

SEC's 2020 Priorities Give Firms 20/20 View of Upcoming Examinations

January 14, 2020



On January 7, 2020, the SEC's Office of Compliance Inspections and Examinations ("OCIE") announced its examination priorities for 2020. Registered investment advisors ("RIAs") and broker-dealers should take note of these priorities, so they can take immediate action to bolster their compliance programs in the areas that will be under the microscope. These priorities reflect OCIE's analysis of the potential risks faced by investors and the U.S. capital markets. OCIE expects RIAs, self-regulatory organizations ("SROs"), clearing firms, and other market participants to mitigate these potential risks.

OCIE's 2020 examination priorities are intended to enhance firms' compliance programs in the high-risk areas highlighted in the publication. Examinations will focus on the following specific areas.

Retail Investors, Including Seniors and Those Saving for Retirement – As in the past, one of OCIE's top priorities is to protect retail investors. This OCIE priority applies to the various intermediaries that provide services to and interact with retail investors. OCIE is also concerned about investments marketed to or designed for retail investors. Examinations will focus on

entities' recommendations and advice targeting:

1. Senior investors, including residents of retirement communities; and
2. Teachers and military personnel.

Examiners will pay particular attention to higher risk products, including private placements and securities. OCIE expressed concerns regarding:

- Complex or non-transparent investments;
- Products charging higher fees and expenses; or the
- Issuer of an investment is affiliated with or related to the registered firm recommending the higher risk product.

Examiners will focus on registered firms' disclosures and their supervision of outside business activities, as well as any conflicts of interest that may arise.

Market Infrastructure – OCIE will remain focused on entities that provide services that are critical to the functioning of the U.S. capital markets, such as clearing agencies, national securities exchanges, alternative trading systems, and transfer agents. OCIE examiners will be looking closely at the security and resiliency of those entities' systems.

Information Security – It is no surprise that OCIE will continue to prioritize cybersecurity and other information security risks in every facet of its examination program. Specifically, OCIE will review RIAs' protection of clients' personal financial information and will evaluate firms':

- Governance and risk management;
- Access controls;
- Data loss prevention;
- Vendor management;
- Training; and
- Incident response and resiliency.

Examiners also will evaluate whether firms are conducting effective oversight of their third party and vendors' information security practices.

Focus Areas Relating to Investment Advisors, Investment Companies, Broker-Dealers, and Municipal Advisors – OCIE will continue to rely on risk-based examinations of these registered entities. OCIE will target RIAs that have never been examined. Along with new advisors, some older firms have yet to be examined or haven't been examined in a long while. In Fiscal Year 2019, OCIE examined 2,180 RIAs, which is roughly 15 percent of SEC-registered firms.

OCIE will continue to review RIAs' compliance programs to ensure they are reasonably designed, implemented, and maintained. Examinations of dually-registered advisors will be prioritized.

Examiners will be looking at RIAs that advise retail investors, as well as private funds. Investment company examinations will focus on mutual funds and exchange-traded funds, the activities of their RIAs, and their board of directors' oversight practices. Broker-dealer examinations will concentrate

on firms' preparation for and implementation of recent rulemaking, along with their trading practices. Examinations of municipal advisors will verify that they are complying with their registration and continuing education requirements and are fulfilling their fiduciary obligations to municipal entity clients.

Anti-Money Laundering Programs – OCIE will continue to prioritize examinations of broker-dealers and investment companies for compliance with applicable anti-money laundering (“AML”) requirements. Firms must customize their AML programs to address their regulatory obligations.

Financial Technology (“Fintech”) and Innovation, Including Digital Assets and Electronic Investment Advice – OCIE’s priorities recognize that financial technology advancements, methods of capital formation and market structures, and registered firms’ use of alternative data, require ongoing attention and review. OCIE will identify and examine SEC-registered firms that provide services to clients using automated investment tools and platforms, more commonly known as robo-advisors. OCIE’s areas of focus will include:

- Eligibility for SEC registration;
- Cybersecurity policies and procedures;
- Marketing practices;
- Adherence to the advisor’s fiduciary duty, including the adequacy of its disclosures; and
- Compliance program effectiveness.

FINRA and MSRB – OCIE will continue to oversee the Financial Industry Regulatory Authority (“FINRA”) by focusing examinations on FINRA’s operations and regulatory programs, as well as the quality of FINRA’s broker-dealer and municipal advisor exams. In addition, OCIE will evaluate the Municipal Securities Rulemaking Board (“MSRB”) to measure the effectiveness of its operations and internal policies, procedures, and controls.

Form CRS – In the publication, OCIE reminded broker-dealers that June 30, 2020, is the compliance date for Regulation Best Interest and the Form CRS Relationship Summary. OCIE has already integrated the Interpretation Regarding Standard of Conduct for Investment Advisors into its examination program. OCIE stated that it intends to assess the content and delivery of Form CRS for investment advisors and broker-dealers after the compliance date.

Conclusion

OCIE reiterated that its published priorities are not exhaustive. Firms should never presume that examinations will only be focused on these stated priorities. The scope of any examination will be based on a risk-based analysis.

By publishing these examination priorities, OCIE hopes to increase transparency, so that firms can evaluate and improve their compliance programs. Robust compliance programs help to protect investors and the U.S. capital markets.

OCIE's 2020 examination priorities are available at:
<https://www.sec.gov/news/press-release/2020-4>.

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