The required books and records shall be maintained and preserved in any method chosen, as long as they can be produced at any time. The books and records may be maintained in hard copy format or electronically or a combination.

Will I be audited?

Yes, all investment advisers in North Carolina can expect an audit, more correctly called a “books and records examination.” All Registrants are subject at any time or from time to time to reasonable periodic, special or other examinations by representatives of the Administrator.

What happens when I'm audited?

First, relax. The audit process should be expected and welcomed as an opportunity to learn constructive information about your compliance. Many audits are unannounced, and we ask that you be flexible and cooperate with the examiner. The examiner will first talk with you about the details of the business and will request items that are required to be maintained. You are required to comply.

The examiner may complete the on-site portion of the audit in one day, but the audit may last longer depending upon your business model and the organization of your records. The auditor often requests additional information or clarification when completing the examination. We appreciate your cooperation.