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SEC's Office of Compliance Inspection: Examination Priorities for 2020

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On January 7, 2020, the Office of Compliance Inspections and Examinations ("OCIE") of the Securities and Exchange Commission ("SEC") published its examination priorities for 2020 (the "2020 Priorities").[1] OCIE's examination priorities are released annually and are designed to preview key areas where OCIE intends to focus its limited resources. The 2020 Priorities address the following eight themes: (1) retail investors, including seniors and those saving for retirement; (2) focus areas involving registered investment advisers and investment companies; (3) information security; (4) financial technology and innovation, including digital assets and electronic investment advice; (5) focus areas involving broker-dealers and municipal advisors; (6) anti-money laundering ("AML") programs for broker-dealers and investment companies; (7) registered entities responsible for critical market infrastructure, including clearing agencies, transfer agents, and national securities exchanges; and (8) the Financial Industry Regulatory Authority ("FINRA") and the Municipal Securities Rulemaking Board ("MSRB"). The 2020 Priorities are largely the same as the examination priorities in 2019.[2] The primary difference between the 2020 Priorities and the 2019 examination priorities is the focus on the package of rulemakings and interpretations adopted in June 2019, including the Interpretation Regarding Standard of Conduct for Investment Advisers, the Form CRS Relationship Summary and Regulation Best Interest.[3]

We remind our clients that the 2020 Priorities do not comprise an exhaustive list.

[1] 2020 Examination Priorities, Office of Compliance Inspections and Examinations, Securities and Exchange Commission (Jan. 7, 2020).

[2] 2019 Examination Priorities, Office of Compliance Inspections and Examinations, Securities and Exchange Commission (Dec. 20, 2018). *See also* OCIE Publishes Examination Priorities for 2019 (Dec. 26, 2018).

[3] Commission Interpretation Regarding Standard of Conduct for Investment Advisers, Release No. IA-5248 (June 5, 2019); Form CRS Relationship Summary; Amendments to Form ADV, Release Nos. 34-86032; IA-5247 (June 5, 2019); Regulation Best Interest: The Broker-Dealer Standard of Conduct, Release No. 34-86031 (June 5, 2019). *See also* SEC Adopts Rules and Interpretive Guidance Addressing Standards of Conduct for Broker- Dealers and Investment Advisers (June 14, 2019).

1. Retail investors, including seniors and those saving for retirement

With retail investors in mind, OCIE will focus on the following areas:

- Standards of care; fraud, sales practices and conflicts. In June 2019, the SEC adopted the Interpretation Regarding Standard of Conduct for Investment Advisers, the Form CRS Relationship Summary and Regulation Best Interest. Firms must come into compliance with the new rules by June 30, 2020. Prior to the compliance date, OCIE will engage with broker-dealers during examinations on their plans and progress for compliance with these new After the compliance date, OCIE will assess implementation by broker-dealers of the requirements of Regulation Best Interest, including policies and procedures regarding conflicts disclosures, and for both broker-dealers and registered investment advisers, the content and delivery of Form CRS.

- OCIE has already integrated the Interpretation Regarding Standard of Conduct for Investment Advisers into its examination programs for registered investment advisers and registered investment companies. In particular, OCIE will continue to examine registered investment advisers to assess whether they have fulfilled their fiduciary duties of care and loyalty. This will include assessing, among other things, "whether registered investment advisers provide advice in the best interests of their clients and eliminate, or at least expose through full and fair disclosure, all conflicts of interest which might incline a registered investment adviser, consciously or unconsciously, to render advice which is not disinterested." In making this assessment, OCIE will focus on risks associated with fees and expenses charged to advisory accounts, and undisclosed, or inadequately disclosed, compensation arrangements. For example, OCIE states that conflicts may arise as a result of revenue sharing arrangements between a registered firm and issuers, service providers, and others, and direct or indirect compensation to advisory personnel for executing client transactions. OCIE also states that duty of care concerns may arise when a registered investment adviser does not aggregate certain accounts for purposes of calculating fee discounts in accordance with its
- OCIE examinations will also focus on (1) higher risk products, including private placements and securities of issuers in new and emerging risk areas, and (2) firms' disclosures and the supervision of the outside business activities of their employees and associated persons, and related
- Retail-targeted investments. OCIE will prioritize examinations of issues related to mutual funds and exchange-traded funds (ETFs), municipal securities and other fixed income securities, and microcap

2. Focus areas involving registered investment advisers and investment companies

OCIE will prioritize examinations of (1) registered investment advisers that are dually registered as, or affiliated with, broker-dealers, or have supervised persons who are registered representatives of unaffiliated broker-dealers (with a focus on best execution, prohibited transactions, fiduciary advice, disclosure of conflicts regarding such arrangements, and due diligence practices, policies, and procedures); (2) firms that utilize the services of third-party asset managers to advise clients' investments (with a focus on such firms' due diligence practices, policies, and procedures); (3) registered investment advisers offering new or emerging

investment strategies, such as strategies incorporating environmental, social, and governance (ESG) criteria (with a focus on the accuracy and adequacy of disclosures); (4) never-before and not-recently-examined advisers; (5) mutual funds, ETFs, and their advisers; and (6) advisers that manage separately managed accounts side by side with private funds (with a focus on controls to prevent the misuse of material, non-public information and conflicts of interest, such as undisclosed or inadequately disclosed fees and expenses, and the use of affiliated service providers).

3. Information security

OCIE will prioritize information security and will focus on proper configuration of network storage devices, information security governance generally, and policies and procedures related to retail trading information security. In examinations, OCIE will assess registered investment advisers' protection of clients' personal financial information, and will focus on, among other areas, governance and risk management, access controls, data loss prevention, vendor management (including oversight practices related to service providers and network solutions, such as cloud-based storage), training, incident response and resiliency, and Regulation S-P and Regulation S-ID compliance.

4. Financial technology and innovation, including digital assets and electronic investment advice

- Digital assets. Noting a significant growth of the digital asset market and related risks, including for retail investors who may not adequately understand the differences between these assets and more traditional products, OCIE will assess in examinations investment suitability, portfolio management and trading practices, safety of client funds and assets, pricing and valuation, effectiveness of compliance programs and controls, and supervision of employee outside business
- Electronic investment advice. With respect to examinations of registered investment advisers that provide services to clients through automated investment tools and platforms (often referred to as "robo-advisers"), OCIE will focus on SEC registration eligibility, cybersecurity policies and procedures, marketing practices, adherence to fiduciary duty, including adequacy of disclosures, and effectiveness of compliance

5. Focus areas involving broker-dealers and municipal advisers

Examinations of broker-dealers will focus on the safety of customer cash and securities and trading and risk management practices (including trading in odd lots, algorithmic trading, and the use of procedures, practices, and controls to manage trading risk). Examinations of municipal advisors will focus on the satisfaction of registration, professional qualification and continuing education requirements, fiduciary duty, and conflicts of interest.

6. Anti-money laundering for broker-dealers and investment companies

OCIE will prioritize examining broker-dealers and investment companies for compliance with their AML obligations with the goal of ensuring that they have policies and procedures in place that are reasonably designed to identify suspicious activity and illegal money laundering activities.

7. Compliance and risk in registered entities responsible for critical market infrastructure

OCIE will examine entities that provide services critical to the proper functioning of capital markets, including clearing agencies, entities subject to Regulation Systems Compliance and Integrity, transfer agents, and national securities exchanges. OCIE will focus on various aspects of their operations and compliance.

8. Select areas and programs of FINRA and MSRB

OCIE will focus on FINRA's operations and regulatory programs, as well as the quality of FINRA's examinations of broker-dealers and municipal advisors that are also registered as broker-dealers. OCIE will also conduct inspections of MSRB to evaluate the effectiveness of select operations and internal policies, procedures, and controls.

Conclusion

The scope of any examination is determined through a risk-based approach, both in selecting registered entities to examine and in determining the scope of risk areas to examine. OCIE notes that this approach remains flexible in order to cover emerging and exigent risks to investors and the marketplace as they arise. Firms should take this time to review their policies and procedures, as well as investor documentation and disclosures, to ensure compliance with applicable requirements, particularly in those areas that OCIE has placed on its 2020 Priorities.