State of North Carolina
Department of the Secretary of State

ELAINE F. MARSHALL
SECRETARY OF STATE

Memorandum

Date: December 18, 2019

To: Joint Legislative Commission on Governmental Operations
Fiscal Research Division, North Carolina General Assembly

From: Kevin M. Harrington
Deputy Securities Administrator
North Carolina Securities Division
Department of the Secretary of State

Re: Investor Protection and Education Trust Fund
Report for Fiscal Year ending June 30, 2019

Pursuant to N.C.G.S. § 147-54.5(f), the Department of the Secretary of State respectfully submits this report on the expenditures from the Investor Protection and Education Trust Fund (hereinafter, "Fund") for the fiscal year ending June 30, 2019. This report includes an update regarding the effectiveness of investor awareness education efforts by the Department of the Secretary of State.

The Securities Division of the North Carolina Department of the Secretary of State (hereinafter, "Securities Division" or "Division") was created to protect the investing public and to enhance legitimate capital formation through its administration of a program designed to combat fraudulent practices in the solicitation of investment capital and to encourage sound investments as well as promote a legitimate competitive business climate. The Securities Division enforces the North Carolina Securities Act, the North Carolina Investment Advisers Act, and the North Carolina Commodities Act, which are a part of the uniform state law framework in which all fifty states participate and is an essential component of the national financial capital formation marketplace.

Specifically, the Securities Division analyzes investment-related complaints received from the public and from the business community, responds to inquiries about investment transactions, conducts investigations and initiates enforcement actions appropriate to protect investors and the public from fraudulent securities activities. In this regard, the Division is responsible for registering both investment products and investment professionals, and for conducting reviews of the background and the business practices of these registrants. As part of its enforcement responsibilities, the Division investigates allegations of fraudulent activity committed in connection with transactions in investment securities. Historically, this has included conducting undercover investigations targeting Ponzi schemes, as well as taking a lead in a multi-state investigation into fraudulent sales practices committed during the marketing of auction rate securities. More recently, the Division was among the first state or federal securities regulator in the nation to bring significant enforcement actions against illegal activities involving online investments in cyrptocurrencies.[1]

[1] (see https://www.sosnc.gov/divisions/securities/cryptocurrencies_and_investing).

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Directly connected to the Division's enforcement responsibility is its Investor Protection and Education Outreach Program (hereinafter "Investor Education Program". The activities, programs and materials of this function are funded through the Fund.

The primary purposes of the Fund are to ***protect*** the investing public from those who would do them financial harm, and to ***educate*** the investing public on actions they can undertake or on resources that they can utilize to become better informed investors and avoid becoming victims of investment fraud. A secondary goal of the fund is to foster a climate wherein the investing public effectively has access to quality business information that enables these investors to identify legitimate investment opportunities. This investor capacity leads to the business community having less expensive financial capital formation costs and the investors accumulating additional wealth to finance their retirement years or their other activities.

The Investor Education Program has developed a robust outreach effort devoted to educating the investing public about securities fraud and providing them with unbiased information about investing and about investment professionals. This program has included in-person presentations to many different groups of potential investors including senior citizens, women, military personnel, and members of different civic, ethnic, religious and professional organizations. **Between March 2006 and June 30, 2019, the Investor Education Program has conducted 1436 different presentations to over 78,500 people in all 100 counties of North Carolina**.

The Investor Education Program also provides an extensive library of resources that it makes available to the public free of charge, and is constantly updating this library as resources are acquired to respond to new, emerging threats targeted at investors. In recent years, for example, educational resources have been added relating to investment-based crowdfunding, cybersecurity, and investments involving cryptocurrencies.

Since FY 2012-13, the Investor Education Program has collected voluntary customer satisfaction surveys from attendees of many of the public events in which Program staff have participated. Between July 2012 and June 30, 2019, 4,273 surveys have been collected from 9,979 program attendees. Ninety-seven percent of respondents have said the presentations were "informative." Furthermore, ninety-five percent have said the presentations were "clear," almost ninety-six percent have rated the presenters as "Excellent" (70.4%) or "Very Good" (25.4%), and ninety-eight percent (98.4%) have said they would recommend the presentations to others.

The Securities Division's investor protection responsibility relates to and is coordinated with its law enforcement duties and activities conducted pursuant to N.C.G.S. Chapters 78A, 78C and 78D. The Department utilizes the Fund to provide training and education about securities, securities fraud and ways to avoid financial abuse or exploitation to a number of constituencies: investment professionals directly regulated by the Division (brokers and investment advisers); the law enforcement community (police and sheriffs' departments and district attorneys' conference); and providers of professional services to the investing public (attorneys, accountants, medical professionals and adult service providers).

Providing training and education to these various groups of professionals through live or recorded or other electronic means serves as a force multiplier for the Securities Division. Building capacity within these groups serves to better protect the investing public from securities fraud and financial exploitation. By increasing awareness among these groups that securities fraud is a statutory crime and that the Department, generally, and the Securities Division, specifically, are the subject matter experts on these types of crimes, enables us to better extend our reach into local communities, giving us the potential to identify, investigate and stop these crimes much earlier. Consequently, we are able to minimize victim losses and maximize victim recoveries.

Through this educational program, the Division likewise promotes greater awareness of investment fraud among those demographic populations that are frequently targeted as especially vulnerable to fraudulent investment schemes (i.e. senior citizens, members of the armed forces, faith-based organizations). In addition, it provides on-going compliance assistance to licensed investment professionals regulated by the Division in the conduct of their lawful business activities. Through this educational program, the Division promotes local capital formation for business growth activities. It also enables the Division to partner with other law enforcement agencies by providing on-going education, consultation and assistance with regard to securities fraud investigations their jurisdictions may undertake.

During Fiscal Year 2018-2019 through the activities undertaken by the efforts of the Investor Education Program, 4,631 North Carolina investors received direct, in-person education and training. Furthermore, over 108,000 educational brochures and packets were distributed statewide. This expertise was included with other public education efforts in the State, such as ones sponsored by local Area Agency on Aging offices, senior centers, North Carolina AARP, Continuing Care Retirement Centers, and churches.

Through outreach activities supported by the Fund, the Division has provided education to small businesses and entrepreneurs through the Small Business Center Network of the North Carolina Community College System, Women's Business Centers, and Veterans Business Outreach Centers. The Division has also participated in initiatives sponsored or promoted by the U.S. Small Business Administration, and other small business and startup mentoring organizations, including the NC Economic Development Partnership.

Investor Protection and Education Trust Fund Expenditures for FY 2018-19

During the 2018-19 fiscal year, expenditures from the Fund totaled $470,549.42. This amount was comprised of the following components:

A. Payments totaling $425,646.50 to conceive, coordinate and execute all of the Department's investor education outreach activities and initiatives. During FY 2018-19, such initiatives included (but were not limited to):

    1. Conceiving and implementing a series of investor protection presentations for civic and professional organizations. During FY 2018-19, the Securities Division provided investor education presentations at a total of 128 events in 60 different cities spanning 41 different counties, and presented to 4,631 people. These activities were directed at demographic groups identified as very vulnerable to investment fraud, including senior citizens, members of the armed services, and faith-based organizations.

    2. Responding to public queries and requests for information, meeting with interested members of the public about investor education and protection activities, and researching investor education/protection topics for articles, letters and presentations. During FY 2018-19, the Securities Division distributed over 108,000 investor education materials as a result of requests from the general public, to attendees of investor education events, and to small businesses/startups and organizations that provide mentoring services to the business community around the state.

    3. Developing the capacity to respond effectively to changes in federal and/or state securities law and to communicate these changes to the relevant interested parties:

a) Enactment of the Wall Street Reform and Consumer Protection Act required registered investment advisers with assets under management (AUM) between $25 million and $100 million to "switch" from federal to state regulatory oversight. This switch substantially increased the size and scope of the Division's workload. It greatly increased the number of firms and representatives the Division is responsible for monitoring. Furthermore, the increase in the AUM threshold for state registration increased the level of complexity of the matters being reviewed. To help address some of these issues proactively, the Division has used resources from the Fund during the past eight fiscal years to conduct an aggressive educational outreach program aimed at educating registered investment advisers and investment adviser representatives. This program not only seeks to improve lines of communication between the Division and the investment advisory community, it promotes greater professionalism and encourages ethical behavior within the community while ensuring the highest level of professional advice to investors. Through FY 2018-19, the Division has conducted 34 such workshops. Additional workshops were conducted during FY 2019-20 and will be reported on next year. These workshops have been very well-received by members of the regulated investment adviser community and likely reduced subsequent audit issues. Through FY 2018-19, 970 investment advisers have attended at least one workshop, and 839 (85%) have completed customer service surveys. Of that number, respondents have rated the "value" of the workshops as "Excellent" (90%) or "Good" (10%). Furthermore, respondents rated the "quality" of the workshops as "Excellent" (80%) or "Good" (16%), and all (100%) said they would recommend the workshops to others.

   During FY2018-19, the Division launched a new cybersecurity outreach initiative aimed at our registered investment advisers that is unique in the nation. All investment advisers are fiduciaries. This means they must safeguard their clients' personal information and money. In addition, all investment advisers are required to keep and maintain up-to-date policies and procedures manuals including policies and procedures on cybersecurity. A study conducted by our agency determined that the approximately 400 investment advisers registered in North Carolina cumulatively manage over $8 billion in investor assets. Furthermore, 87 percent of these advisers are one- or two-person businesses. Unlike larger, federally-regulated firms, most state-registered advisers do not have personnel dedicated to providing cybersecurity services for their firm. Most rely on their own skills or the services provided by their internet service providers or off-the-shelf anti-virus/-malware software. Through online surveys and in-person interviews with advisers, the Division has confirmed that most advisers do not have in-depth policies and procedures with which to respond to a cyberattack. This puts their clients – our citizens – at significant risk.

   The initiative the Division is conducting, and which will span well into the next fiscal year and beyond, helps state-registered advisers prepare and utilize more relevant and meaningful cybersecurity policies and procedures. The exercises are based on best practice recommendations from the National Institute of Science and Technology (NIST), the Financial Industry Regulatory Authority (FINRA), the US Securities and Exchange Commission (SEC) and the North American Securities Administrators Association (NASAA). More information about this program will be contained in next year's annual report.

b) The enactment of significant federal legislation in recent years has fundamentally changed the way securities issuers or promoters may solicit investors. Federal crowdfunding regulations went into full effect in May 2016. The Department was instrumental in crafting and promoting North Carolina intrastate crowdfunding legislation which was enacted in July 2016 and which took full effect April 1, 2017.

With these new laws, issuers are now able to market their securities offerings in person or over the Internet.

Beginning soon after enactment of the federal crowdfunding legislation in 2016, the Division anticipated the need to educate not only business startups and investors about the coming changes, but also the network of state, local and private organizations that support and promote small business mentorship and job creation.

Consequently, the Division has undertaken a number of educational initiatives to improve the understanding of investors, the business community, and those professionals who serve as advisers to or intermediaries between these two groups about the benefits and risks associated with these new capital financing options. Such initiatives have included organizing or participating in conferences aimed at potential investors, entrepreneurs, small businesses and other organizations of professional working adults. It has also included organizing and participating in a series of official education programs for CPAs, accountants, attorneys and law students.

4. Expanding the "in-house" ability to provide investor education via the Department's social media platforms and to offer training seminars via the Internet. This continues to enhance the Division's ability to support business activities and facilitate capital formation within the state by better delivering educational content to investors, the professional community and entities with similar interests and goals. During FY 2018-19, the Department saw the number of "followers" rise from 1,266 at the beginning of the year to 2,116 at the close of the fiscal year, representing a 67% increase. The number of "likes" rose from 1,204 to 2,020 during the fiscal year, representing an almost 68% increase. On Twitter, the number of "followers" rose from 712 followers at the beginning of the fiscal year to 954 by the close, representing an almost 34% increase. Similarly, the Department's LinkedIn page started the fiscal year with 1,376 followers and ended with 1,520, an increase of 10%. The Department's YouTube following has increased to from 450 subscribers to 724, an increase of 61%. To date, our videos have generated over 85,000 total views.

5. Taking active participation in the activities of such organizations as the North Carolina Financial Literacy Council, the Joint Legislative Task Force on Frauds Against Older Adults, the North Carolina Partnership to Address Adult Abuse, the North Carolina Senior Consumer Fraud Task Force, the Southern Piedmont Consumer Fraud Task Force, the Jump$tart Coalition, and the North American Securities Administrators Association. This has resulted in a more coordinated and cooperative effort by these various groups to combat financial fraud.

B. Payments totaling $44,902.92 were made to various vendors for equipment maintenance, office supplies, printing and shipping costs of various investor education publications and administrative expenses.

This concludes the FY 2018-19 Investor Protection and Education Trust Fund activity report. Please contact me if the Department can provide further information.

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APPENDIX – EXAMPLES OF INVESTOR EDUCATION PROGRAM INITIATIVES

Outreach to Small Businesses and Entrepreneurs

In recent years there have been significant changes to federal and state securities laws. In 2012, the federal Jumpstart Our Business Startups (JOBS) Act was enacted. In July 2016, North Carolina passed an intrastate crowdfunding law, the NC Providing Access to Capital for Entrepreneurs and Small Business (NC PACES) Act. Helping small businesses, investors and professionals keep pace and understand these significant changes have been a focus of the Fund. With enactment of these laws, investment crowdfunding is now legal under both federal and state law. Crowdfunding provides a registration exemption for small businesses seeking to raise capital from investors via the internet, thus making it easier and less costly for businesses to raise the capital they need for growth. It also offers all investors an opportunity to invest in potentially up-and-coming businesses at an earlier stage. Between July 2012 and June 30, 2019, the Investor Education Program has conducted or participated in 330 educational outreach events relating to financial capital formation issues. These activities are on-going and will continue to be a focus of the Investor Education Program going forward because this approach improves the skill sets of those seeking to comply with the laws and thereby avoids inadvertent violations which could destabilize an otherwise commercially viable enterprise. During FY 2018-19, the Investor Education Program worked with Directors of the Small Business Centers various locations around the state on both in-person and online presentations focusing on capital formation activities. We anticipate this being an on-going part of the Program during FY 2019-20.

Securities 101 for Law Enforcement Officers initiative

Beginning in FY 2010-11, the Investor Education Program piloted an outreach program designed to make local law enforcement agencies more familiar with investment fraud crimes and the ways the NC Department of the Secretary of State Securities Division could assist local law enforcement agencies with the investigation and development of such cases. These outreach efforts are on-going. An on-going goal for the Division is to create an official NC Justice Academy training course which will have the effect of serving as a force multiplier in the fight against white collar financial crimes.

Investment Adviser Workshop Initiative

Beginning in FY 2010-11, and continuing each fiscal year since, the Investor Education Program has conducted an educational outreach initiative in partnership with the NC Securities Division's Enforcement Section designed to help professionals in the investment advisory profession better understand the requirements of the NC Securities and Investment Advisers Acts and their associated regulations. Between September 2010 and November 2018, 34 workshops have been conducted in various locations around the state, attracting 839 investment advisers or their representatives. In addition to providing their clients better advice and money management, another benefit of this educational initiative has been to establish a more open working relationship with investment advisers located in North Carolina and regulated by the Division. By conducting such training workshops, the Division is promoting a higher level of professionalism within the regulated investment advisory services community, thereby ensuring the state's investors are served by ethical and competent investment professionals. The comments from those advisers who attended showed their appreciation for the Division's efforts to support and assist owners of small businesses in North Carolina. As mentioned earlier in this report, reaction to this educational outreach program by the investment advisory community has been overwhelmingly positive. Comments have ranged from "Excellent job by all. Great idea! Looking forward to my exam!" to "Would like to see these workshops be made mandatory."

"Elder Fraud: A Multi-Jurisdictional Approach to Justice"

During FY 2012-13, the Department joined the NC Conference of District Attorneys in co-sponsoring a training conference entitled, "Elder Fraud: A Multi-Disciplinary Approach to Justice". This two-day, first-of-its-kind multidisciplinary course offered 180 prosecutors, victim witness legal assistants, law enforcement officers, Adult Protective Services staff, senior advocates, and other allied professionals an intense training opportunity regarding the investigation and prosecution of elder abuse. The Securities

Division provided several speakers who gave presentations on securities fraud during the general session as well as in two separate breakout sessions. Attendees whose job functions require them received continuing education credits for participating in this conference. As the expertise of the Division became more widely recognized within the law enforcement and fraud prevention communities, the Division has been asked to participate in an increasing number of similar conferences. For example, during FY 2014-15, the Division provided speakers at Pfeiffer University's 2015 Fraud and Forensic Investigations Conference in Charlotte, which attracted 150 attendees. The Department continues to support and engage in similar initiatives. During FY 2018-19, a representative of our office worked with a committee convened by the NC Conference of District Attorneys to create a Prosecutor's Manual on Elder Abuse and Exploitation. Included in the draft manual is an entire section dealing with investigating and prosecuting financial crimes.

Elder Investment Fraud and Financial Exploitation (EIFFE) Prevention Program

Beginning in FY 2011, the Investor Education Program has been a sponsor of the North Carolina presentation of the Elder Investment Fraud and Financial Exploitation (EIFFE) Prevention Program, a national investor education initiative developed by the Baylor College of Medicine. The EIFFE program is specifically designed to train medical professionals to be more aware of the signs of investment fraud and financial abuse of elderly patients, so that such patients (or their caregivers) could be promptly referred to Adult Protective Services, to the Secretary of State's Securities Division, or to other local law enforcement or community-based service agencies. The program has also been modified to appeal more broadly to adult services providers. The Division has partnered with the UNC School of Medicine and has presented training seminars to the spring 2011 conference of the NC Academy of Family Physicians, a special seminar presented in March 2012 at the J. Paul Sticht Center on Aging at Wake Forest Baptist Hospital, and a seminar at the Mountain Area Health Education Center (MAHEC) in Asheville in November 2012. Approximately 250 people attended these events. Medical professionals who attended these seminars were able to receive one hour of AMA PRA Category 1™ education credit. Every fiscal year since, presentations have been and will continue to be given on this topic to various interest groups.

Cybersecurity Initiative

As described in paragraph A.3.a. above, the North Carolina Department of the Secretary of State Securities Division has identified the cybersecurity of state registered investment advisors and state registered investment adviser representatives to be a critically important issue. As Investment Advisors increasingly use information technology to conduct their business activities, the need to protect confidential and sensitive information related to these activities from third parties has also increased. Cybersecurity protection is crucial to the operation of our financial markets. The scope and severity of risks that cyber threats present have increased dramatically. The impact of a successful cyber-attack may have consequences that extend beyond the firm compromised to other market participants and retail investors that may not be well-informed of these risks and consequences. While review of an investment adviser's cybersecurity policies and procedures has been a part of the Securities Division's routine financial investigation protocol for several years, the Division has now initiated a program to provide additional cybersecurity information to help investment advisers, investment adviser representatives, and other market participants protect their customers and their money from cyber threats. This initiative is being conducted through the Investor Protection and Education Services Program and will be further elaborated on in next year's report.