

SEC Announces 2020 Examination Priorities

The Securities and Exchange Commission's Office of Compliance Inspections and Examinations ("OCIE") recently announced its examination priorities for 2020 (available [here](#)). OCIE's examination priorities are released annually. The 2020 priorities highlight the following eight non-exhaustive areas on which OCIE intends to focus during the year.

1. Retail investors, including seniors and individuals saving for retirement
2. Information security
3. Financial technology (Fintech) and innovation, including digital assets and electronic investment advice
4. Registered investment advisers ("RIA"s) and investment companies
5. Broker-dealers and municipal advisors
6. Anti-money laundering ("AML") programs
7. Market infrastructure
8. Financial Industry Regulatory Authority ("FINRA") and Municipal Securities Rulemaking Board ("MSRB")

The 2020 examination priorities are similar to the 2019 priorities. OCIE again emphasizes a commitment to compliance from C-level and similar executives to "set a tone from the top that compliance is integral to the organization's success and that there is tangible support for compliance at all levels of an organization."

While the priorities drive many of OCIE's examinations, the selection of firms to examine and the related risk areas of focus are determined through OCIE's risk-based analysis. OCIE's risk-based approach results in examinations that are focused on key aspects of the SEC's regulatory oversight, such as the adequacy of disclosures concerning services, fees and expenses; firms' management and handling of conflicts of interest for RIAs; and sales practice, trading and execution quality issues for broker-dealers.

OCIE's 2020 Examination Priorities

1. Retail Investors, Including Seniors and Individuals Saving for Retirement

OCIE will continue its focus on intermediaries that serve retail investors (namely, RIAs and broker-dealers) and investments marketed to, or designed for, retail investors. Examinations in these areas will focus on disclosures relating to fees, expenses and conflicts of interest.

A new aspect of OCIE's focus on retail investors concerns the SEC's adoption in June, 2019, of Regulation Best Interest, the Interpretation Regarding Standard of Conduct for RIAs, and Form CRS Relationship Summary, which enhances standards of conduct for broker-dealers and RIAs. (See our prior Client Alert, *SEC Adopts Regulations and Interpretations to Enhance Standards of Conduct for Broker-Dealers and Investment Advisers*, dated July 7, 2019, available [here](#).) To assist broker-dealers before the June 30, 2020 compliance date for Regulation Best Interest and Form CRS, OCIE will engage with broker-dealers during examinations on their progress for compliance with the new rules. After the compliance date, OCIE will assess implementation by broker-dealers of Regulation Best Interest, including policies and procedures regarding conflicts disclosures, and for both broker-dealers and RIAs, the content and delivery of Form CRS. OCIE already has integrated into its RIA examination program the requirement for RIAs to comply with the Interpretation Regarding Standards of Conduct.

2. Information Security

Information Security is critical to the operation of the financial markets and the confidence of its participants. The impact of a breach in information security, including a successful cyber-attack, may have consequences that extend beyond the firm that has been compromised. OCIE is focused on working with firms to identify and address information security risks, including cyber-related risks. Specific to RIAs, OCIE will continue to focus its examinations on assessing RIA's protection of clients' personal financial information. Particular focus areas will include governance and risk management; access controls; data loss prevention; vendor management; training; and incident response and resiliency.

3. Financial Technology (Fintech) and Innovation, Including Digital Assets and Electronic Investment Advice

OCIE recognizes that advancements in financial technologies, methods of capital formation, market structure, investor interfaces, and uses of new sources of data (often referred to as "alternative data") that drive investment decision-making, require ongoing attention. Therefore, OCIE examinations will focus on firms' use of digital assets and technologies to interact with investors.

- Digital assets – OCIE believes that retail investors may not adequately understand the difference between digital assets and more traditional products. Due to the inherent risks involved in digital assets, OCIE will examine SEC-registered market participants engaged in this space. Examinations will assess 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 employees' outside business activities.
- Electronic Investment Advice – With respect to RIAs that provide services to their clients through automated investment tools and platforms (often referred to as "robo-advisers"), OCIE examinations will focus on SEC registration eligibility; cybersecurity; policies and procedures; marketing practices; adherence to fiduciary duty, including adequacy of disclosures; and effectiveness of compliance programs.

4. Focus Areas Involving RIAs and Investment Companies

OCIE will continue its risk-based examination of RIAs and investment companies. Examination of RIAs will prioritize RIAs that are duly registered as, or are affiliated with, broker-dealers; RIAs that utilize the services of third-party asset managers to advise clients' investments; RIAs that offer clients new types or emerging

investment strategies; RIAs that have never been examined, including newly registered RIAs and RIAs registered for several years that have yet to be examined; previously examined RIAs that have not been examined for a number of years; and RIAs to private funds, especially when they provide side-by-side management with separately-managed accounts.

The examinations will focus on whether the firms maintain effective compliance programs to address the risks associated with best execution, prohibited transactions, fiduciary advice, or disclosure of conflicts regarding such arrangements; whether compliance programs have been adapted appropriately in light of any substantial growth or change in business models; and whether the firm has controls in place to prevent misuse of material, nonpublic information and conflicts of interest, such as undisclosed or inadequately disclosed fees and expenses, and the use of RIA affiliates to provide services to clients.

5. Focus Areas Involving Broker-Dealers and Municipal Advisors

Broker-dealer examinations will focus on safety of customer cash and securities (including compliance with the net capital rule); risk management; trading activity (including examination of controls around the use of automated trading algorithms by broker-dealers); the effects of evolving commissions and other cost structures; best execution; payment for order flow arrangements; and firms' use of internal procedures, practices and controls to monitor trading risk.

Municipal advisor examinations will focus on whether they have met registration, professional qualification, and continuing education requirements. OCIE also will focus on the municipal advisor's fiduciary obligations to municipal entity clients, fair dealing with market participation requirements, and conflicts of interest.

6. AML Programs

OCIE will continue to prioritize examining broker-dealers and investment companies for compliance with their AML obligations in order to assess whether they (i) have established appropriate customer identification programs; (ii) are satisfying their SAR filing obligations; (iii) are conducting due diligence on customers; (iv) are complying with beneficial ownership requirements; and (v) are conducting robust and timely independent tests of their AML programs.

7. Market Infrastructure

OCIE will examine entities that provide services critical to the functioning of capital markets, including (i) clearing agencies (to assess, among other things, the financial and operational risks borne and presented by them to financial institutions and their ability to monitor and control such risks); (ii) national securities exchanges (to assess, among other things, how they react to market disruptions and how they maintain member activity); (iii) entities subject to Regulation SCI (to assess, among other things, the adequacy of their written policies and procedures designed to ensure that their system capacities are adequate to maintain operational capability and promote maintenance of fair and orderly markets); and (iv) transfer agents (to assess, among other things, adequacy of timely turnaround of items and transfers, recordkeeping, and safeguarding funds and securities).

8. Focus on FINRA and MSRB

OCIE conducts risk-based oversight of FINRA, designed to identify those aspects of FINRA's operations that are critical to the protection of investors and market integrity. Based on the outcome of its risk-assessment process, OCIE conducts inspections of FINRA's major regulatory programs. OCIE also conducts oversight examinations of the examinations FINRA conducts of certain broker-dealers and municipal advisors.

OCIE also conducts risk-based examinations of MSRB to ensure compliance with MSRB rules. Examinations of MSRB evaluate the effectiveness of its policies, procedures and controls.

Conclusion

OCIE's 2020 priorities are not exhaustive and will not be the only areas on which it focuses in its examinations. The scope of OCIE's examinations is determined through a risk-based approach – both in selecting the entities to be examined and in determining the risk areas to examine – which includes a given entity's "history, operations, services, products offered, and other risk factors."

OCIE views its efforts to formulate examination priorities as collaborative, including feedback from examination staff, market and regulatory developments, tips, complaints, referrals and coordination with other divisions of the SEC and other regulators.

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If you receive notice of an OCIE examination or if you would like assistance preparing for one, please contact Meryl Wiener, any of the undersigned, or your regular Warshaw Burstein attorney.

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