

## **House Bill 1011**

### **Testimony of North Dakota Securities Commissioner Tim Karsky Before the House Appropriations Government Operations Committee**

**January 13, 2025**

Mr. Chairman and Members of the Committee, good morning. I am Tim Karsky, the North Dakota State Securities Commissioner. It is a pleasure to share some time with you today to discuss the budget appropriation for the North Dakota Securities Department, and to answer any questions you may have regarding the Department's budget request.

#### **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 25-27 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.

Current biennium revenues are on track to meet or exceed \$24 million.

The Department's total budget request for the 2025-2027 biennium is \$3,413,261. This breaks down as \$2,770,090 for the Salaries and Wages line item, and \$643,171 for the Operating line item.

## **DEPARTMENT REVENUE**

The Securities Department is a revenue generating agency for the state, taking in over \$26 million dollars in revenue for the 21-23 biennium. Over the last several budget cycles, the Department has spent approximately 10 to 12 cents per revenue dollar generated. In the past 20 years, net deposit to the general fund from this agency is over \$180 million dollars.

## **REVENUE SOURCES**

The majority of the Department's revenue is generated in two categories - from securities registrations and filings, and from the registration of

investment 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.

A 3-year look-back for filings from North Dakota businesses seeking to raise capital through a securities offering shows approximately 125 companies filing to raise approximately \$1.5 billion dollars, with business representing diverse industry sectors of Health, Hospitality, Energy, Technology, Agriculture, Real Estate, and Finance.

### **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.

For the number of investment industry firms and professionals doing business in the state of North Dakota, an industry registration snapshot as of the end of December 2024 shows:

1165	Broker-Dealers
124,257	Broker-Dealer Agents
834	Investment Advisers
1613	Investment Adviser Reps

Industry firms and professionals must make an initial registration filing and then renew each year they want to continue operating in the state. The annual renewal of these industry registrations takes place at the end of December. The most recent renewal payment made was over \$7.8 million for 124,255 renewals. These are completed in an entirely automated process, through our registration system called the Central Registration Depository (CRD). This renewal process occurs at no cost to the state.

CRD is both a registration system and a comprehensive data depository, holding important information about all the investment firms and professionals operating in the investment industry in the US. The data in the CRD is used by regulators and the industry, but it is also available to

the public to assist them in evaluating the background of a firm or professional under consideration for providing services.

### **2025-2027 Revenue Projections**

Looking ahead, we are expecting revenue projections for the upcoming biennium to be equal or similar to the 2023 –2025 biennium of approximately \$24 million.

### **MISC ITEMS**

There are no other line items included in our budget bill and the Department did not have any one-time funding items in the current biennium.

There were no financial audit findings in the Department's last audit, for which the audit period was for the two-year period ending June 30, 2022.

### **Accomplishments and Challenges**

The 23-25 biennium has posed challenges to the North Dakota Securities Department. Our agency was involved in two of the largest investigations in the history of the agency.

Investigations can involve a variety of types of fraud. These include: the sale of unregistered promissory notes, fee-for-funding scams, precious

metal frauds, crypto fraud and bankruptcy related cases, private placement fraud, Ponzi schemes, social media- influenced fraud, and romance scams.

One of our largest investigations involved a nationwide Ponzi Scheme that scammed investors out of approximately \$130 Million dollars. Our agency along with other state securities regulators partnered with the Securities and Exchange Commission to stop this fraudulent activity efficiently. North Dakota was the most impacted state seeing investors losses at approximately \$45M. Our agency continues to work with national enforcement agencies to bring this case to a close.

The other investigation involves potential fraud in the millions of dollars and is ongoing. The total loss to North Dakota investors is not yet clear however, this case has proven the importance for a strong and resilient Securities Department in order to ensure investor protection under the securities laws of this state. The enforcement and investigative team continue to work diligently on this case.

### **Workforce Transitions – Challenge**

We currently have four vacant positions. One of the positions is currently advertised and expected to be filled within the next couple of weeks. One is ready to advertise within the next week. The other two open positions are expected to be filled in the coming months. After years of low turnover,

our

department has entered a retirement and restructuring period. We are currently working diligently to hire and train key positions. In the last 6 years, we have had approximately 135 years of experience leave the department.

Early 2024, we had the retirement of our talented, highly experienced attorney who had been practicing law for 42 years, 16 of which were with the Department. I replaced the former Commissioner who was with the department for over 20 years.

## **Next Biennium goals and plans**

### **Fintech Focus**

Financial Technology innovations, and the benefits and risks created by these innovations, remain a primary focus for the Department. These financial products and services present new regulatory challenges, and they include but are not limited to robo-advisors, app-based stock trading platforms, crowdfunding platforms for capital formation by start-up companies, cryptocurrency and digital or crypto asset derivative products, digital asset intermediaries, crypto interest accounts, and securities token offerings which are a new approach to raising capital.



Related to our focus on fintech, the Department has seen and anticipates continued growth in social media driven investment fraud as well as fraud related to cryptocurrency. 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 continued heightened concern:

- 1) Social platforms are commonly used to perpetrate investment fraud related to certain stocks and digital financial instruments such as securities tokens and cryptocurrency. The frauds may be pushed through discussion communities and apps like reddit, quora, medium and telegram, and the fake businesses will also have a more mainstream social presence like facebook and twitter. Financial criminals can easily establish highly convincing fake profiles, connect to potential victims through common interests, and extract personal information after establishing a relationship – this is leading to an increase in “romance scams”, and of particular concern is that as seniors become more comfortable with these social sites, apps and services, they also become more easily targeted.
- 2) Financial criminals establish fake company websites and cryptocurrency trading platforms on the internet. Social media hooks

are used to push victims to the trading platforms. A typical fraud formula is to give the victim a period of trading success and get them to add money to their account and trade more. Eventually when a victim tries to withdraw funds, they are told they have to pay taxes and fees with new money before they can access their gains. The victim then adds more money to their account and continues unsuccessfully to attempt to withdraw funds. Eventually the account is drained by the financial criminals.

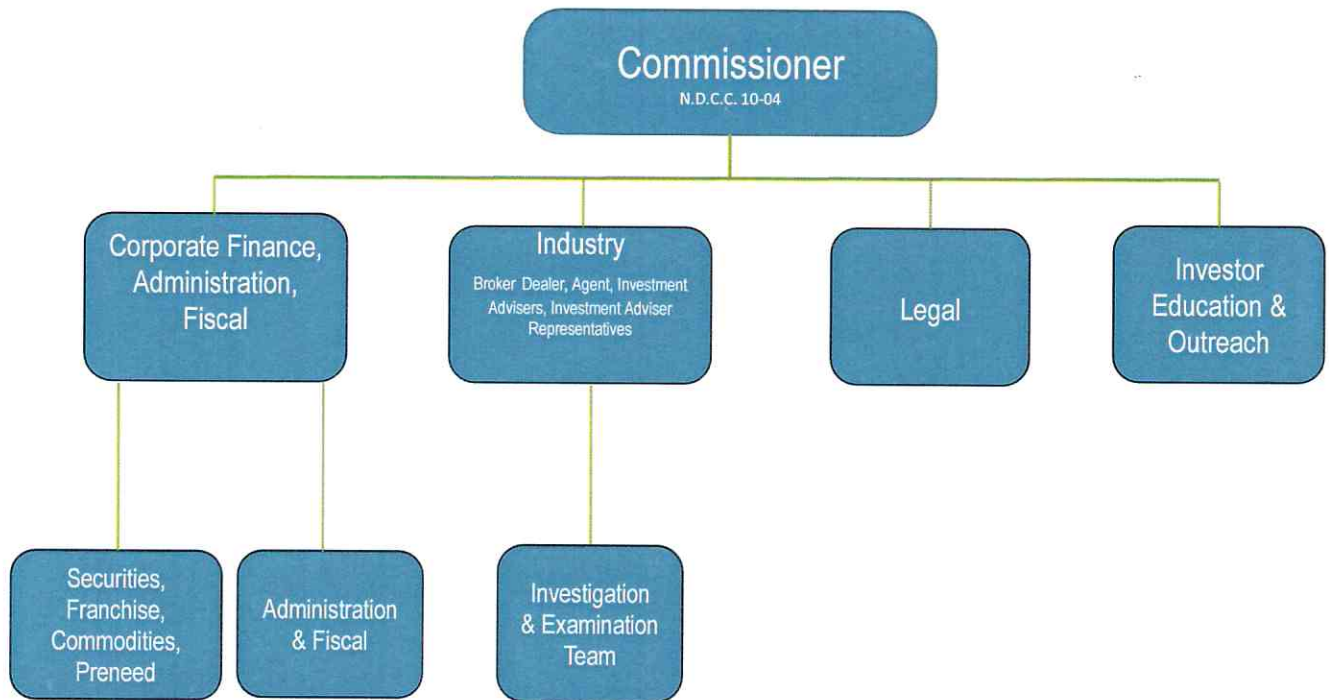
### **Examination System/Industry Outreach**

Supported by our new case management system, which was completed in April of 2021, the Department launched a new approach to managing examinations of investment industry firms and professionals, with an enhanced focus on state registered investment adviser firms. From July 1, 2021, through June 30, 2023, two hundred and seventeen examinations were either opened, closed, or worked on. One hundred and forty-nine investigations were either open, closed or worked on during the same period.

### **Focus on Seniors**

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. In 2023 legislation was passed establishing a restitution assistance fund managed by the securities department to specifically assist harmed seniors also considered vulnerable adults.

# ORGANIZATIONAL CHART



## NORTH DAKOTA SECURITIES DEPARTMENT

### WHO WE ARE

**10**

Full-time Team Members

### WHAT WE DO

We **protect** investors and **support** legitimate capital formation.

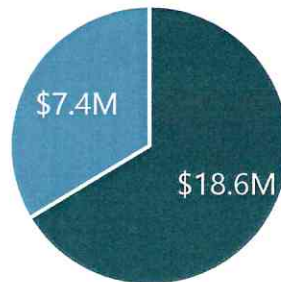
### WHY WE DO IT

In a **securities** transaction, it is the **investor** that carries the **risk**. Investor **confidence** in the **integrity** of our **capital markets** drives economic **growth** and financial **security**.

### WHAT WE EARN

**\$26 million**

- Industry Registration
- Securities & Franchise Filings

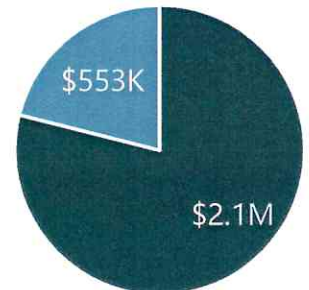


2021-2023

### WHAT WE SPEND

**\$2.2 million**

- Salaries
- Operating



2021-2023

### WHO WE SERVE

#### Investors

who seek to build wealth and financial security by investing in our capital markets.



#### Business Owners

who seek to raise capital from investors by issuing securities.



#### Industry

firms and professionals who want to do business with North Dakota investors.



#### Teachers & Students

who support and benefit from financial capability programs.



#### Seniors

who are target #1 and need to learn about financial fraud and exploitation.

