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Investment Adviser & Investment Adviser Representative Guidebook

Doug Burgum, Governor

Karen Tyler, Securities Commissioner



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THE NORTH DAKOTA SECURITIES DEPARTMENT

The North Dakota Securities Department protects investors and supports legitimate capital formation.

The Department regulates investment industry firms and professionals, and also regulates capital formation involving the offer and sale of securities. We strive to adequately balance the support of efficient, legitimate capital formation with appropriate protections for investors who commit capital to businesses.

The investigation of investment fraud and other securities law violations is also our responsibility, and we may take enforcement actions that result in disciplinary remedies and act as a deterrent for further violations.

Through our investor education programs and resources, we strive to help North Dakotans make informed investment decisions, avoid fraud, and build financial security.

DISCLAIMER:

This compilation of material and information was prepared by the North Dakota Securities Department to provide general information and assistance regarding the Department's oversight of investment advisers and investment adviser representatives in North Dakota. This information is not legal advice and is not a substitute for a thorough review of the relevant statutory provisions set out in Chapter 10-04 of the North Dakota Century Code (N.D.C.C.).

INTRODUCTION

The North Dakota Securities Act (the "Act") provides for oversight of investment advisers and investment adviser representatives operating in North Dakota. This oversight is administered and enforced by the North Dakota Securities Department. Subject to certain limited exceptions, all investment advisers operating in North Dakota must be either registered by the Department or in compliance with certain notice filing requirements. Further, subject to certain limited exceptions, all investment adviser representatives with a place of business in North Dakota must be registered by the Department. Filings and fees for investment adviser registration or notice filings must be submitted electronically through the Investment Adviser Registration Depository (IARD), a nationwide database and filing system maintained by the Financial Industry Regulatory Authority (FINRA) that is available at www.iard.com. Filings and fees for investment adviser representative registration must be submitted electronically through the Central Registration Depository (CRD), the companion FINRA database to IARD.

Pursuant to the federal National Securities Markets Improvement Act of 1996, as amended, and the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, only certain investment advisers are eligible to be registered with the federal Securities and Exchange Commission (SEC). Generally, there are eleven categories of investment advisers that are permitted to register with the SEC. The most relied upon category is for investment advisers that have assets under management of one hundred million dollars (\$100,000,000) or more. Subject to certain limited exceptions, investment advisers registered with the SEC that are operating in North Dakota must comply with the Act's notice filing requirements.

Investment advisers operating in North Dakota that are not registered with the SEC must be registered by the Department, subject to limited exceptions.

Similarly, all investment adviser representatives with a place of business in North Dakota must be registered by the Department, subject to limited exceptions. The general rule requiring registration for investment adviser representatives holds true regardless of whether the investment adviser representative is affiliated with an SEC-registered investment adviser or a state-registered investment adviser.

The starting points for consideration of North Dakota investment adviser and investment adviser representative requirements are the definitional sections. "Investment adviser" is

defined in N.D.C.C. 10-04-02(10). “Investment adviser representative” is defined in N.D.C.C. 10-04-02(11). These definitions align closely with the definitions of these terms found in federal law.

If a person meets the definition of investment adviser or investment adviser representative under North Dakota law, the person then must look to the Act’s registration and notice filing requirements. N.D.C.C. 10-04-10(3) and N.D.C.C. 10-04-10(4) set forth the registration and notice filing requirements for investment advisers, and N.D.C.C. 10-04-10(5) sets forth the registration requirements for investment adviser representatives.

Finally, investment advisers and investment adviser representatives are subject to certain anti-fraud and conduct standards. These standards are found primarily in N.D.C.C. 10-04-10.1, 10-04-10.3 and 10-04-15.

Violations of the Securities Act may result in civil penalties of up to \$10,000 per violation. Additionally, any willful violation of the Act, or any rule or order of the Commissioner made thereunder, is a class B felony. Consequently, the Department urges investment advisers and investment adviser representatives to take their compliance responsibilities seriously.

All references to the North Dakota Century Code can be reviewed on the North Dakota Securities Department website at www.securities.nd.gov.

PART 1 – REGISTRATION – APPLICATIONS, RENEWALS, TERMINATION

INVESTMENT ADVISER REGISTRATION

ARE YOU AN INVESTMENT ADVISER UNDER NORTH DAKOTA LAW?

"INVESTMENT ADVISER"

The North Dakota definition of "investment adviser" is found under N.D.C.C. 10-04-02(10), and closely aligns with the federal definition (see § 202(a)(11) of the Investment Advisers Act of 1940).

In general, an investment adviser is a person who: (1) for compensation; (2) engages in the business of; (3) advising others as to the value of securities or the advisability of investing in securities.

THREE ELEMENTS

The three elements are broadly construed. The "compensation" element is satisfied by the receipt of any economic benefit by the person providing advice. The "engaged in the business" element is satisfied if any one of the following occurs: (1) the person holds themselves out as an investment adviser or as one who provides investment advice; (2) the person receives compensation that represents a clearly definable charge for providing advice about securities; or (3) the person, on anything other than rare, isolated and non-periodic instances, provides specific investment advice. Finally, as to the third element, the advice must pertain to "securities." However, in order to satisfy the "securities" element, the advice need not be about specific securities, but rather only about securities as an investment alternative.

Keep in mind that it is not necessary that a person's activities consist solely of investment advisory services to qualify as an investment adviser; the test is whether any part of the person's activities meets the three elements of "for compensation," "engaged in the business," and "regarding securities." For example, a recommendation to sell securities holdings in order to purchase a particular insurance product may satisfy the definition of an investment adviser where the insurance sale results in a commission payment.

EXCLUSIONS FROM THE DEFINITION OF “INVESTMENT ADVISER”

N.D.C.C. 10-04-02(10) excludes several classes of persons from the definition of investment adviser. These exclusions closely align with the exclusions from the federal definition of investment adviser. (See § 202(a)(11)(A)-(F) of the Investment Advisers Act of 1940). Whether an exclusion is available depends on all the relevant facts and circumstances.

HOW TO FORM AN INVESTMENT ADVISER FIRM IN NORTH DAKOTA

If you determine that you meet the definition of an Investment Adviser under North Dakota law and that you are required to be registered, you need to take steps to become registered.

- Determine the legal status of your firm. The most common structures are Corporation, Sole Proprietorship, Limited Partnership, Partnership, and Limited Liability Company. To determine the best structure for your firm, consult with an attorney or accounting professional for guidance.
- Register your firm with the North Dakota Secretary of State’s office and obtain an EIN for your firm, if applicable. Helpful sites to visit are: [ND Secretary of State](#) website and www.irs.gov.
- Establish that your firm has a representative that meets minimum competency requirements. Investment adviser representative registration requirements are discussed later in this guide.
- Establish an IARD account, through FINRA’s Web IARD at: www.iard.com/accessIARD.asp. IA firms must utilize this site for registration and fund the payments for registration and future renewals. IARD Gateway Call Center representatives can be reached at 240-386-4848.
- Applications for registration must be submitted electronically using the IARD system. Create and file on the IARD system the Form ADV Parts 1A and 1B, Parts 2A and 2B, and wrap fee brochure, if applicable. These documents make up your firm’s application. The Form ADV in its entirety as well as the instructions and glossary are available at: www.sec.gov/about/forms/formadv.pdf.
- Pay the applicable registration fees for your firm and all investment adviser representatives as prescribed in N.D.C.C. 10-04-10(8).
- Create your firm’s compliance manuals, policies and procedures, business continuity plan and investment advisory agreement. These requirements are discussed in more detail in the Compliance Manual section of this guide. It is strongly recommended that investment adviser firms implement cybersecurity policies and procedures as well.

- Install your initial recordkeeping procedures, including your accounting records that you will use for creating the required financial statements. These requirements are discussed in the Books and Records section of this guide.
- Once you have filed your initial application material on the IARD, the Department will conduct a Pre-Registration Examination. The exam will require that certain documents be provided.

INVESTMENT ADVISER BRANCH OFFICES

There are no Form BR or fee filing requirements for separate North Dakota branch offices of a North Dakota registered investment adviser.

ESTABLISHING AN INVESTMENT ADVISER FIRM AS A SOLE PROPRIETOR

A sole proprietor investment adviser must pass required qualifying examinations and register as an investment adviser representative. See the Qualifying Examinations section below.

APPLICATION REVIEW PROCESS – APPROVAL OR DENIAL

Failure to answer all questions on the appropriate forms, and failure to provide all required information will delay the Department's review of an application. The Department may terminate an application with unresolved deficiencies that remains pending for more than 180 days.

Pursuant to 10-04-10(3), the Department may require any additional information as it deems necessary in consideration of the application.

If the Commissioner has reason to believe there are grounds to refuse the approval of an application, the Commissioner may, by order, summarily postpone the approval of the application. The applicant may, within 15 days, either withdraw the application, or, pursuant to N.D.C.C. 10-04-12, request an administrative hearing. Failure to withdraw the application or request a hearing within 15 days will result in the issuance by the Commissioner of a final order to deny the application.

INVESTMENT ADVISER REPRESENTATIVE (IAR) REGISTRATION

ARE YOU AN INVESTMENT ADVISER REPRESENTATIVE UNDER NORTH DAKOTA LAW?

The definition of "investment adviser representative" is found in N.D.C.C. 10-04-02(11) and aligns closely with the federal definition (See Investment Adviser Act Rule 203A-3(a)).

An investment adviser representative is an individual who is employed by or associated with an investment adviser firm, and: (1) makes any recommendations or otherwise renders advice regarding securities directly to advisory clients; (2) manages the accounts or portfolios of clients; (3) determines which recommendations or advice regarding securities should be given; (4) provides investment advice or holds out as providing investment advice, receives compensation to solicit, offer, or negotiate for the sale of or sells investment advisory services; or (5) immediately supervises employees in the performance of any of the foregoing.

HOW DO I APPLY TO BE AN IAR IN NORTH DAKOTA?

Under N.D.C.C. 10-04-10(5) an application for an investment adviser representative registration shall consist of:

- A completed Form U-4 filed through the IARD
- Successful completion of qualifying examination requirements
- Payment of the registration fee under 10-04-10(8)

<i>Annual Cost Table</i>	North Dakota Registration Fee	IARD System User Fee	Total
<i>Investment Adviser Firm</i>	\$100	-0-	\$100
<i>Investment Adviser Representative</i>	\$ 50	\$15	\$65

FINGERPRINTING REQUIREMENT

Investment adviser representatives are not currently required to be fingerprinted when applying for registration.

INVESTMENT ADVISER REPRESENTATIVES QUALIFYING EXAMINATIONS

A sole proprietor investment adviser or an individual representing an investment adviser or federal covered adviser seeking registration as an investment adviser representative in North Dakota must have a passing score on the following examinations:

- [Series 65](#) - Uniform Investment Adviser Law Exam (as modified on January 1, 2000), a North American Securities Administrators Association (NASAA) exam administered by FINRA; **or**
- Securities Industry Essentials (SIE) Exam; [Series 7](#) - General Securities Representative Exam (as revised on October 1, 2018), and [Series 66](#) - Uniform Combined State Law Exam (as modified on January 1, 2000).

PROFESSIONAL DESIGNATIONS - QUALIFYING EXAMINATIONS WAIVER

As an alternative to the qualifying examinations requirement, an applicant may qualify for registration with the Department by providing verification that they are in good standing with the organization that issues credentials for one of the following designations:

- Certified Financial Planner;
- Chartered Financial Analyst;
- Chartered Investment Counselor;
- Chartered Financial Consultant; and
- Certified Public Accountant with a Personal Financial Specialist designation.

An applicant who is not affiliated with a FINRA-registered securities dealer may register for the Series 63, Series 65, or Series 66 by submitting to FINRA a completed Form U-10, Uniform Examination Request for Non-FINRA Candidates. These examinations are administered by NASAA (North American Securities Administrators Association). For information about registration, scheduling, and study guides, visit their website: www.nasaa.org

CONTINUING EDUCATION REQUIREMENT

On October 10, 2023, North Dakota Securities Commissioner Karen Tyler signed an Order setting forth continuing education (CE) requirements for investment adviser representatives (IARs). Pursuant to the Commissioner's authority under 10-04-03(2), the Order implements the continuing education requirements set forth in statute under 10-04-10(5). IARs must take and report CE credits beginning in 2024.

This continuing education requirement represents the culmination of years of work by the North American Securities Administrators Association (NASAA), its members (state securities regulators), and industry to develop a relevant and responsive IAR continuing education program. This CE program will promote heightened regulatory compliance while also helping investment adviser representatives better serve their clients by remaining knowledgeable of current regulatory requirements and best practices.

IAR CE REQUIREMENTS

Each IAR will need to complete 12 CE credits each year to maintain their IAR registration. The 12 credits must include six credits of Products and Practices and six credits of Ethics and Professional Responsibility. The mandatory CE program will apply to all registered IARs of both state-registered and federal covered investment advisers. IARs will self-manage selecting and completing courses, which will enable them to tailor their CE to their interests and business models. Courses are offered by NASAA approved course providers, which can be found on [NASAA's website](#).

APPLICATION REVIEW PROCESS – APPROVAL AND DENIAL

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Pursuant to 10-04-10(5) the Department may require any additional information it deems necessary in consideration of an application.

If the Commissioner has reason to believe there are grounds to refuse the approval of an application, the Commissioner may, by order, summarily postpone the approval of the application. The applicant may, within 15 days, either withdraw the application or, pursuant to N.D.C.C. 10-04-12, request an administrative hearing. Failure to withdraw the application or request a hearing within 15 days will result in the issuance by the Commissioner of a final order to deny the application.

RENEWAL AND EXPIRATION OF REGISTRATION

All investment adviser and investment adviser representative registrations expire on December 31st each year unless they are renewed through the Web IARD/CRD. All investment advisers must renew the firm and their investment adviser representatives' registrations through the Web IARD/CRD.

A preliminary renewal statement is made available to each firm online in Web IARD/CRD in mid-November each year. The firm's renewal account must be funded for the entire preliminary renewal statement amount, regardless of whether there are additions or deletions in the number of investment adviser representatives, in order for the firm and their investment adviser representatives to be renewed. Failure to fund the renewal account with the entire amount of the preliminary renewal account statement will result in the firm and its investment adviser representatives being terminated. The renewal account must be funded prior to Web IARD/CRD shutdown in mid to late December. All renewals must be managed through Web IARD/CRD. **The North Dakota Securities Department cannot accept direct payments.**

All registrations not renewed by the deadline will terminate as a matter of law – there are no grace periods. Investment advisers and investment adviser representatives that “fail to renew” must re-apply with the Department.

HOW TO TERMINATE A REGISTRATION – DISCONTINUING BUSINESS

A notice of withdrawal from registration shall be filed with the Department via the IARD on Form ADV-W in accordance with its instructions. The withdrawal will not become effective until approved by the Department.

An investment adviser discontinuing business shall arrange for and be responsible for the preservation of the records in compliance with the North Dakota Securities Act for a period of three years after the firm ceases doing business. The IA should include on the Form ADV-W the exact address where the books and records will be maintained during such period.

Investment adviser representatives licensed with the terminating firm should have a Form U5 filed on their behalf.

PART 2 - COMPLIANCE OBLIGATIONS

BOOKS AND RECORDS

North Dakota Century Code 10-04-10.3(c)

The following books and records must be maintained in true and accurate form by every investment adviser that maintains its principal place of business in North Dakota and is registered with the Department.

- 1) Financial documents of the investment adviser which shall include:
 - a. Journals and ledgers tracking income and expenses of the investment adviser. These documents must be continually maintained to within 30 days of current.
 - b. Trial balances, financial statements, and internal audit papers.
 - c. Checkbooks and statements on any type of account on which the investment adviser has check-writing privileges.
 - d. Statements regarding any account of the investment adviser with any insurance company, broker-dealer, investment adviser, federal covered adviser, or financial institution.
- 2) A record of all incoming and outgoing correspondence between the investment adviser or its representative and any of its customers, prospective customers, or former customers. Correspondence shall include all writings in any form, including but not limited to text messages, direct messaging, emails, and email attachments.
- 3) A record of each customer complaint against the investment adviser or a representative of the investment adviser.
- 4) A record of all advertisements used by the investment adviser or a representative of the investment adviser. To the extent that past performance of the investment adviser is used in advertising materials, the investment adviser shall maintain all accounts, records, and internal working papers that form the basis of the performance of the investment adviser, pursuant to 10-04-10.3(1)(c)(4).
- 5) Copies of all contracts between the investment adviser and its customers.
- 6) A manual regarding the supervisory procedures of the investment adviser, unless the investment adviser is wholly owned by the only representative of the investment adviser and the investment adviser has no employees.
- 7) With respect to discretionary accounts:

- a. A list of all discretionary accounts.
 - b. A record of all discretionary trading agreements.
 - c. A list of all trades that were conducted on a discretionary basis.
- 8) All records created by the investment adviser or provided by a client or prospective client of an investment adviser regarding the financial condition of the client or prospective client.
 - 9) Records tracking all securities purchased by or advice provided by the investment adviser and the payment for the services if any. These records shall disclose whether the investment adviser or the investment adviser representative had any direct or indirect beneficial interest in the investment involved.
 - 10) An updated copy of parts 2A and 2B of the form ADV and a summary of all material updates to the same. See the Brochure Rule section below.
 - 11) A list of all parties to whom referral fees have been paid and the amount of money paid to each such person.
 - 12) A record containing the date of receipt and date of transmission of all customer funds provided to the investment adviser for the purpose of deposit with the custodian of the investment adviser.

FIDUCIARY DUTY RECORDS

Advisers have a fiduciary duty to act in the best interests of clients and to disclose actual or potential conflicts of interest. Some specific obligations resulting from this fiduciary duty are:

- A duty to employ reasonable care to avoid misleading clients;
- A duty to have a reasonable independent basis for investment advice;
- A duty to ensure that investment advice is suitable; and
- A duty to obtain best execution of client transactions.

This duty requires advisers to make a reasonable inquiry as to the investment objectives, financial situation, needs, and other relevant information necessary to make recommendations that are in the client's best interest.

The Department strongly encourages advisers obtaining clients' **Trusted Contact Authorizations** as a best practice. This should be separate (although may be similar) to any Trusted Contact Authorizations executed between the client and third parties (e.g., your custodian). A client's Trusted Contact Authorization may be used if the adviser has questions or concerns about the client's health (capacity and well-being) or welfare (financial exploitation),

or if the adviser is unable to contact the client. The adviser would then be legally permitted to speak with the person(s) listed about the client. The Trusted Contact Authorization should be signed by the client and updated as needed. While there is no prescribed format for a Trusted Contact Authorization, advisers may wish to refer to [FINRA's template](#) while customizing their own.

RETENTION PERIOD OF BOOKS AND RECORDS

All books and records required to be made shall be maintained and preserved in an easily accessible place for a period of no less than three years from the end of the fiscal year during which the last entry was made on the record. The first two years must be maintained in an appropriate office of the investment adviser.

ELECTRONIC STORAGE

The records required to be maintained and preserved may be maintained and preserved electronically, however the investment adviser must arrange and index the records in a way that permits easy location, access and retrieval of the record and must be able to promptly provide legible true and complete copies when requested by the Department. The Department permits advisers to maintain records exclusively with third parties (e.g. cloud storage); however, it is the ultimate responsibility of the investment adviser to comply with all aspects of the record retention rules.

BOOKS AND RECORDS SHOULD BE KEPT CURRENT

Each investment adviser registered with the Department shall make and keep true, accurate and current books and records relating to its advisory business. Records must be created at the time of or in proximity to the entry, action, or occurrence.

As part of the requirement to keep books and records current, all changes to the ADV must be made promptly. As a reminder:

- Solicitors should always have the most updated version of an adviser's Form ADV.
- All referenced links to the Form ADV (i.e. on a website or within a publication) should be to the most updated version.
- All links and information provided on an adviser's website and other social media must be kept current and all links must be tested for accuracy.

THE BROCHURE RULE - FORM ADV (PARTS 1 AND 2)

FORM ADV PART 1

Part 1 of Form ADV is required to be updated within 90 days AFTER the end of your fiscal year. In addition to your annual updating amendment, you must amend your Form ADV Part 1, including corresponding sections of Schedules A, B, C, and D, by filing additional amendments promptly if:

- Information you provided in response to Items 1, 3, 9 (except 9.A.(2), 9.B.(2), 9.E., and 9.F.), or 11 of Part 1A or Items 1, 2.A. through 2.F., or 2.I. of Part 1B becomes inaccurate in any way; or
- Information you provided in response to Items 4, 8, or 10 of Part 1A or Item 2.G. of Part 1B becomes materially inaccurate.

Instructions for completing Form ADV Parts 1 & 2 can be found on the [SEC's website](#).

FORM ADV PARTS 2 A AND B

(a/k/a "brochure" or "disclosure document" and "brochure supplement")

Every investment adviser is required to deliver to each client and prospective client a written disclosure document, describing the investment adviser's business practices, education, and business background.

An investment adviser shall follow all current instructions to the Form ADV issued by the Securities and Exchange Commission with regard to the completion, filing, delivery, and updating of the form ADV Part 2A (Brochure Statement) and Form ADV Part 2B (Brochure Supplement). A general summary is as follows:

PROVIDE YOUR BROCHURE

You must provide a brochure to each client before or at the time you enter into an advisory agreement. Evidence of providing the brochure is required. This evidence can be in the form of a signed receipt, or language can be made as part of the client contract.

UPDATE YOUR BROCHURE

Update your brochure each year at the time you file your annual updating amendment on the IARD system. The amount of client assets under management and fee schedule should be updated at this time. Item 2, Material Changes, should also be updated by clearly indicating

that you are including only material changes since the last annual update of your brochure. You must then provide the date of the last annual update of your brochure. If there are no material changes since your last update, you should state that there are no material changes. Please note that you must maintain each update in your files.

FILE YOUR BROCHURE

File your brochure through the IARD annually within 90 days of the end of your fiscal year. However, if information in your brochure becomes materially inaccurate, you must update it promptly. A change in assets under management is not considered material for purposes of this requirement.

ANNUAL DELIVERY

Each year you must either deliver within 120 days of your fiscal year-end your brochure to each client, that either includes or is accompanied by a summary of material changes (Item 2), OR you must provide a summary of material changes and offer your clients the brochure if they are interested. **If you do not have any material changes:** You do not have to deliver or offer the brochure to your clients annually.

INTERIM DELIVERY

If any information in response to Item 9 of Part 2A (disciplinary information) changes, you are required to deliver an interim amended brochure statement to clients. An interim amendment can be in the form of a document describing the material facts relating to the amended disciplinary event.

MATERIAL CHANGES

Depending on the facts and circumstances, examples of material changes may include, but are not limited to:

- Change of address/location or contact information (e.g., phone number, email),
- New owners of investment adviser entity,
- Significant change in services offered,
- New potential conflict of interest,
- A new fee schedule,
- Changes in disciplinary history,
- Changes in the custodian or broker used, and/or
- Changes in licensing status with the SEC or state(s).

WRAP FEE PROGRAM DISCLOSURES

For advisers offering a wrap fee program, all current instructions to the Form ADV issued by the SEC regarding the completion, filing, delivery, and updating of the Form ADV Part 2A, will apply.

PREPARING A WRAP FEE PROGRAM BROCHURE

If you sponsor a wrap fee program, you must prepare a wrap fee program brochure. If you sponsor more than one wrap fee program, you may prepare a single wrap fee program brochure describing all the programs or you may prepare separate brochures for each program. If you provide advisory services outside of a wrap fee program, you must prepare a separate brochure for those advisory services. If a wrap fee program that you sponsor has multiple sponsors, and another sponsor creates and delivers to your wrap fee program clients a brochure that includes all the required information, you do not have to create or deliver a separate wrap fee program brochure.

PROVIDE WRAP FEE PROGRAM BROCHURE TO EACH CLIENT

You must give a wrap fee program brochure to each client of the wrap fee program before or at the time the client enters into a wrap fee program contract. Evidence of providing such is required. This evidence can be in the form of a signed receipt, or language can be made as part of the client contract.

UPDATE YOUR WRAP FEE PROGRAM BROCHURE ANNUALLY

Update your wrap fee program brochure each year at the time you file your annual updating amendment on the IARD system and otherwise promptly whenever any information in the wrap fee program brochure becomes materially inaccurate.

FILE YOUR WRAP FEE PROGRAM BROCHURE ANNUALLY

File your wrap fee program brochure through the IARD annually within 90 days of the end of your fiscal year. However, if information in your wrap fee program brochure becomes materially inaccurate, you must update it promptly.

ANNUAL DELIVERY

Each year you must either deliver within 120 days of your fiscal year-end your wrap fee program brochure to each client, that either includes or is accompanied by a summary of material changes (Item 2), OR you must provide a summary of material changes and offer your wrap fee program brochure.

INTERIM DELIVERY

If any information in response to Item 9 of Part 2A (disciplinary information) changes, you are required to provide an interim update of your wrap fee program brochure to your wrap fee clients.

*NOTE: An IA with both wrap fee and non-wrap fee clients will have to deliver updated brochures to each type of client.

ADVERTISING

North Dakota Century Code 10-04-08.2, 10-04-10.1, 10-04-10.3

Advertising includes any circular, prospectus, advertisement, form or market letter, report, document, pamphlet, leaflet, script, or other written or printed matter, or any communication by radio, television, or similar communications media, or any other communication by electronic means including but not limited to email, the Internet, and social media platforms, which are disseminated to more than one person, used in connection with the offer, sale, or rendering investment advice with respect to any security in this state.

An advertisement may **NOT**:

- Use or refer to testimonials (which include any statement of a client's experience or endorsement),
- Refer to past, specific recommendations made by the adviser that were profitable, unless the advertisement sets out a list of all recommendations made by the adviser within the preceding period of not less than one year, and complies with other, specified conditions,
- Represent that any graph, chart, formula, or other device can, in and of itself, be used to determine which securities to buy or sell, or when to buy or sell such securities, or can assist persons in making those decisions, unless the advertisement prominently discloses the limitations thereof and the difficulties regarding its use, or represent that any report, analysis, or other service will be provided without charge unless the report, analysis or other service will be provided without any obligation whatsoever.

PERFORMANCE ADVERTISING

North Dakota Century Code 10-04-10.1, 10-04-10.3(c)(4)

Consistent with the position taken by the Securities and Exchange Commission, the Department takes the position that an adviser may advertise its past performance (both actual performance and hypothetical or model results), only if the advertisement meets certain conditions and restrictions. An advertisement using performance data must disclose all material facts necessary to avoid any unwarranted inference.

Among other things, an adviser **may not** advertise its performance data if the adviser:

- Fails to disclose the effect of material market or economic conditions on the results portrayed (e.g., an advertisement stating that the accounts of the adviser's clients appreciated in value 25% without disclosing that the market generally appreciated 40% during the same period).
- Includes model or actual results that do not reflect the deduction of advisory fees, brokerage or other commissions, and any other expenses that a client paid or would have paid.
- Fails to disclose whether and to what extent the results portrayed reflect the reinvestment of dividends and other earnings.
- Suggests or makes claims about the potential for profit without also disclosing the possibility of loss.
- Compares model or actual results to an index without disclosing all material facts relevant to the comparison (e.g. an advertisement that compares model results to an index without disclosing that the volatility of the index is materially different from that of the model portfolio).
- Fails to disclose any material conditions, objectives, or investment strategies used to obtain the results portrayed (e.g. the model portfolio contains equity stocks that are managed with a view towards capital appreciation).
- Fails to prominently disclose the limitations inherent in model results, particularly the fact that such results do not represent actual trading and that they may not reflect the impact that material economic and market factors might have had on the adviser's decision-making if the adviser were actually managing clients' money.
- Fails to disclose, if applicable, that the conditions, objectives, or investment strategies of the model portfolio changed materially during the time period portrayed in the advertisement and, if so, the effect of any such change on the results portrayed.

- Fails to disclose, if applicable, that any of the securities contained in, or the investment strategies followed with respect to, the model portfolio do not relate, or only partially relate, to the type of advisory services currently offered by the adviser (e.g., the model includes some types of securities that the adviser no longer recommends for its clients).
- Fails to disclose, if applicable, that the adviser's clients had investment results materially different from the results portrayed in the model.
- Fails to prominently disclose, if applicable, that the results portrayed relate only to a select group of the adviser's clients, the basis on which the selection was made, and the effect of this practice on the results portrayed, if material.

AN ADVISER MUST CREATE AND RETAIN ALL DOCUMENTS NECESSARY TO SUBSTANTIATE ANY PERFORMANCE INFORMATION CONTAINED IN ADVERTISEMENTS OR COMMUNICATIONS.

CLIENT CONTRACTS

North Dakota Century Code 10-04-10.1(5), 10-04-10.3(c)(5)

- All advisory contracts shall be in writing and signed and dated by the client and the adviser.
- The contract should clearly state that the contract may not be assigned without the client's consent. Assignment generally includes any direct or indirect transfer of an investment advisory contract by the investment adviser to another adviser, entity, or firm. A transaction that does not result in a change of actual control or management of the investment adviser (e.g. a reorganization for purposes of changing an adviser's state of incorporation), would not be deemed to be an assignment for these purposes.
- If an investment adviser is organized as a partnership, the advisory contract must provide that the adviser will notify the client of a change in its partnership makeup.
- The investment adviser shall provide written notice to the client within 15 days of any change of ownership in excess of five percent.
- If client fees are pre-paid, the contract should contain a provision for the pro rata refund of fees if the contract is terminated.

If the adviser has trading authority but does not have discretionary authority, it is recommended that the adviser contract include language that the adviser cannot trade without prior approval of the customer.

The adviser must maintain copies of all contracts between the adviser and its clients.

SUPERVISION AND COMPLIANCE MANUAL

North Dakota Century Code 10-04-10.3(c)(6)

Every investment adviser registered by the Department shall reasonably supervise its investment adviser representatives and other persons employed or associated with the investment adviser.

Part of the supervision obligation requires the investment adviser to adopt and implement written policies and procedures reasonably designed to prevent violations by the adviser and its supervised persons. These written policies and procedures are often referred to as the adviser's "compliance manual."

Compliance considerations must be relevant to the operations of the adviser, and not simply an "off the shelf" version adopted without modifications tailored to the activities of the adviser.

In connection with adopting and implementing the written compliance program, an adviser must designate a person, who is a supervised person, as the "Chief Compliance Officer" ("CCO") responsible for administering the program.

The CCO should establish procedures for those they supervise to:

- prevent violations from occurring;
- detect violations that have occurred; and
- promptly correct any violations that have occurred.

COMPLIANCE MANUAL

The Department recommends an investment adviser review, no less frequently than **annually**, the adequacy of the policies and procedures and their effectiveness. In addition, the Department recommends documentation of the review and receipt of the policy manual by employees.

Investment advisers registered with the Department have an obligation to establish, maintain, and enforce written policies and procedures reasonably designed to prevent and detect any violation by its investment adviser representatives or other persons, employed by or associated with, the investment adviser. While the Department cannot provide a compliance manual template, the following is a list of the most common fiduciary and regulatory obligations of an adviser that should be addressed in the firm's written compliance program, where applicable:

CORRESPONDENCE/COMMUNICATIONS

- Establish policies regarding if/when internal approvals will be required prior to use of any client correspondence or communications
- Document how client correspondence and communications will be retained
- Correspondence/communications includes all written and recordable formats (letters, emails, text messages, video messages, etc.)

CONFLICTS OF INTEREST

- Identify potential risks
- Establish policies addressing how the adviser will address these risks

REGISTRATION AND LICENSING

- Keep the Form ADV current – must be reviewed and updated no less than annually
- IARD Entitlement and personnel responsible for all IARD duties
- IA Registration – maintain compliance with registration requirements in North Dakota and other states, when necessary
- IAR Registration – who is required to be registered as an Investment Adviser Representative

BOOKS AND RECORDS

- List the firm's required records
- Identify who maintains the records, how, and where – including off-site storage
- Manner in which records are secured from unauthorized alteration or use
- Retention and destruction of records
- Maintaining and preserving electronic records and safeguarding them from loss

DISCLOSURE

- Brochure Rule, Form ADV – how it's offered originally and annually
- Form U4 disclosures

- Client referral arrangements
- The accuracy of disclosures made to investors, clients, and regulators, including account statements and advertisements

TRADING PRACTICES

- Best execution
- Policies on when the adviser can trade in stocks recommended to clients
- Guidelines on whether IARs need to trade with a certain broker- dealer
- Soft dollar arrangements
- Batch trading (aggregation of orders)
- Proprietary trading of the adviser and personal trading activities of supervised persons
- Trade errors

PRIVACY POLICY

- The sharing of client information with others
- Office personnel having access to files/computer
- Establish safeguards for confidential personal information

PORTFOLIO MANAGEMENT PROCESSES

- The allocation of investment opportunities among clients
- The consistency of portfolios with clients' investment objectives
- Disclosures by the adviser, and applicable regulatory restrictions

MANDATORY REPORTING REQUIREMENTS – SENIOR FINANCIAL EXPLOITATION LEGISLATION

North Dakota Century Code 10-04-08.5 - Financial Exploitation Vulnerable Adult went into effect August 1, 2017.

- Requiring all "qualified individuals" which includes investment adviser representatives and supervisory, compliance, and legal personnel of an investment adviser who have "reasonable cause to believe" that an adult is being financially exploited to notify the Commissioner and the Department of Health and Human Services.
- Policies and procedures of your firm shall incorporate this requirement and must include a detailed process for how your firm will document compliance.

MARKETING/ADVERTISING

- Required internal approval prior to use
- Use of social media, website, blogs, posts (etc.)
- The use of solicitors – solicitors must be registered
- Record retention

FEES

- Processes to value client holdings
- Disclosure
- Refunds

BUSINESS CONTINUITY AND DISASTER RECOVERY PLANS

- Recovery of books and records
- Alternate means of communications with customers, employees, service providers (including third-party custodians), and regulators
- Office relocation due to unavailability of office
- Death or incapacity of principal(s)

CUSTODY

- Under North Dakota Century Code 10-04-10.1(6) Custody IS NOT ALLOWED, with the exception of certain limited circumstances if the adviser is acting in a fiduciary capacity as an executor, guardian, conservator, receiver, or trustee.

COMPLAINTS

- How they are handled (procedures for reporting and addressing)
- How related records are maintained

COMPUTER AND CYBERSECURITY

- Anti-virus – installation, updates
- Preservation of the records from loss, alteration, destruction (use of back-ups)
- Encryption
- Secure emails
- Dissemination of client information
- Inventory of hardware
- Passwords
- Procedures for lost or stolen data/information

- Customer access via web portals

INSIDER TRADING

- Prevention of the misuse of material, nonpublic information

CYBERSECURITY AND BEST PRACTICES

Disclaimer: The information provided herein is for your convenience only, is illustrative, and is not intended as legal advice.

In response to the growing number of cybersecurity deficiencies found through a NASAA coordinated examination of investment advisers throughout North America, the Department is providing the following Cybersecurity Checklist for Investment Advisers (Issued: 2017). This checklist is only a tool to help investment advisers:

- Identify risks,
- Protect electronic mail,
- Protect devices for backups and retention,
- Protect the use of cloud services,
- Protect the firm websites,
- Protect custodian and other third-party vendors,
- Protect encryption,
- Detect anti-virus protection and firewalls,
- Respond to a cyber event,
- Recover with cyber insurance, and
- Disaster recovery.

[VIEW THE CYBERSECURITY CHECKLIST FOR INVESTMENT ADVISERS HERE.](#)

CUSTODY

Under North Dakota Century Code 10-04-10.1(6) **custody IS NOT ALLOWED**, with the exception of certain limited circumstances in which the adviser is acting in a fiduciary capacity as an executor, guardian, conservator, receiver, or trustee.

“Custody” means holding directly or indirectly, client funds or securities, or having any authority to obtain possession of them, or having the ability to appropriate them. Custody is triggered any time an adviser acts in a capacity that gives the adviser legal ownership of, or access to, client funds or securities.

An investment adviser has custody if a related person holds, directly or indirectly, client funds or securities, or has any authority to obtain possession of them, in connection with advisory services the investment adviser provides to clients.

Custody includes:

- Possession of client funds or securities unless the investment adviser receives them inadvertently and returns them to the sender promptly, but in any case within three business days of receiving them.
- Any arrangement (including a general power of attorney) under which the investment adviser is authorized or permitted to withdraw client funds or securities maintained with a custodian upon the investment adviser’s instruction to the custodian.
- Any capacity (such as general partner of a limited partnership, managing member of a limited liability company or a comparable position for another type of pooled investment vehicle, or trustee of a trust) that gives the investment adviser or its supervised person legal ownership of or access to client funds or securities.
- Receipt of checks drawn by clients and made payable to third parties will not be considered custody if forwarded to the third party within three business days of receipt and appropriate records are maintained.
- An adviser has custody any time it physically holds client stock certificates, bonds or cash – even if temporarily.

- Authorization to sign checks on a client's behalf to withdraw funds or securities from a client's account or to dispose of client funds or securities for any purpose other than authorized trading.
- Authorization to deduct advisory fees or other expenses directly from a client's account
- An investment adviser possessing a general power of attorney for a client.

FEES

Investment advisers and investment adviser representatives must disclose to clients all material information regarding compensation. This includes providing accurate fee schedules, disclosing when fees will be charged, and how clients will be billed.

UNREASONABLE OR UNEARNED FEES

Depending on the facts and circumstances, the Department may consider advisory fees to be unreasonable or unearned, and a breach of the adviser's fiduciary duty. The Department may consider whether advisory fees are unreasonable in relation to: (1) the complexity and nature of the services provided for which the fee was charged; (2) the fees charged by other investment advisers or investment adviser representatives for similar services in the geographic area; and (3) the likelihood that the services provided by the investment adviser or investment adviser representative will result in returns in excess of the fees charged.

MINIMUM FEES

If minimum fees are charged, the adviser has a fiduciary obligation to ensure that fees for small accounts are not abusive. Assessing a minimum fee on a small account may be unreasonable.

REFUNDING FEES FOR TERMINATED ACCOUNTS

If fees are paid in advance the investment adviser should also disclose its refund policy. A non-refundable feature goes against an investment adviser's fiduciary responsibility. An advisory contract must provide in substance for a pro rata refund of a prepaid advisory fee.

PERFORMANCE FEES

North Dakota Century Code 10-04-10.1(5)(a)

An investment adviser may not be compensated on the basis of a share of capital gains, earnings, or capital appreciation of the funds or any portion of the funds of the client. This does not prohibit an investment advisory contract that provides for compensation based on the total value of a fund determined as of a definite date or averaged as of definite dates or over a definite period. An investment advisory contract may provide for performance fees that are permitted and determined in accordance with section 205 of the Investment Advisers Act of 1940.

WRAP FEE PROGRAM

DESCRIPTION

In a wrap fee program, a client pays a single fee (usually measured as a percentage of assets under management) for a group of services that are bundled, or “wrapped” together. Typically, the services include investment advice, brokerage, custodial services, and other administrative functions. Generally, a wrap fee program is an arrangement in which a client is charged a specified fee or fees, not based directly on transactions in the client’s account, for investment advisory services and execution of transactions.

SPONSOR

A wrap fee program is offered by a program “sponsor,” which may be broker-dealer, an investment adviser, bank, or other financial institution. A wrap fee sponsor typically is subject to regulation as an investment adviser. Normally a client enters into a contract directly with the sponsor, and a sponsor has specific disclosure obligations.

PORTFOLIO MANAGER

After contracting with the sponsor, the typical wrap fee program permits the client to choose a portfolio manager from a list provided by the sponsor. This permits a client with a smaller account that might not warrant separate management by an investment adviser to obtain individualized treatment. Typically, the portfolio manager will have investment discretion in accordance with pre-determined investment objectives. As a result, clients with the same investment objectives receive the same investment advice and may hold the same, or substantially the same, securities in their accounts. In light of this similarity of management, a wrap fee program can effectively function like a mutual fund.

An investment adviser registered or required to be registered by the Department, that is compensated under a wrap fee program for sponsoring, organizing, or administering the program, or for selecting, or providing advice to clients regarding the selection of other investment advisers in the program, must furnish each client and prospective client of the wrap fee program with a written disclosure statement ADV Part 2A, Appendix 1.

WRAP FEE STATEMENT

An investment adviser that is required to furnish a wrap fee statement must furnish the wrap fee statement to each client at the time they enter into the agreement with the investment adviser. An investment adviser's fiduciary duty extends to wrap fee program recommendations. In particular, an investment adviser sponsor of a wrap fee program should consider at least the following issues:

- Whether the portfolio manager is suitable for the client;
- Whether the program is suitable for the client; and
- Whether the chosen strategy is suitable for the client.

FIDUCIARY STANDARD

Investment advisers and IARs stand in a fiduciary relationship with their clients. This duty is a long-standing doctrine of both federal and state common law. As fiduciaries, advisers have "an affirmative duty of utmost good faith and full and fair disclosure of all material facts." (See *Transamerica Mortg. Adv. Inc. v. Lewis*, 444 U.S. 11, 17 (1979)). In addition, an adviser has the duty to act in the best interest of their clients and to disclose all material information about actual or potential conflicts of interest. Specifically, an adviser or IAR has a duty to:

- employ reasonable care to avoid misleading clients;
- have a reasonable independent basis for investment advice;
- ensure that investment advice is suitable; and
- obtain "best execution" of client transactions.

With regard to suitability of investment advice in particular, the Department will expect to see current documentation demonstrating how the investment advice is suitable for the client, taking into consideration the client's financial situation, investment experience, and investment objectives.

SOLICITORS AND REFERRAL FEES

North Dakota Century 10-04-02(11)(a)(4)

Generally, a solicitor is any person who, for compensation, directly or indirectly, solicits any client for, or refers any client to, an investment adviser or investment adviser representative. There is no registration exemption or safe harbor for solicitors under North Dakota law. The definition of "investment adviser representative" includes any individual who provides investment advice or holds out as providing investment advice, or receives compensation to solicit, offer, or negotiate for the sale of or sells investment advisory services.

BEST EXECUTION AND SOFT DOLLARS

As a fiduciary, an adviser has an obligation to obtain "best execution" of clients' transactions. In meeting this obligation, an adviser must execute securities transactions for clients in such a manner that the client's total cost or proceeds in each transaction are the most favorable under the circumstances.

In assessing whether this standard is met, an adviser should consider the full range and quality of a broker's services when placing brokerage orders, including, among other things, execution capability, commission rate, financial responsibility, responsiveness to the adviser, and the value of any research services provided.

An investment adviser must keep in mind the fiduciary obligation of best price and best execution when considering these factors.

When an investment adviser causes an account to pay more than the lowest available commission to a broker-dealer in return for research products and services, these payments are commonly referred to as "soft dollars." Federal law contains a "safe harbor" for certain soft dollar payments in section 28(e) of the Securities Exchange Act of 1934, and the Department recognizes this safe harbor for state registered investment advisers operating in North Dakota. This safe harbor protects an adviser from claims for breach of fiduciary duty based solely on the fact that the adviser paid more than the lowest available commission rate if the adviser, in good faith, determined that the higher commission was reasonable in relation to the value of

the brokerage and research services provided. Section 28(e)(3) provides that brokerage and research services within the safe harbor include:

- Furnishing advice, either directly or through publications or writings, as to the value of the securities, the advisability of investing in, purchasing, or selling securities, and the availability of securities or purchasers or sellers of securities;
- Furnishing analyses and reports concerning issuers, industries, securities, economic factors and trends, portfolio strategy, and the performance of accounts; or
- Effecting securities transactions and performing functions incidental thereto (such as clearance, settlement, and custody) or required in connection therewith by rules of the Commission or a self-regulatory organization of which such person is a member or person associated with a member or in which such person is a participant.

The Commission has issued extensive guidance under section 28(e). See Securities Exchange Act Release No. 34-23170 (April 23, 1986). The Department takes the position that this guidance, along with section 28(e), sets out the appropriate standards to follow regarding soft dollar arrangements for all investment advisers operating in North Dakota.

AGGREGATION OF CLIENT ORDERS ("BATCH ORDERS")

In directing orders for the purchase or sale of securities to a broker-dealer for execution, an adviser may aggregate or "batch" those orders on behalf of two or more of its accounts, so long as the batching is done for purposes of achieving best execution, and no client is systematically advantaged or disadvantaged by the aggregate approach. An investment adviser may include accounts in which it or its officers or employees have an interest in a batched order. Investment advisers must have procedures in place that are designed to ensure that the trades are allocated in such a manner that all clients are treated fairly and equitably.

PRINCIPAL TRANSACTIONS AND AGENCY CROSS TRANSACTIONS

North Dakota Century Code 10-04-10.1(3)

North Dakota law prohibits an investment adviser or an investment adviser representative, acting as principal for their own account, from knowingly selling any security to or purchasing any security from a client ("principal transaction"), without notifying the client in writing, and obtaining the client's consent before the completion of the transaction. The Department shares the view of the Commission that a transaction is "completed" upon its settlement. Thus, consent must be obtained prior to execution or prior to settlement.

Notification and consent for principal transactions must be obtained separately for each transaction. However, this requirement does not apply to any investment adviser registered with the Commission, or to any transaction with a customer of a licensed dealer or salesperson who is not acting as an investment adviser or investment adviser representative in relation to the transaction.

Investment advisers registered or required to be registered by the Department, and their investment adviser representatives, may act as broker for both its advisory client and the party on the other side of the brokerage transaction ("agency cross transaction"), if the adviser first makes a written disclosure to the client of the capacity in which the person is acting and obtains the client's written consent to the transaction.

Investment advisers must uphold their duty to obtain best execution and best price for any transaction. A principal or agency cross transaction executed by an affiliate of an adviser is deemed to have been executed by the adviser for purposes of N.D.C.C. 10-04-10.1(3).

OTHER DISCLOSURE REQUIREMENTS

North Dakota Century Code 10-04-10.3

It is a violation of the Securities Act for any investment adviser, investment adviser representative or an affiliate to create or cause to be created any record that contains a material misstatement or misrepresentation regarding a customer or a customer's investments, and the investment adviser, investment adviser representative or affiliate knew or should have

known of the falsity of the information or acted in reckless disregard of the truthfulness of the information.

If the information contained in any document filed with the Department is or becomes inaccurate or incomplete in any material respect, the investment adviser must promptly file a correcting amendment.

OVERVIEW OF ANTI-FRAUD AND CONDUCT STANDARDS

Investment advisers and investment adviser representatives are fiduciaries who have an affirmative obligation of utmost good faith and full and fair disclosure, and who owe their clients undivided loyalty. Further, advisers have a duty to avoid misleading their clients, and may not engage in activity that may conflict with a client's interest without the client's consent.

Statutory anti-fraud standards are set out in N.D.C.C. 10-04-10.1 and 10-04-15(3) and generally prohibit misstatements or misleading omissions of material facts and other fraudulent acts and practices in connection with the conduct of an advisory business. These prohibitions on unlawful activity apply to all investment advisers and investment adviser representatives operating in North Dakota.

The following are some examples of conduct that may be deemed dishonest or unethical practices or are otherwise contrary to an adviser's fiduciary duty:

- Failing to disclose to their client in writing that a material conflict of interest exists;
- Misrepresenting the qualifications of the adviser or IAR;
- Borrowing or lending money or securities from or to a client;
- Making guarantees;
- Placing an order without authority to do so;
- Making a recommendation without reasonable grounds to believe the recommendation is suitable;
- Providing a report or recommendation to a client prepared by someone else without disclosing that fact;
- Charging an excessive fee;
- Failing to disclose a legal or disciplinary event that is material;

- Disclosing the identity, affairs, or investments of any client to a third party unless required by law or consented to by the client.

PART 3 – EXAMINATIONS CONDUCTED BY THE DEPARTMENT

North Dakota Century Code 10-04-10.3(4)

The Department may conduct periodic, focused, or for-cause examinations of any investment adviser or investment adviser representative, and their books, records, documents, accounts, and work papers as it deems material or relevant to the protection of investors or in the public interest. While most examinations are scheduled in advance, the Department has authority to conduct unannounced for-cause examinations of its registrants at any time it is necessary for the protection of investors or in the public interest.

ONSITE EXAMINATION PROGRAM

BEFORE THE EXAM

Investment advisers registered in North Dakota can expect an examination of the firm's books and records routinely once registered. Generally, prior to the examination date the firm will be contacted with notification that an examination is to be scheduled. This correspondence will be followed with a confirmation of the date and time of the exam and a list of records that should be readily available. Additional records may be requested by the examiner during or after the exam. It is important that you promptly notify the Department if the address is incorrect or if you cannot adhere to the scheduled date.

THE EXAM

During the examination, the examiner will spend time interviewing key personnel. The examiner will then review all the documents and information the adviser was asked to make available. Copies of some documents may be requested by the examiner for further review. If records are maintained in electronic form, electronic copies may be provided to the examiner in lieu of hard copies. However, it may be necessary and will be requested of the adviser to print or provide access for the examiner to view such records. The examiner will also be

available to answer questions but cannot provide legal advice. The length of the examination will vary depending on the focus of the exam. Key personnel must be available for the duration of the examination.

AFTER THE EXAM

Once the examination is complete, the examiner may explain what can be expected, including a deficiency letter if certain deficiencies were noted. A deficiency letter may be sent from the Department requiring the adviser to correct deficiencies and otherwise may make recommendations that the Department believes are good business practices. The adviser will be given adequate time to reply and submit corrected documents if required. Once the adviser has addressed all items in the deficiency letter, the Department will provide a closing letter.

NON-COMPLIANCE

Failure to be prepared for or co-operate with the Department's on-site examination program, as well as a failure to timely and satisfactorily respond to the Department's deficiency letter if applicable, may result in administrative action against the investment adviser and investment adviser representative's registrations, including suspension or revocation. Common compliance deficiencies are listed on page 35.

FOCUSED EXAMINATIONS

Focused exams will typically be conducted through electronic communication and will not require an on-site visit. Exam topics include, but are not limited to: ADV filings, fee calculations and billing, and suitability. The programs' exam cycle is designed to ensure that each IA will be examined in some capacity every three years. The level of exam conducted in any cycle may or may not vary depending on many factors, including prior exam findings and risk or compliance concerns.

COMMON DEFICIENCIES

This is a list of the most common compliance deficiencies identified by Department examinations:

- **FORM ADV CONSISTENCY** The description of the firm's advisory business and services in Part 1 should match the description of the advisory business and services in Part 2.
- **ANNUAL FORM ADV UPDATES** The investment adviser must annually update Form ADV within 90 days of the firm's fiscal year end. Investment advisers are required to make this annual filing on the IARD system, even if nothing about the adviser's business has changed. The Form ADV should reflect the firm's actual, not anticipated, business.
- **FAILURE TO SUBMIT IARD CHANGES** Many advisers make amendments to their ADV on the IARD system, save the changes, but then fail to SUBMIT the filing changes. Firms are reminded to select the SUBMIT button once all amendments are completed or the changes will not be available to the Department or the investing public.
- **FORM ADV, PART I, ITEM 9F** This item is commonly answered incorrectly or is misunderstood. It is important that investment advisers understand that if fees are directly deducted from client accounts, for the purposes of this question, they are considered to have custody of client assets. North Dakota law does not allow custody of client assets. *Please refer to the ADV instructions found at: www.sec.gov/about/forms/formadv.pdf.*
- **BOOKS AND RECORDS DEFICIENCIES** Investment advisers registered in North Dakota are required to make all records set forth under 10-04-10.3(c) and keep them for a period of three years.
- **COMPLIANCE MANUAL** The Department does not provide a template for a compliance manual, but expects the compliance manual to reflect all the policies and procedures that apply to the investment adviser's business. The purchase of "off the shelf" compliance manuals is acceptable as long as the manual is reviewed and amended to reflect only the items that apply to the investment adviser.
- **SUITABILITY** Investment advisers must keep client suitability related information current and updated regularly in order to uphold the adviser's fiduciary duty to their clients.

- **REFUNDS** Investment advisers may not retain unearned fees. Any fees paid in advance must be refunded. If an adviser collects fees in advance, the advisory contract must contain a provision to refund unearned fees if the client terminates the relationship.
- **DISCRETION** If an investment adviser is not granted discretion in the written advisory contract, the firm is required to obtain client approval for all trades prior to the trade being made. The adviser must establish a means of documenting this client contact and approval of securities transactions.
- **BROCHURE RULE** The ADV Part 2 requires that the investment adviser give a brochure statement to each client or potential client before or at the time they enter into an advisory agreement. Evidence of providing such is required and may be accomplished by including this obligation in the advisory contract.
- **DEFICIENCY LETTERS** The importance of responding to Department communications cannot be over-stated. Consideration will be given to reasonable requests for extensions of time to respond to records production requirements. Failure to respond to Department requests or any conduct that would otherwise impede an examination may result in an enforcement action.

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