

State of North Carolina
Department of the Secretary of State

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Memorandum

Date: January 4, 2022

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

From: Rodney Maddox
Chief Deputy Secretary & Acting 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, 2021

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, 2021. 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.

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. In addition, 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. 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. 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 cryptocurrencies.

Directly connected to the Division's enforcement responsibility is its Investor Protection and Education Outreach Program (hereinafter "Investor Education Program" or "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 in order to make prudent investment decisions 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 registered investment professionals. The 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, 2021, the Investor Education Program has conducted 1,590 different presentations to over 107,400 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 and other new types of investment products.

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. The COVID-19 pandemic has obviously impacted the Program's ability to conduct in-person events. All in-person events were cancelled after the State of Emergency Declaration of March 2020, thereby reducing the number of opportunities to conduct surveys. Nevertheless, between July 2012 and June 31, 2021, 4,629 surveys have been collected from 11,006 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" (70.7%) or "Very Good" (25.0%), 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 expertise 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 serious 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. This gives the Division the opportunity to identify, investigate and stop these crimes much earlier. Consequently, we are able to minimize victim losses and maximize victim recoveries. Of particular note, the IPET program was very involved with the effort by the NC Conference of District Attorneys to produce the first-in-the-nation training handbook for the state's prosecutors on how to investigate and prosecute all forms of abuse and exploitation (including investment fraud) of the elderly. This handbook will serve as a national model for other states to emulate.

Through the Investor Education 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 community 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 the 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 that their jurisdictions may undertake.

The pandemic has had an obvious impact on the number of in-person educational outreach events the Program was able to conduct since March 2020. Upon the declaration of a state of emergency in March 2020, organizations with whom the Investor Protection Program had scheduled in-person educational presentations either switched them to virtual ones or cancelled them outright. For FY 2020-21, almost every presentation was done via the internet.

Despite these challenges, the Program provided education and training to in excess of 12,700 North Carolinians. This represents more than a 174 percent INCREASE in the number of people serviced over the FY 2018-2019 number, the last full year of in-person presentations. Much of this increase resulted from the increase in the number of tele-town hall events the Program participated in with organizations like NC AARP. The Program's expertise supplemented 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. Of particular note is the role the Program is playing to help position North Carolina as a national role model in the fight against the financial abuse and exploitation of vulnerable adults. For more information, please see the paragraph, "*HelpVul – Help for Vulnerable Adults*" in the Appendix below.

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, Veterans Business Outreach Centers, and Women's Business 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 2020-21

During the 2020-21 fiscal year, expenditures from the Investor Protection and Education Trust Fund totaled \$249,893.25. This amount was comprised of the following components:

Payments totaling \$249,893.25 to conceive, coordinate and execute all of the Department's investor education outreach activities and initiatives. During FY 2020-21, 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 2020-21, the Securities Division provided investor education presentations at a total of 58 events in 26 different cities spanning 25 different counties, and presented to over 12,700 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 2020-21, the Securities Division distributed over 23,500 pieces of educational materials, including materials distributed 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 to conduct an aggressive educational outreach program (the Investor Education Program) aimed at educating registered investment advisers and investment adviser representatives. The 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 2020-21, the Division has conducted 39 such workshops. Additional workshops will be conducted during FY 2021-22 and will be reported on next year. These workshops have been very well-received by members of the regulated investment adviser community and reduced subsequent audit issues. Through FY 2020-21, 1,141 investment advisers have attended at least one workshop, and 987 (87%) have completed customer service surveys. Of that number, respondents have rated the "value" of the workshops as "Excellent" (89%) or "Good" (11%). Furthermore, respondents rated the "quality" of the workshops as "Excellent" (85%) or "Good" (13%), and all (100%) said they would recommend the workshops to others.

Beginning in 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 have a high level of duty to 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 of client records and funds. A study conducted by our agency during that fiscal year determined that the approximately 400 investment advisers registered in North Carolina cumulatively managed over \$8 billion in investor assets. Furthermore, 87 percent of those 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 many advisers do not have adequate policies and procedures with which to respond to a cyberattack. This puts their clients – our citizens – at significant risk of financial loss.

The practices the Division is promoting 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).

- 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.

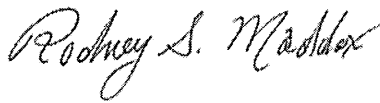
Consequently, the Division has undertaken a number of educational initiatives to improve the understanding of investors, the business community, and those professionals who serve as advisers to or intermediaries between these two groups about the benefits and risks associated with these new capital financing 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 the course of FY 2020-21, the number of combined followers on its four social media platforms (Facebook, Twitter, YouTube and LinkedIn) rose in excess of 28% from the previous reporting period. Of significant note, the Department’s YouTube channel generated nearly 192,000 views, an 80.5% increase from the previous fiscal year, resulting in nearly 14,000 viewing hours. In

response to the COVID-19 pandemic, the Investor Education Program conducted many of its outreach presentations via web-based platforms like WebEx, Zoom and Teams.

5. Taking active participation in the activities of such organizations as the North Carolina Financial Literacy Council, the North Carolina Partnership to Address Adult Abuse, the North Carolina Senior Consumer Fraud Task Force, 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.

This concludes the FY 2020-21 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

HelpVul – Help for Vulnerable Adults

Beginning in FY2019-20, the Securities Division partnered with the NC Department of Health and Human Services Division of Aging and Adult Services on a US Department of Justice pilot project to develop an electronic platform that brokerage firms can use to make simultaneous reports of suspected elder financial abuse and exploitation to local Adult Protective Services (APS) offices and the NC Department of the Secretary of State Securities Division. As the project progressed, it was decided to expand and individualize the HelpVul platform for the state of North Carolina to improve investigations involving financial exploitation beyond those involving securities and commodities-related misconduct handled by the North Carolina Department of the Secretary of State. This expansion continued into FY 2020-21 and included enabling APS caseworkers to submit referrals to the Secretary of State's office and the US Postal Inspection Service that came from community reporters. We also undertook a concerted effort to provide direct training to APS offices around the state in an effort to train them on what potential investment fraud looks like and how to make more relevant and effective referrals to our office. Project partners are working with the NC Conference of District Attorneys with hopes that the state's prosecutors can be brought onto the platform, too. Doing so would mean this would be an electronic platform that would facilitate information sharing by financial institutions, North Carolina County DSS Adult Protective Services Units, the North Carolina Department of the Secretary of State's office, the US Postal Inspection Service, and the state's prosecutors. Including the district attorneys on the platform also would facilitate compliance with the statutory mandate that APS (the DSS director) notify the district attorney: "[u]pon finding evidence indicating that a person has abused, neglected, or exploited a disabled adult." N.C.G.S. §108A-109. This pilot project will serve as a national model. This is an on-going project and more will be reported on it the FY 2021-22 annual report.

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, forms of investment crowdfunding are 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, 2021, the Investor Education Program has conducted or participated in 379 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 2020-21, the Investor Education Program worked with Directors of the Small Business Centers and Women's Business Centers in various locations around the state on both in-person and online presentations whether they focus on capital formation activities or in connection with other small-business trainings. We anticipate this being an on-going part of the Program during FY 2021-22.

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 September 2020, 39 workshops have been conducted in various locations around the

state, attracting 1,141 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. As a result, investors will be better 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."

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 project 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. During FY 2019-2020, the Investor Education Program expanded its initiative to lawyers and Adult Protective Services (APS) professionals with an NC Bar Association-hosted training for lawyers and two in-service trainings for APS hosted by the NC Department of Health and Human Services Division of Aging & Adult Services. Now incorporated into DHHS in-service financial exploitation training, we anticipate additional opportunities in the new fiscal year, along with more referrals from APS professionals in the field.

"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. This effort continued into FY 2020-21, resulting in the publication of the first-in-the-nation handbook in early FY 2021-22. The Conference has distributed copies to every prosecutor in the state.

Cybersecurity Initiative

As described in paragraph A.3.a. above, the Securities Division has identified the security of client records and funds in the possession of state registered investment advisers and state registered investment adviser representatives to be a critically important issue. As Investment Advisers 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 efficient operation of our financial markets. The scope and severity of risks that cyber threats present have increased dramatically. The impact of a criminal 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 Education Program.

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 University 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 groups, including civic (e.g., Rotary), social (e.g., book clubs), religious groups (e.g., a Baptist church), senior communities, senior centers, and more. During FY 2019-2020, those groups included the National Aging in Place webinar, NC Association of Department of Social Service Directors, "grand rounds" for the staff at Cherry Hospital and the North Carolina State Aging Conference for aging service providers, students and seniors in Wilmington. During FY 2020-21, such discussions also included information about the Advance Health Care Directives Registry which the Department maintains as well.