

House Bill 1011

Testimony of North Dakota Securities Commissioner Karen Tyler

Before the Senate Appropriations Committee

March 12, 2021

STATUTORY RESPONSIBILITIES

The Securities Department is a regulatory agency that serves the citizens of North Dakota through the administration and enforcement of the North Dakota Securities Act (10-04), the North Dakota Commodities Act (51-23), the Franchise Investment Law (51-19) and Pre-Need Funeral Services Law (43-10.1).

REGULATORY POLICY OBJECTIVES AND FUNCTIONS

The primary regulatory policy objectives of the Securities Department are investor protection and the support of legitimate capital formation. We execute on those objectives through our work in following areas:

- 1) We regulate the capital formation and franchise registration process.

- 2) We register, and regulate the conduct of, securities industry firms and professionals who want to do business in the state.
- 3) We perform conduct focused examinations of broker-dealer and investment adviser firms and professionals.
- 4) We investigate investment fraud and take enforcement actions as necessary and appropriate, and we also make criminal referrals and support criminal cases. The majority of our resources are dedicated to this enforcement function.
- 5) We produce and deliver investor education and financial literacy programs.

The North Dakota Securities Department is a small agency, with 10 full time employees. No additional FTEs are requested in our 21-23 budget. The Department's Organizational Chart is included in your copies of this testimony.

BUDGET REQUEST

The Securities Department is a revenue generating, special fund agency. The Department's total budget request for the 2021-2023 biennium is \$2,825,725. This breaks down as \$2,230,622 for the Salaries and Wages line item, and \$595,103 for the Operating line item.

The only changes requested from the Base Level budget are the enhancements set forth in the Governor's executive budget for salary and benefit adjustments, and a small increase in IT related costs. For our Department, those adjustments are \$67,064 for salaries and benefits, and \$1,542 for IT costs.

There is no one-time funding in our current budget, and no one-time funding in the Department's request for the 21-23 biennium.

DEPARTMENT REVENUE

We are a revenue generating agency for the state, taking in over \$22 million dollars in revenue last biennium, and we estimate we will meet or exceed that revenue level in the current biennium. Over the last 5 budget cycles, the Department has spent approximately 8 to 10 cents for every revenue dollar generated. Attached to my testimony is a 10 year look back for total revenues, total expenditures, and net total collected for the general fund.

REVENUE SOURCES

The majority of the Department's revenue is generated from securities registrations and filings, and the registration of industry firms and professionals. A small percentage of our revenue is derived from franchise registrations, and we may also generate revenue from civil penalties assessed by the Commissioner. Approximately 98% of the Department's revenue comes from out of state.

Securities Filings

Examples of types of securities registrations and filings that generate revenue for the Department would be Mutual Fund notice filings, Unit Investment Trust notice filings, Non-traded Real Estate Investment Trust registrations, and small business capital formation filings to either register securities or qualify for an exemption from registration.

Investment Industry Registration

Investment industry registrations include broker-dealer and investment adviser firms, and their registered professionals – defined in the Securities Act as securities agents and investment adviser representatives.

Data for the number of investment industry firms and professionals doing business in the state of North Dakota as of the end of January 2021 shows:

1,126	Broker-Dealers
97,519	Broker-Dealer Agents
810	Investment Advisers
1,683	Investment Adviser Reps

Industry firms and professionals must make an initial registration filing and then renew each year. The annual renewal of these industry registrations takes place December 31. For 2020, a new record total of 98,510 registration renewals were completed in an entirely automated process, through our registration system called the Central Registration Depository, and a payment of just over \$6 million was collected for the 2020 renewal cycle. This renewal process occurs at no cost to the state.

Virus Impact

In regard to virus impact on revenues, while midway through 2020 we had seen a decrease from projected collections, our revenues have since recovered and are tracking with original projections.

2021-2023 Revenue Projections

We are holding our revenue projections for the upcoming biennium at \$22 million, the same level for the current biennium.

MISC ITEMS

There are no other sections included in our budget bill.

At this time, I am not aware of any other bills being considered by the Legislative Assembly that would have a potential budgetary impact on the Securities Department.

We are not asking the committee to consider any changes to the executive recommendation, and we are submitting no optional adjustment requests.

The Department did not seek or spend any COVID-19 related funding.

There were no financial audit findings in the Department's last audit, for which the audit period was July 1, 2016 - June 30, 2018.

FOCUS INITIATIVES

Launch of Electronic Securities Filings

The Department has been successfully migrating to an electronic securities filing system over the last 18 months. This approach to securities filings is supported by a technology system called the Electronic Filing Depository (EFD). When the system is operating at full capacity, it is anticipated that 95% of our securities filings, numbering approximately 25,000/year, will be made through the system. Franchise filings will also be made through the EFD. All fees associated with these filings, which make up approximately half of the Departments annual/biennial revenue, will be collected through this system. Our national organization (NASAA) funds the development and support of the EFD, and it is utilized at no cost to the state. The shift to electronic filing included a go-paperless project component in which 479,630 records were scanned and stored.

Fintech Focus

The Department now has a team member in place responsible for conducting research, examination and investigation functions related to emerging regulatory issues driven by continuously evolving financial technology innovations, including

but not limited to Robo-Advisors, Crowdfunding, Cryptocurrency and Digital Assets, and Initial Coin Offerings and Securities Token Offerings.

Enforcement

The Department anticipates continued growth in Social Media driven investment fraud. Social media platforms and dating websites and applications are proving exceptionally fertile ground for financial criminals to exploit victims and steal money. Two areas of heightened concern: 1) Social platforms are commonly used to perpetrate investment fraud related to digital financial instruments such as securities tokens and cryptocurrency. 2) The ease of establishing fake profiles, connecting through common interests, and extracting personal information is leading to an increase in “romance scams”, and as seniors become more comfortable with these social sites and services, they also become more easily targeted.

Industry Outreach

In the 2017 Legislative Session, the legislature passed a law to strengthen protections for seniors and vulnerable adults who may be targeted for financial exploitation. Section 10-04-08.5 of the Securities Act requires brokerage firms and investment adviser firms to report to the Securities Department and Adult

Protective Services if they believe a client is being financially exploited, and provides the firms the ability, with indemnity, to withhold distribution of funds. The Department will be engaging in an outreach and education initiative to improve industry awareness regarding the law and their obligations under it.

Launch of New Examination Matrix

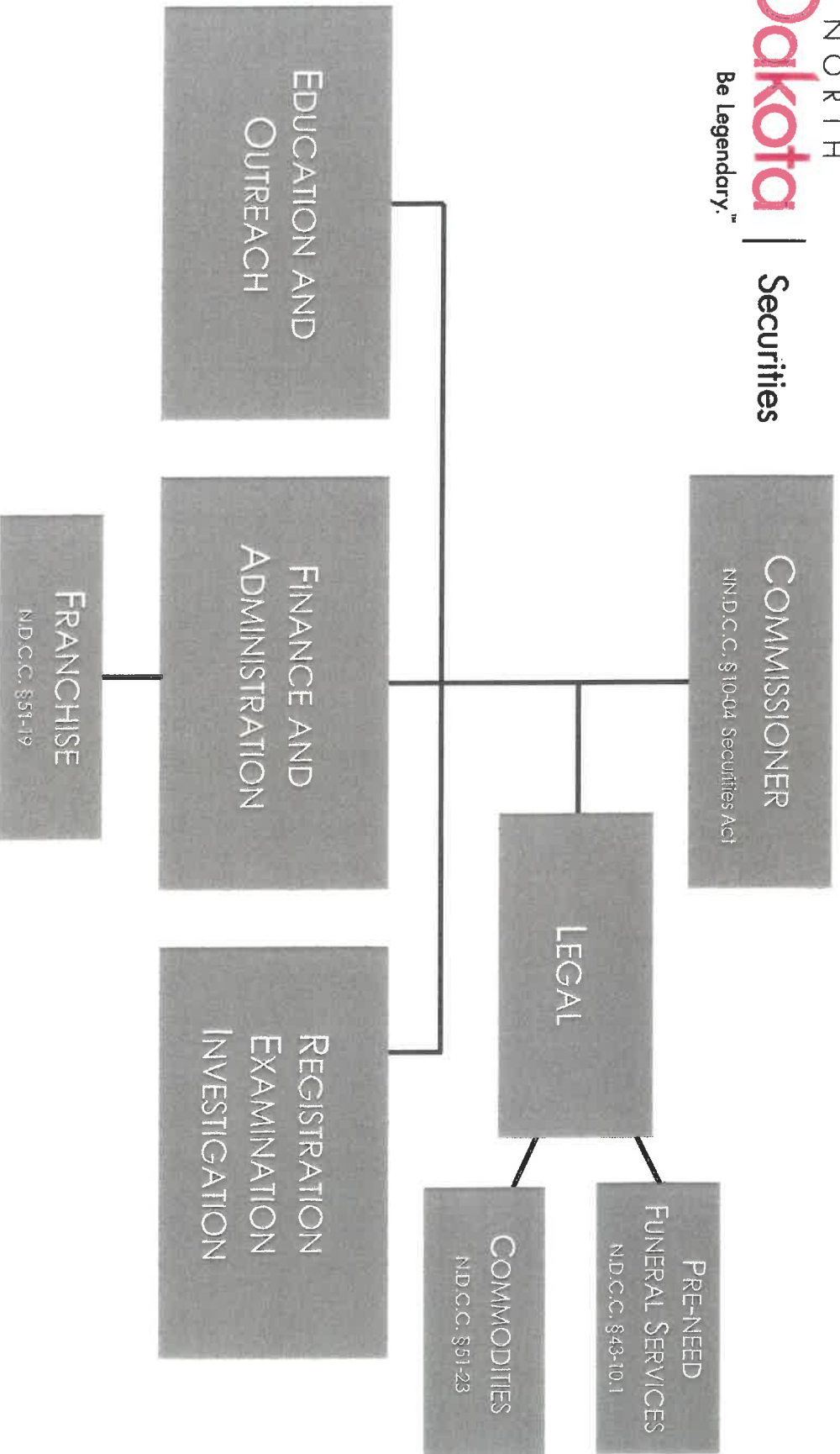
Early this year the Department launched a new Industry Examination Matrix to facilitate planning and execution of broker-dealer and investment adviser examinations for all exam type categories across an annual exam cycle.

Fargo Location Established – NDSU Research and Technology Park

Transitions Navigated – New Workplace, Retirements

Current and Upcoming Technology Projects – Website, Case Management System, Registration and Data Management System

ORGANIZATIONAL CHART



TOTAL REVENUE VS. EXPENSE

Ten Year Totals 2009 - 2019

