

Chapman Client Alert

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Current Issues Relevant to Our Clients

SEC Examination Priorities for 2020

The Securities and Exchange Commission's ("SEC") Office of Compliance Inspections and Examinations ("OCIE") has released its 2020 Examination Priorities. Focus themes for the 2020 exam priorities include:

- Retail investor protection with an emphasis on seniors and retirement savings;
- Information security;
- Financial technology and innovation;
- Anti-money laundering programs;
- Market infrastructure;
- FINRA and the MSRB; and
- Other selected areas for examinations of investment advisers, investment companies and broker-dealers.

OCIE indicated that its examinations and analysis will continue to remain grounded in four main pillars:

- Promoting compliance;
- Preventing fraud;
- Identifying and monitoring risk; and
- Informing SEC policy.

A more complete discussion of the exam priorities is included below. Firms should review their policies, procedures and business activities in light of OCIE's 2020 priorities. A copy of the examination priorities publication is available [here](#).

Retail Investor Protection

Protecting retail investors, and in particular seniors and those saving for retirement, remains a priority for OCIE in 2020. It is expected to continue to be a focus for the foreseeable future. OCIE has indicated that it will focus on the following areas, among others, in conducting its 2020 examinations:

- **Fraud, Sales Practices and Conflicts:** Examiners will continue to focus on whether required disclosures are made to investors with an emphasis on fees, expenses and conflicts. Examiners will also focus on whether firm actions match their disclosures. OCIE will focus exams on advice given to retail investors with a particular focus on:
 - Recommendations and advice to seniors, teachers and military personnel;
 - Recommendations and advice by firms targeting retirement communities;

- Higher risk products including private placements in new and emerging risk areas;
 - Registered firms' disclosures and supervision of outside business activities of employees and associated persons and related conflicts; and
 - Whether investment advisers have fulfilled their duties of care and loyalty.
- **Retail-Targeted Investments:** OCIE will continue to prioritize examination of retail-targeted investments including:
 - **Mutual funds and ETFs**, with a focus on financial incentives to financial services firms and professionals that may influence the selection of particular mutual fund share classes along with conducting reviews for proper application of mutual fund fee discounts;

- **Municipal securities and other fixed income securities**, with a focus on best execution, fairness of pricing, markups/markdowns and commissions, and confirmation disclosure requirements;
- **Microcap securities**, through a review of broker-dealers and transfer agents for those that may be engaged in, or aiding and abetting, pump and dump schemes, market manipulation and illegal distribution of smaller market capitalization securities among other things.
- **Standards of Care:** With the adoption and June 30, 2020 compliance date for Regulation Best Interest and the Form CRS Relationship Summary, OCIE will engage with broker-dealers during examinations on their implementation progress, answer questions and begin to assess implementation of the requirements after the compliance date. OCIE has already integrated the Interpretation Regarding Standard of Conduct for Investment Advisers into the investment adviser examination process.

Information Security

OCIE will continue to prioritize information security in its examination programs with a focus on:

- Proper configuration of network storage devices;
- Information security governance generally; and
- Retail trading information security.

OCIE will also continue to examine registrants for compliance with Regulations S-P and S-ID, focus on online access controls and examine safeguards around proper disposal of retired hardware.

During its investment adviser exams it will also focus on:

- Governance and risk management;
- Access controls;
- Data loss prevention;
- Vendor management including oversight practices relating to service providers and network solutions including cloud-based storage;

- Training; and
- Incident response and resiliency.

Financial Technology and Innovation

OCIE exams of financial technology and innovation will focus on firms' use of alternative data sets and technologies to interact with and provide services to investors, firms and other service providers. In particular, OCIE will examine:

- **Digital asset investments** with a focus on 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 activities.
- **Electronic investment advice (e.g. "robo-advisers")** focusing on SEC registration eligibility and requirements, cybersecurity policies and procedures, marketing practices, adherence to fiduciary duties and effectiveness of compliance programs.

Anti-Money Laundering Programs

OCIE will continue to examine whether SEC regulated entities are establishing appropriate anti-money laundering programs including establishing appropriate customer identification programs, meeting Suspicious Activity Reports ("SARs") filing obligations, conducting due diligence on customers, complying with beneficial ownership requirements and conducting robust and timely independent testing of anti-money laundering programs.

Market Infrastructure

OCIE will continue to focus on examining entities providing services critical to the proper functioning of capital markets including:

- **Clearing Agencies:** OCIE will continue annual examinations of clearing agencies designated as systematically important with a focus on compliance with SEC standards, responsiveness to comments received in prior examinations and other areas identified by the SEC's Division of Trading and Markets and other regulators, among other things.

- **National Securities Exchanges:** Examinations will focus on how exchanges react to market disruptions and how they monitor member activity for compliance with federal securities laws and rules.
- **Regulation Systems Compliance and Integrity (“SCI”) Entities:** OCIE will continue to examine SCI entities to ensure compliance with applicable requirements and to ensure their systems’ capacity, integrity, resiliency, availability and security. OCIE will also continue to evaluate whether SCI entities have established, maintained and enforced required written SCI policies and procedures.
- **Transfer Agents:** Examinations will focus on transfer agents’ core functions, the requirement for transfer agents to annually file a report by an independent account concerning their system of internal accounting controls, as well as compliance with obligations to search for lost securityholders and providing notices to unresponsive payees.
- dually registered firms and firms affiliated with a broker-dealer;
- firms that utilize the services of third-party asset managers to advise clients’ investments;
- new and emerging investment strategies, such as strategies focused on sustainable and responsible investing;
- never examined and not recently examined registered investment advisers; and
- registered investment advisers to private funds that have a greater impact on retail investors such as firms that provide management to separately managed accounts side-by-side with private funds.

Selected Areas for Examinations of Investment Companies

OCIE will prioritize examinations of mutual funds and ETFs, the activities of their registered investment advisers and oversight practices of their boards of directors. Examinations will assess industry practices and compliance in a variety of areas with a focus on:

- investment advisers that use third-party administrators to sponsor the mutual funds they advise or are affiliated with;
- mutual funds or ETFs that have not previously been examined; and
- investment advisers to private funds that also manage a registered investment company with a similar investment strategy.

Selected Areas for Examinations of Broker-Dealers

In addition to the focus on sales practices, OCIE broker-dealer examinations will focus on:

- Broker-dealer financial responsibility, to ensure that assets are safeguarded in accordance with the Customer Protection Rule and Net Capital Rule;
- Trading and broker-dealer risk management practices including:

FINRA and MSRB

OCIE will continue its oversight and examination of FINRA and the MSRB focusing on operations, regulatory programs, examination programs and internal policies, procedures and controls.

Selected Areas for Examinations of Registered Investment Advisers

OCIE typically assesses compliance programs of registered investment advisers in one or more core areas including:

- The appropriateness of account selection;
- Portfolio management practices;
- Custody and safekeeping of client assets;
- Best execution;
- Fees and expenses; and
- Valuation of client assets for consistency and appropriateness of methodology.

In addition, OCIE’s 2020 examination priorities of investment advisers include:

- examining firms' trading of odd lots in compliance with laws and regulations including best execution requirements;
 - controls around automated trading; and
 - use of internal procedures, practices and controls to manage trading risk, generally;
- Municipal advisors with a prioritization on the review of municipal advisor fiduciary duty obligations to municipal entity clients, fair dealing with market participant requirements and the disclosure of conflicts of interest.

Conclusion

Firms should consider the SEC examination priorities as they conduct their annual reviews of policies, procedures and business activities. Where firms observe deficiencies in their own practices, adjustments should be made before they find themselves the subject of an SEC investigation, examination or enforcement action.

For More Information

If you would like further information concerning the matters discussed in this Client Alert, please contact a member of the Investment Management Group or visit us online at chapman.com.

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