SECTION .1800 - MISCELLANEOUS PROVISIONS - INVESTMENT ADVISERS

18 NCAC 06A .1801 DISHONEST OR UNETHICAL PRACTICES

(a) An investment adviser or an investment adviser covered under federal law is a fiduciary and has a duty to act primarily for the benefit of its clients. The provisions of this Section apply to investment advisers covered under federal law only to the extent that the conduct alleged is fraudulent or deceptive, or as otherwise permitted by the National Securities Markets Improvement Act of 1996 (Pub. L. No. 104-290). While the extent and nature of his duty varies according to the nature of the relationship between an investment adviser and its clients and the circumstances of each case, an investment adviser or an investment adviser covered under federal law shall not engage in unethical business practices, including the following:

(1) Recommending to a client to whom investment supervisory, management or consulting services are provided the purchase, sale or exchange of any security without reasonable grounds to believe that the recommendation is suitable for the client on the basis of information furnished by the client after reasonable inquiry concerning the client's investment objectives, financial situation and needs, and any other information known or acquired by the investment adviser after reasonable examination of such of the client's financial records as may be provided to the investment adviser;

(2) Placing an order to purchase or sell a security for the account of a client without authority to do so;

(3) Placing an order to purchase or sell a security for the account of a client upon instruction of a third party without first having obtained a written third-party trading authorization from the client;

(4) Exercising any discretionary authority in placing an order for the purchase or sale of securities for a client without obtaining written discretionary authority from the client within 10 business days after the date of the first transaction placed pursuant to oral discretionary authority. Discretionary power does not include a power relating solely to the price at which, or the time when, an order involving a definite amount of a specified security shall be executed, or both;

(5) Inducing trading in a client's account that is excessive in size or frequency in view of the financial resources, investment objectives and character of the account;

(6) Borrowing money or securities from a client unless the client is a dealer, an affiliate of the investment adviser, or a financial institution engaged in the business of lending funds or securities;

(7) Lending money to a client unless the investment adviser is a financial institution engaged in the business of lending funds or a dealer, or unless the client is an affiliate of the investment adviser;

(8) Misrepresenting to any advisory client, or prospective advisory client, the qualifications of the investment adviser or any employee of the investment adviser, or misrepresenting the nature of the advisory services being offered or fees to be charged for such service, or omitting to state a material fact necessary to make the statements made regarding qualifications, services or fees, in light of the circumstances under which they are made, not misleading;

(9) Providing a report or recommendation to any advisory client prepared by someone other than the adviser without disclosing that fact. (This prohibition does not apply to a situation in which the adviser uses published research reports or statistical analyses to render advice or where an adviser orders such a report in the normal course of providing service.);

(10) Charging a client an advisory fee that is unreasonable in the light of the type of services to be provided, the experience and expertise of the adviser, the sophistication and bargaining power of the client, and whether the adviser has disclosed that lower fees for comparable services may be available from other sources;

(11) Failing to disclose to a client in writing before entering into or renewing an advisory agreement with that client any material conflict of interest relating to the adviser or any of its employees which could reasonably be expected to impair the rendering of unbiased and objective advice including:

  (A) Compensation arrangements connected with advisory services to clients which are in addition to compensation from such clients for such services; and

  (B) Charging a client an advisory fee for rendering advice when a commission for executing securities transactions pursuant to such advice will be received by the adviser or its employees;

(12) Guaranteeing a client that a specific result will be achieved (gain or no loss) as a result of the advice which will be rendered;

(13) Publishing, circulating or distributing any advertisement which does not comply with Rule 206(4)-1 under the Investment Advisers Act of 1940;

(14) Disclosing the identity, affairs or investments of any client to any third party unless required by law to do so, or unless consented to by the client;

(15) Taking any action, directly or indirectly, with respect to those securities or funds in which any client has any beneficial interest, where the investment adviser has custody or possession of such securities or funds when the adviser's action is subject to and does not comply with the safekeeping requirements of Rule 206(4)-2 under the Investment Advisers Act of 1940, unless the investment adviser is exempt from such requirements by virtue of Rule 206(4)-2(b);

(16) Entering into, extending or renewing any investment advisory contract, other than a contract for impersonal advisory services, unless such contract is in writing and discloses, in substance: the services to be provided; the term of the contract; the advisory fee or the formula for computing the fee; the amount or the manner of calculation of the amount of the prepaid fee to be returned in the event of contract termination or non-performance; whether the contract grants discretionary authority to the adviser; and that no assignment of such contract shall be made by the investment adviser without the consent of the other party to the contract;

(17) Failing to disclose to any client or prospective client all material facts with respect to:

(A) A financial condition of the adviser that is reasonably likely to impair the ability of the adviser to meet contractual commitments to clients, if the adviser has discretionary authority (express or implied) or custody over such client's funds or securities, or requires prepayment of advisory fees of more than five hundred dollars ($500.00) from such client, six months or more in advance; or

(B) A legal or disciplinary event that is material to an evaluation of the adviser's integrity or ability to meet contractual commitments to clients; and

(18) Utilizing an agent or subagent who satisfies the definition of an investment adviser representative as set forth in G.S. 78C-2(3), where such agent or subagent is not registered as an investment adviser representative pursuant to G.S. 78C-16;

(19) Failing to establish, maintain, and enforce written policies and procedures reasonably designed to prevent the misuse of material nonpublic information contrary to the provisions of Section 204A of the Investment Advisers Act of 1940;

(20) Entering into, extending, or renewing any advisory contract contrary to the provisions of Section 205 of the Investment Advisers Act of 1940;

(21) Indicating in an advisory contract, any condition, stipulation, or provisions binding any person to waive compliance with any provision of this Act or of the Investment Advisers Act of 1940, or any other practice that would violate Section 215 of the Investment Advisers Act of 1940;

(22) Engaging in any act, practice, or course of business which is fraudulent, deceptive, or manipulative in contravention of Section 206(4) of the Investment Advisers Act of 1940;

(23) Engaging in conduct or any act, indirectly or through or by any other person, which would be unlawful for such person to do directly under the provisions of this Act or any rule or regulation thereunder.

The conduct set forth in Rule .1801(a) is not exclusive. It also includes employing any device, scheme, or artifice to defraud or engaging in any act, practice or course of business which operates or would operate as a fraud or deceit. The federal statutory and regulatory provisions referenced herein shall apply both to investment advisers and to investment advisers covered under federal law, to the extent permitted by the National Securities Markets Improvement Act of 1996 (Pub. L. No. 104-290).

(b) There shall be a rebuttable presumption that the following legal or disciplinary events involving the adviser or a management person of the adviser (any of the foregoing being referred to hereafter as "person") that were not resolved in the person's favor or subsequently reversed, suspended, or vacated are material within the meaning of Subparagraph (a)(17)(B) of this Rule for a period of 10 years from the time of the event:

(1) A criminal or civil action in a court of competent jurisdiction in which the person:

(A) was convicted, pleaded guilty or nolo contendere ("no contest") to a felony or misdemeanor, or is the named subject of a pending criminal proceeding (any of the foregoing referred to hereafter as "action"), and such action involved: an investment-related business, fraud, false statements, or omissions; wrongful taking of property; or bribery, forgery, counterfeiting, or extortion;

(B) was found to have been involved in a violation of an investment-related statute or regulation; or

(C) was the subject of any order, judgment, or decree permanently or temporarily enjoining the person from, or otherwise limiting the person from, engaging in any investment-related activity;

(2) Administrative proceedings before the Administrator, Securities and Exchange Commission, any other federal regulatory agency or any other state agency (any of the foregoing being referred to hereafter as "agency") in which the person:

(A) was found to have caused an investment-related business to lose its authorization to do business;

(B) was found to have been involved in a violation of an investment-related statute or regulation and was the subject of an order by the agency denying, suspending, or revoking the authorization of the person to act in, or barring or suspending the person's association with, an investment-related business or otherwise significantly limiting the person's investment-related activities; or

(C) was found to have engaged in an act or a course of conduct which resulted in the issuance by the agency of an order to cease and desist the violation of the provisions of any investment-related statute or rule; or

(3) Self-Regulatory Organization (SRO) proceedings in which the person:

(A) was found to have caused an investment-related business to lose its authorization to do business; or

(B) was found to have been involved in a violation of the SRO's rules and was the subject of an order by the SRO barring or suspending the person from membership or from association with other members, or expelling the person from membership; fining the person more than two thousand five hundred dollars ($2,500.00); or otherwise significantly limiting the person's investment-related activities.

(c) The information required to be disclosed by Subparagraph (a)(17) shall be disclosed to clients promptly, and to prospective clients not less than 48 hours prior to entering into any written or oral investment advisory contract, or no later than the time of entering into such contract if the client has the right to terminate the contract without penalty within five business days after entering into the contract.

(d) For purposes of this Rule:

(1) "Management person" means a person with power to exercise, directly or indirectly, a controlling influence over the management or policies of an investment adviser which is not a natural person or to determine the general investment advice given to clients;

(2) "Found" means determined or ascertained by adjudication or consent in a final SRO proceeding, administrative proceeding, or court action;

(3) "Investment-related" means pertaining to securities, commodities, banking, insurance, or real estate [including, but not limited to, acting as or being associated with a dealer, investment company, investment adviser, government securities broker or dealer, municipal securities dealer, bank, savings and loan association, entity or person required to be registered under the Commodity Exchange Act (7 U.S.C. 1 et seq.), or fiduciary];

(4) "Involved" means acting or aiding, abetting, causing, counseling, commanding, inducing, conspiring with or failing reasonably to supervise another in doing an act; and

(5) "Self-Regulatory Organization" or "SRO" means any national securities or commodities exchange, registered association, or registered clearing agency.

(e) For purposes of calculating the ten-year period during which events are presumed to be material under Paragraph (b), the date of a reportable event shall be the date on which the final order, judgment, or decree was entered, or the date on which any rights of appeal from preliminary orders, judgments, or decrees lapsed.

(f) Compliance with this Rule shall not relieve any investment adviser from the obligations of any other disclosure requirement under the Act, the rules thereunder, or under any other federal or state law.

History Note: Authority G.S. 78C-18(b); 78C-30(a);
Temporary Rule Eff. January 2, 1989, for a period of 180 days to expire on June 30, 1989;
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Amended Eff. September 1, 1995;
Temporary Amendment Eff. October 1, 1997;
Amended Eff. August 1, 1998;

Pursuant to G.S. 150B-21.3A, rule is necessary without substantive public interest Eff. December 6, 2016.