



U.S. SECURITIES AND  
EXCHANGE COMMISSION

2020

# EXAMINATION PRIORITIES

Office of Compliance Inspections and Examinations



# CONTENTS

Message From OCIE's Leadership Team .....	1
Importance of Compliance .....	1
FY 2019 Results .....	1
Registered Investment Adviser Coverage .....	3
Anticipated Impact of Significant Rulemaking .....	4
Risk, Technology, and Industry Trends .....	5
Firm and Investor Outreach and Risk Alerts .....	6
Introduction .....	8
Retail Investors, Including Seniors and Individuals Saving for Retirement .....	9
Fraud, Sales Practices, and Conflicts .....	9
Retail-Targeted Investments .....	10
Standards of Care .....	12
Information Security .....	13
Financial Technology (FINTECH) and Innovation, Including Digital Assets and Electronic Investment Advice .....	14
Digital Assets .....	14
Electronic Investment Advice .....	14
Additional Focus Areas Involving RIAs and Investment Companies .....	15
RIA Compliance Programs .....	15
Never-Before and Not Recently-Examined RIAs .....	15
Mutual Funds and ETFs .....	16
RIAs to Private Funds .....	16
Additional Focus Areas Involving Broker-Dealers and Municipal Advisors .....	16
Broker-Dealer Financial Responsibility .....	16
Trading and Broker-Dealer Risk Management .....	16
Municipal Advisors .....	17
AML Programs .....	17
Market Infrastructure .....	18
Clearing Agencies .....	18
National Securities Exchanges .....	19
Regulation Systems Compliance and Integrity (SCI) .....	19
Transfer Agents .....	20
Focus on FINRA and MSRB .....	21
FINRA .....	21
MSRB .....	21
Conclusion .....	22

---

DISCLAIMER: This statement represents the views of the staff of the Office of Compliance Inspections and Examinations. It is not a rule, regulation, or statement of the U.S. Securities and Exchange Commission (Commission). The Commission has neither approved nor disapproved its content. This statement, like all staff guidance, has no legal force or effect: it does not alter or amend applicable law, and it creates no new or additional obligations for any person.



## MESSAGE FROM OCIE'S LEADERSHIP TEAM

The Office of Compliance Inspections and Examinations (OCIE) of the U.S. Securities and Exchange Commission (SEC) is pleased to announce our examination priorities for fiscal year (FY) 2020, marking the 8th year of their publication. We hope you find our discussion of key risks, trends, and examination priorities valuable in overall efforts to promote and improve compliance and ultimately protect investors.

### Importance of Compliance

As a threshold matter, we would like to emphasize that compliance programs, chief compliance officers, and other compliance staff play critically important roles at firms. Indeed, culture and tone from the top are key. In the course of conducting thousands of examinations of many different types of firms, the hallmarks of effective compliance become apparent. One such hallmark includes compliance's active engagement in most facets of firm operations and early involvement in important business developments, such as product innovation and new services. Another is a knowledgeable and empowered chief compliance officer with full responsibility, authority, and resources to develop and enforce policies and procedures of the firm. And perhaps most importantly, 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.

#### DID YOU KNOW?

A hallmark of effective compliance is a commitment from senior executives to set the tone that compliance is integral to the organization's success.

### FY 2019 Results

For OCIE, quality is the most important aspect of the work we perform. Examiners ask themselves: Did our risk scoping correctly capture the highest risks at a firm? Did we appropriately expand our scope as we identified significant risks not initially scoped? Did we spend sufficient time and devote appropriate staffing resources (both in technical experience and team size) to ensure an effective examination? Did we promote compliance? And ultimately, did we identify errors, fraud or misappropriation at the firm, if present? Examiners ask these and countless other questions before closing an examination, all with the primary purpose of achieving OCIE's investor protection mission.

OCIE is mindful that numbers never tell the complete story of our effectiveness and efficiency. While certain statistics are discussed below, they do not completely capture or measure the quality of our examination program. Statistics do, however, convey certain reference points that provide some insights into our examination program. OCIE completed 3,089 examinations in FY 2019, which is a 2.7 percent decrease from FY 2018. This relatively minor decrease, when viewed in light of an approximate month-long suspension of virtually all examination activity due to a lapse in appropriations, is illustrative of the OCIE staff's hard work, continued improved efficiency, resiliency and dedication to the SEC's and OCIE's mission to protect investors. Examinations of registered investment advisers (RIAs) in FY 2019 remained strong at approximately 2,180, covering 15 percent of this population. Examinations of investment companies increased this year to over 150, increasing by approximately 12 percent, driven primarily by the six initiatives OCIE announced in November 2018.<sup>1</sup> OCIE completed over 350 examinations of broker-dealers, 110 examinations of national securities exchanges, and over 90 examinations of municipal advisors and transfer agents. OCIE also completed over 160 examinations of the Financial Industry Regulatory Authority (FINRA), including examinations of critical FINRA program areas as well as oversight reviews of FINRA examinations. Finally, OCIE completed 15 examinations of clearing agencies.

#### DID YOU KNOW?

The quality of examinations is the most important aspect of OCIE's work.

Through its examinations, OCIE is promoting compliance and making a difference for investors and our securities markets. For example, during FY 2019, OCIE issued more than 2,000 deficiency letters, with many firms taking direct corrective actions in response to those letters, including

by amending compliance policies and procedures or a regulatory filing; enhancing their disclosures; or, returning fees back to investors, among other things. To fight against fraud and misappropriation of investor assets, OCIE also commits significant resources to verify the existence of investor assets at custodians and to ensure that they are valued properly, a process called asset verification. In FY 2019, OCIE verified over 3.1 million investor accounts, totaling over \$1.5 trillion. Similarly, when RIAs have access to client funds or securities, OCIE prioritizes examination for compliance with the Custody Rule (Rule 206(4)-2 under the Investment Advisers Act of 1940 (Advisers Act)), which includes important client safeguards like third party audits and surprise examinations. For broker-dealers, OCIE reviews for compliance with the Customer Protection Rule (Rule 15c3-3 under the Securities Exchange Act of 1934 (Exchange Act)) and the Net Capital Rule (Rule 15c3-1 under the Exchange Act) to help ensure that customer securities and assets exist and are protected from misappropriation and that firms are adequately capitalized.

<sup>1</sup> <https://www.sec.gov/ocie/announcement/ocie-risk-alert-registered-investment-company-initiative>

Another way OCIE promotes compliance and protects investors is by encouraging firms to make investors whole when fees have been improperly calculated and charged. Examinations closed in FY 2019 have so far resulted in firms returning more than \$70 million to investors. When its findings are significant with respect to such improper charges or other issues, however, OCIE may refer these matters to the Division of Enforcement.

Many important Enforcement matters have resulted from OCIE examinations and referrals, including, for example: the SEC's first two settled Enforcement actions with clearing agencies; two settled matters involving Regulation SCI; dozens of settled matters involving RIAs' selection of higher cost mutual fund share classes for clients when lower cost options were available; the first settled actions brought against providers of electronic investment advice; dozens of settled actions against advisers to private funds; and settled actions against broker-dealers that misappropriated retail client funds. More than 150 enforcement referrals from FY 2019 examinations have been made so far, and we anticipate more to come. Recoveries and referral metrics may lag fiscal year reporting as OCIE continues to work to get results for harmed investors, which, for example, included 30 additional referrals and \$13 million in recoveries in FY 2019 from examinations that were completed in FY 2018.

### **Registered Investment Adviser Coverage**

OCIE reports annually the percentage of the population of RIAs examined each year. This metric is important as OCIE is the primary, and often only, regulator responsible for supervising this segment of financial firms. The population of RIAs has grown significantly in recent years, as has the amount of assets those RIAs manage. More specifically, in just the last five years, the number of RIAs OCIE oversees increased from about 11,500 to 13,475, and the assets under management of RIAs increased from approximately \$62 trillion to \$84 trillion.

#### **DID YOU KNOW?**

In FY 2019, OCIE completed over 3,000 examinations.

In addition to this significant growth, the financial industry and marketplace are constantly evolving and responding to investor needs, regulatory changes, technology, and competition. RIAs' complexity, interconnectivity, and dependency on a variety of market participants also continue to grow: more than 3,700 RIAs manage over \$1 billion in assets; approximately 36 percent of RIAs manage a private fund; more than 55 percent of RIAs have custody of client assets; more than 60 percent of RIAs are affiliated with other financial industry firms; and approximately 12 percent of RIAs provide advisory services to a mutual fund, exchange-traded fund, or other registered investment company.

Despite this significant growth and complexity, OCIE has made significant strides over the past several years to increase its RIA coverage, including through: (1) implementation of program efficiencies, both through process and technology; (2) realignment of internal staffing to address the coverage rates for RIAs; and (3) continued investment in our human capital, through ongoing training of staff and the onboarding of experienced subject matter experts, among other things. These efforts are paying dividends: OCIE has increased its examination coverage of RIAs over the past several years from 10 percent in FY 2014 to a high of 17 percent in FY 2018. OCIE's coverage of RIAs in FY 2019, a year in which the RIA population continued to increase and the SEC experienced a 35-day lapse in appropriations, was 15 percent.

While OCIE will continue to make improvements in efficiency, there remains a significant risk that, in light of industry growth and increased complexity and other factors, it does not have sufficient resources to adequately cover the RIA space. OCIE's coverage rates will likely not keep pace with the continued growth in the population and complexity, without corresponding staffing increases. While OCIE has made great strides to improve the coverage rate, the risks of diminished coverage, quality, and effectiveness are possible without further support. Ultimately, this trend is concerning and a focus for OCIE and Chairman Clayton.

### **Anticipated Impact of Significant Rulemaking**

The Commission finalized many new rules and interpretations in FY 2019 that will impact firms and OCIE. The most significant is the package of rulemakings and interpretations designed to enhance the quality and transparency of retail investors' relationships with RIAs and broker-dealers, bringing the legal requirements and mandated disclosures in line with reasonable investor expectations, while preserving access, in terms of choice and cost, to a variety of investment services and products. Specifically, these actions include new Regulation Best Interest, the new Form CRS Relationship Summary, and two separate interpretations under the Advisers Act, which will be FY 2020 examination priorities.

OCIE recognizes that these new rules will require various market participants to make changes to their operations, including to required disclosures, marketing materials and compliance programs. In order to assist firms with planning for compliance with these new rules, the SEC established an inter-Divisional Standards of Conduct Implementation Committee—of which staff across OCIE are members. We encourage firms to actively engage with OCIE and other SEC staff as they plan for implementation. Questions may be submitted by email to: [IABDQuestions@sec.gov](mailto:IABDQuestions@sec.gov).

## **Risk, Technology, and Industry Trends**

In FY 2020, OCIE will continue to monitor industry developments and market events to assess impact on retail investors and SEC-registered firms, and continue to tailor its risk-based program to respond. The footprint of registered entities has become more global and diverse, often with an increased dependency on services and operations worldwide. And the use of third-party service providers and other vendors by registrants continues to increase, which can bring improved expertise and effectiveness, but also additional challenges and risks to organizations. OCIE will continue to focus on third-party risk management in FY 2020. OCIE will also closely track and evaluate the impact of several major risk themes affecting its registrant population, including information security and resiliency risks, geopolitical events, and the industry's transition away from LIBOR. OCIE, in coordination with other SEC Divisions and Offices, will engage with firms on these risks, among others, to better assess impact and what, if any, compliance challenges develop.

OCIE continues to make investments in human capital, technology and data analytics. In FY 2019, OCIE added over twenty-seven new staff positions, and it anticipates that these hires will each bring a wealth and variety of experience and knowledge to the examination program. OCIE's technology tools and data analytics work also continue to mature and help drive many of its risk identification efforts, initiatives and examination processes. All of these resources help OCIE identify potential stresses on compliance programs and operations, conflicts of interest, and conduct issues that may ultimately harm investors.

As OCIE continues to advance its use of technology and data analytics, it is mindful of its responsibility to ensure that information requested during an examination is appropriately calibrated and, once information is provided, is protected. During an examination, staff may request certain books and records that include sensitive information such as customer transactions, communications and other personal data to assess whether firms are complying with the federal securities laws. OCIE strives to appropriately tailor its requests for data and encourages dialogue with staff where a registrant may have a preferred or alternative data solution that would meet examination objectives.

While balancing the importance of data protection with effectively protecting investors, OCIE has experienced challenges with examining non-U.S. registrants that are increasingly subject to laws on data protection and privacy, among others, that may impact the cross-border transfers of certain information. These challenges are particularly acute with the growing population of off-shore RIAs that now number close to 1,000, managing

over \$10 trillion in investor assets. U.S. securities laws, SEC rules, and registration forms require non-U.S. RIAs to certify that they will provide to the SEC required records necessary for inspection. In light of this conflict of law, OCIE is seeking additional information from non-U.S. applicants for RIA registration to ensure these firms can comply with inspection requirements of U.S. securities laws, which are designed to protect impacted investors. The SEC continues to work with both industry and its counterparts in other countries to address this challenge.

### **Firm and Investor Outreach and Risk Alerts**

OCIE's priorities provide an overview of key areas where it intends to focus its limited resources. That said, the stated priorities and other examinations OCIE conducts do not encompass all of OCIE's efforts to improve compliance. To promote compliance, and to further the effective and efficient allocation of examination resources, OCIE proactively engages with registrants through outreach events, including national and regional compliance seminars. In FY 2019, OCIE staff participated in or held more than 100 such outreach events. OCIE staff also conducted outreach to investors, including specific efforts directed toward members of the military and teachers, designed to inform them about retirement planning and investment basics.

OCIE also engaged with and informed the industry through risk alerts in efforts to raise awareness of compliance and industry risks. During FY 2019, OCIE published the following eight risk alerts, which represent the most risk alerts in a year since it began publishing them in FY 2011.

- Investment Adviser Compliance Issues Related to the Cash Solicitation Rule;
- Risk-Based Examination Initiatives Focused on Registered Investment Companies;
- Observations from Investment Adviser Examinations Relating to Electronic Messaging;
- Transfer Agent Safeguarding of Funds and Securities;
- Investment Adviser and Broker-Dealer Compliance Issues Related to Regulation S-P—Privacy Notices and Safeguard Policies;
- Safeguarding Customer Records and Information in Network Storage—Use of Third Party Security Features;
- Observations from Examinations of Investment Advisers: Compliance, Supervision, and Disclosure of Conflicts of Interest; and
- Investment Adviser Principal and Agency Cross Trading Compliance Issues.

OCIE will continue its publication of risk alerts that both describe its national initiatives as well as outline findings from examinations in key areas with the hopes that sharing this information will further promote compliance within registered firms and ultimately further protect the investing public.

Finally, please know that OCIE is always interested in hearing more about new and emerging risk areas and products as well as how it can be more effective in its mission. OCIE's contact information can be found at: <https://www.sec.gov/contact-information/sec-directory>. Please engage with our staff. If you suspect or observe activity that may violate the federal securities laws or otherwise operates to harm investors, please notify SEC staff at <https://www.sec.gov/tcr>. And thank you for doing your part to protect investors and promote compliance.



## INTRODUCTION

In 2020, OCIE will prioritize the examination of certain practices, products, and services that it believes present potentially heightened risks to investors or the integrity of the U.S. capital markets. Examinations of these priority areas are designed to support the SEC's mission to protect investors, facilitate capital formation, and maintain fair, orderly, and efficient markets.

Many of the themes noted below are perennial risk areas OCIE routinely covers in its examinations. Their importance to retail investors, the seriousness and frequency of prior years' examination findings, or both, demonstrate the need for OCIE to continue to be vigilant in these significant areas. Moreover, the priorities described below are not exhaustive and will not be the only issues OCIE addresses in its examinations, published risk alerts, and investor and industry outreach.

### DID YOU KNOW?

In FY 2019, OCIE achieved examination coverage of approximately 15 percent of registered investment advisers.

While the priorities drive many of OCIE's examinations, the selection of firms to examine and the related scoped risk areas of focus are determined through OCIE's risk-based analysis. OCIE's risk-based approach varies depending on the type of registered firm and the nature of its business.

For RIAs and broker-dealers, OCIE considers dozens of potential risk factors, which can include: products and services offered, including certain products identified as higher risk; compensation and funding arrangements; prior examination observations and conduct; disciplinary history of associated individuals and affiliates of a registered firm; changes in firm leadership or other personnel; and, whether a firm has access to investor assets, *i.e.*, custody. While the aforementioned characteristics and factors are not exhaustive, they provide insight into criteria that OCIE considers in its risk assessment process. 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 analytic efforts and examinations remain firmly grounded in its four pillars: promoting compliance, preventing fraud, identifying and monitoring risk, and informing policy. The risk-based approach, both in selecting registrants as examination candidates and in scoping risk areas to examine, provides OCIE with greater flexibility to cover emerging and exigent risks to investors and the marketplace as they arise. For example, as our registrants and other market participants transition away from LIBOR as a widely

used reference rate in a number of financial instruments to an alternative reference rate, OCIE will be reviewing firms' preparations and disclosures regarding their readiness, particularly in relation to the transition's effects on investors. Some registrants have already begun this effort and OCIE encourages each registrant to evaluate its organization's and clients' exposure to LIBOR, not just in the context of fallback language in contracts, but its use in benchmarks and indices; accounting systems; risk models; and client reporting, among other areas. Insufficient preparation could cause harm to retail investors and significant legal and compliance, economic and operational risks for registrants.

## RETAIL INVESTORS, INCLUDING SENIORS AND INDIVIDUALS SAVING FOR RETIREMENT

OCIE will again emphasize the protection of retail investors, particularly seniors and those saving for retirement. Concentrated in our two largest program areas, the Investment Adviser-Investment Company (IAIC) and Broker-Dealer and Exchange programs, OCIE will prioritize examinations:

- Of intermediaries that serve retail investors, namely RIAs, broker-dealers, and dually-registered firms, and
- Focused on investments marketed to, or designed for retail investors, such as mutual funds and exchange-traded funds (ETF), municipal securities and other fixed income securities, and microcap securities.

### Fraud, Sales Practices, and Conflicts

It is critically important that registered firms provide investors with the disclosures required by the federal securities laws, including those relating to fees and expenses, and conflicts of interest, which will help enable the investing public to make better informed choices. Registered firms must effectively implement controls and systems to ensure those disclosures are made as required and that a firm's actions match those disclosures.

Examinations will focus on recommendations and advice given to retail investors, with a particular focus on: (1) seniors, including recommendations and advice made by entities and individuals targeting retirement communities; and (2) teachers and military personnel. Additionally, OCIE will focus on higher risk products—including private placements and

#### DID YOU KNOW?

In FY 2019, OCIE verified over 3.1 million investor accounts, totaling over \$1.5 trillion.

securities of issuers in new and emerging risk areas—such as those that: (1) are complex or non-transparent; (2) have high fees and expenses; or (3) where an issuer is affiliated with or related to the registered firm making the recommendation. Examinations will relatedly focus on registered firms’ disclosures and supervision of outside business activities of its employees and associated persons, and any conflicts that may arise from those activities.

OCIE will also continue to examine RIAs to assess whether, as fiduciaries, they have fulfilled their duties of care and loyalty. This will include assessing, among other things, whether RIAs 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 an RIA, consciously or unconsciously, to render advice which is not disinterested. That RIAs are acting in a manner consistent with their fiduciary duty and meeting their contractual obligations to their clients is paramount to maintaining investor confidence in the markets and investment professionals. OCIE, therefore, will continue to focus on risks associated with fees and expenses, and undisclosed, or inadequately disclosed, compensation arrangements.

#### DID YOU KNOW?

In FY 2019, OCIE completed over 150 examinations of investment companies (IC) and conducted six national IC initiatives.

Fee and compensation-based conflicts of interest may take many forms, including 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. In addition, duty of care concerns may arise when an RIA does not aggregate certain accounts for purposes of calculating fee discounts in accordance with its disclosures. These potential breaches of fiduciary duty may adversely impact portfolio management costs, reduce investor returns, and inappropriately influence investment decision-making.

### **Retail-Targeted Investments**

Certain securities products can pose elevated risks when marketed or sold to retail investors, whether as a result of the characteristics of those securities, the dynamics in the markets, or due to the significant amount or concentration of assets retail investors have invested in a product. As in past years, OCIE will continue to prioritize examinations

of issues focused on retail investors, including those related to mutual funds and ETFs, municipal securities and other fixed income securities, and microcap securities.

#### **Mutual Funds and ETFs**

Mutual funds and ETFs are the primary investment vehicle for many retail investors. In addition to the other mutual fund and ETF priorities identified below, OCIE will continue to prioritize the examination of financial incentives provided to financial services firms and professionals that may influence the selection of particular mutual fund share classes. OCIE also will review for mutual fund fee discounts that should be provided to investors as a result of policies, contractual or disclosed breakpoints, such as discounts provided based on achieving managed investments of a specific size.

#### **Municipal Securities and Other Fixed Income Securities**

OCIE will examine broker-dealer trading activity in municipal and corporate bonds for compliance with best execution obligations; fairness of pricing, mark-ups and mark-downs, and commissions; and confirmation disclosure requirements, including retail disclosures relating to mark-ups and mark-downs.

#### **Microcap Securities**

OCIE will examine broker-dealers and transfer agents to review for those that may be engaged in, or aiding and abetting, pump and dump schemes, market manipulation, and illegal distributions of securities of smaller market capitalization companies—*i.e.*, companies with a market capitalization under \$250 million. Broker-dealers may be selected for examination based on factors such as employing registered representatives with disciplinary history, engaging in significant trading activity in unlisted securities, and making markets in unlisted securities. Focus areas for examinations will include: transfer agent handling of microcap distributions and share transfers; broker-dealer sales practices; broker-dealer supervision of high risk registered representatives; and broker-dealer compliance with certain regulatory requirements, including those concerning quotations under Rule 15c2-11 Exchange Act, the locate requirement of Regulation SHO, and the obligation to file suspicious activity reports (SARs).

## Standards of Care

The Commission's June 2019 adoption of Regulation Best Interest, the Interpretation Regarding Standard of Conduct for Investment Advisers, and the Form CRS Relationship Summary will have a direct impact on the retail investor experience with broker-dealers and RIAs.<sup>2</sup> Regulation Best Interest requires broker-dealers, or a natural person who is an associated person of a broker or dealer, among other things, to act in the best interest of their retail customers when making a recommendation of any securities transaction or investment strategy involving securities without placing their financial or other interests ahead of the interests of the retail customer. The standard of conduct draws from key fiduciary principles and cannot be satisfied through disclosure alone. The Interpretation Regarding Standard of Conduct for Investment Advisers reaffirms, and in some cases clarifies, aspects of an RIA's fiduciary duty that comprises duties of care and loyalty to their clients.

In order to assist firms with planning for compliance with the new rules, the SEC established an inter-Divisional Standards of Conduct Implementation Committee, of which OCIE representatives are members.<sup>3</sup> To further 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 on implementing the new rules and questions they may have regarding the new rules. After the compliance dates, OCIE intends to assess implementation of the requirements 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. Moreover, OCIE has already integrated the Interpretation Regarding Standard of Conduct for Investment Advisers into the IAIC examination program.

---

<sup>2</sup> See Regulation Best Interest: The Broker-Dealer Standard of Conduct, Rel. No. 34-86031 (June 5, 2019), available at <https://www.sec.gov/rules/final/2019/34-86031.pdf>. Commission Interpretation Regarding Standard of Conduct for Investment Advisers, Rel. No. IA-5248 (June 5, 2019), available at <https://www.sec.gov/rules/interp/2019/ia-5248.pdf>; Form CRS Relationship Summary; Amendments to Form ADV, Rel. No 34-86032 (June 5, 2019), available at <https://www.sec.gov/rules/final/2019/34-86032.pdf>.

<sup>3</sup> The SEC encourages firms to actively engage with this committee as questions arise in planning for implementation. You may send your questions by email to [IABDQuestions@sec.gov](mailto:IABDQuestions@sec.gov).

## 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 compromised to other market participants and retail investors, who may not be well informed of these risks and the potential consequences. OCIE is focused on working with firms to identify and address information security risks, including cyber-related, and to encourage market participants to actively and effectively engage regulators and law enforcement in this effort.

### DID YOU KNOW?

OCIE prioritized information security in each of its five examination programs in FY 2019.

OCIE will continue to prioritize information security in each of its five examination programs. Examinations will focus on, among other things, proper configuration of network storage devices, information security governance generally, and retail trading information security. Specific to RIAs, OCIE will continue to focus its examinations on assessing RIAs' protection of clients' personal financial information. Particular focus areas will include: (1) governance and risk management; (2) access controls; (3) data loss prevention; (4) vendor management; (5) training; and (6) incident response and resiliency.

In the area of third-party and vendor risk management, OCIE will also focus on oversight practices related to certain service providers and network solutions, including those leveraging cloud-based storage. OCIE will continue to conduct examinations of registrants to review for compliance with Regulations S-P and S-ID. OCIE also will focus on the controls surrounding online access and mobile application access to customer brokerage account information. Finally, OCIE will examine for the safeguards around the proper disposal of retired hardware that may contain client information and potential network information that could create an intrusion vulnerability.

## FINANCIAL TECHNOLOGY (FINTECH) AND INNOVATION, INCLUDING DIGITAL ASSETS AND ELECTRONIC INVESTMENT ADVICE

Innovations and advancements in financial technologies, methods of capital formation, market structures, and investor interfaces continue to grow at a rapid pace. For example, registered firms are increasingly using new sources of data, often referred to as “alternative data” by the industry that, among other things, may drive investment decision-making. OCIE remains focused on keeping abreast of these developments, and examinations will focus on firms’ use of these data sets and technologies to interact with and provide services to investors, firms, and other service providers and assess the effectiveness of related compliance and control functions.

### **Digital Assets**

The digital assets market has grown rapidly and presents various risks, including for retail investors who may not adequately understand the differences between these assets and more traditional products. Due to these risks, OCIE will continue to identify and examine SEC-registered market participants engaged in this space. Examinations will assess the following: (1) investment suitability, (2) portfolio management and trading practices, (3) safety of client funds and assets, (4) pricing and valuation, (5) effectiveness of compliance programs and controls, and (6) supervision of employee outside business activities.

### **Electronic Investment Advice**

In addition, OCIE will continue its focus on RIAs that provide services to their clients through automated investment tools and platforms, often referred to as “robo-advisers.” Areas of focus include, among others: (1) SEC registration eligibility, (2) cybersecurity policies and procedures, (3) marketing practices, (4) adherence to fiduciary duty, including adequacy of disclosures, and (5) effectiveness of compliance programs.

## ADDITIONAL FOCUS AREAS INVOLVING RIAS AND INVESTMENT COMPANIES

OCIE typically assesses compliance programs of RIAs 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 will often assess the adequacy of disclosures and governance practices in the core areas reviewed.

### RIA Compliance Programs

OCIE will continue to review the compliance programs of RIAs, including whether those programs and their policies and procedures, are reasonably designed, implemented, and maintained.

OCIE will continue to prioritize examinations of RIAs that are dually registered as, or are affiliated with, broker-dealers, or have supervised persons who are registered representatives of unaffiliated broker-dealers. Areas of focus will include 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. OCIE will also prioritize examining firms that utilize the services of third-party asset managers to advise clients' investments to assess, among other things, the extent of these RIAs' due diligence practices, policies, and procedures.

#### DID YOU KNOW?

OCIE staff participated in or held more than 100 compliance outreach events in FY 2019.

OCIE has a particular interest in the accuracy and adequacy of disclosures provided by RIAs offering clients new types or emerging investment strategies, such as strategies focused on sustainable and responsible investing, which incorporate environmental, social, and governance (ESG) criteria.

### Never-Before and Not Recently-Examined RIAs

OCIE will continue to conduct risk-based examinations of RIAs that have never been examined, including new RIAs and RIAs registered for several years that have yet to be examined. OCIE will also prioritize examinations of RIAs that were previously examined but have not been examined for a number of years to focus on whether the RIAs' compliance programs have been appropriately adapted in light of any substantial growth or change in their business models.

### **Mutual Funds and ETFs**

As retail assets continue to flow into investment companies, OCIE will prioritize examinations of mutual funds and ETFs, the activities of their RIAs, and oversight practices of their boards of directors. Examinations will assess industry practices and regulatory compliance in various areas, including a focus on: (1) RIAs that use third-party administrators to sponsor the mutual funds they advise or are affiliated with; (2) mutual funds or ETFs that have not previously been examined; and (3) RIAs to private funds that also manage a registered investment company with a similar investment strategy.

### **RIAs to Private Funds**

OCIE will continue to focus on RIAs 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. Moreover, OCIE will review RIAs to private funds to assess compliance risks, including 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 RIA affiliates to provide services to clients.

## **ADDITIONAL FOCUS AREAS INVOLVING BROKER-DEALERS AND MUNICIPAL ADVISORS**

In addition to the aforementioned areas focusing on sales practices, broker-dealer examinations will also focus on the safety of customer cash and securities, risk management, certain types of trading activity, the effects of evolving commissions and other cost structures, best execution, and payment for order flow arrangements.

### **Broker-Dealer Financial Responsibility**

Broker-dealers that hold customer cash and securities have a responsibility to ensure that those assets are safeguarded in accordance with the Customer Protection Rule and the Net Capital Rule. Examinations of broker-dealers will continue to focus on compliance with these rules, including the adequacy of internal processes, procedures, and controls.

### **Trading and Broker-Dealer Risk Management**

OCIE will also examine firms' trading and risk management practices. For example, OCIE will examine firms' trading and other activities in "odd lots," that is, orders under 100 shares. These orders often represent retail interest and require special treatment by broker-dealers to ensure compliance with applicable

#### **DID YOU KNOW?**

OCIE will continue to publish Risk Alerts describing its national initiatives and outlining findings from examinations in key areas. We believe sharing this information further promotes compliance and protects investors.

laws and regulations, including best execution. OCIE will also continue to examine for controls around the use of automated trading algorithms by broker-dealers. Algorithmic trading has expanded into multiple asset classes and is subject to SEC and FINRA rules governing trading activity. Poorly designed trading algorithms have the potential to adversely impact market and broker-dealer stability. OCIE will, therefore, examine how broker-dealers supervise algorithmic trading activities, including the development, testing, implementation, maintenance, and modification of the computer programs that support their automated trading activities and controls around access to computer code. Finally, OCIE will examine registered firms' use of internal procedures, practices, and controls to manage trading risk.

### **Municipal Advisors**

Municipal advisors provide advice to, or on behalf of, a municipal entity or obligated person with respect to municipal financial products or the issuance of municipal securities or municipal financial products. OCIE will continue to conduct examinations of municipal advisors, concentrating on whether they have satisfied their registration, professional qualification, and continuing education requirements. OCIE will prioritize 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. OCIE will also focus on the conduct of municipal advisors when faced with conflicts while representing their clients, and compliance with recently-effective Municipal Securities Rulemaking Board (MSRB) Rule G-40 concerning advertisements.

## **AML PROGRAMS**

The Bank Secrecy Act requires financial institutions, including broker-dealers and investment companies, to establish anti-money laundering (AML) programs. These programs must, among other things, include policies and procedures reasonably designed to identify and verify the identity of customers and beneficial owners of legal entity customers, perform customer due diligence (as required by the Customer Due Diligence rule), monitor for suspicious activity, and, where appropriate, file SARs with the Financial Crimes Enforcement Network. SARs are used to detect and combat terrorist financing, public corruption, market manipulation, and a variety of other fraudulent behavior.

Given the importance of these requirements, OCIE will continue to prioritize examining broker-dealers and investment companies for compliance with their AML obligations in order to assess, among other things, whether firms have established appropriate customer identification programs and whether they are satisfying their SAR filing obligations, conducting due diligence on customers, complying with beneficial ownership requirements, and conducting robust and timely independent tests of their AML programs. The goal of these

examinations is to ensure that broker-dealers and investment companies have adequate policies and procedures in place that are reasonably designed to identify suspicious activity and illegal money-laundering activities.

## MARKET INFRASTRUCTURE

### Clearing Agencies

Title VIII of the Dodd-Frank Act requires the SEC to examine, at least once annually, registered clearing agencies that the Financial Stability Oversight Council has designated as systemically important and for which the SEC serves as the supervisory agency (SEC SIFMU Clearing Agencies). Pursuant to Section 807 of the Dodd-Frank Act, the Commission must conduct exams of SEC SIFMU Clearing Agencies in order to assess, among other things: (1) the financial and operational risks borne and presented by them to financial institutions, critical markets and the financial system; (2) their resources and capabilities to monitor and control such risks; (3) the safety and soundness of the organization; and (4) their compliance with the Exchange Act, the rules and regulations promulgated under the Exchange Act, and the Dodd-Frank Act. OCIE fulfills the SEC's requirements under the Dodd-Frank Act through examinations conducted by its Office of Clearance and Settlement and its Technology Controls Program.

#### DID YOU KNOW?

OCIE encourages market participants to actively and effectively engage regulators and law enforcement in identifying and addressing information security risks.

OCIE will conduct risk-based exams focusing on SEC SIFMU Clearing Agency's core risks, processes, and controls which touch on each requirement of the Dodd-Frank Act. OCIE will also conduct risk-based examinations of other registered clearing agencies.

The Standards for Covered Clearing Agencies are codified in the Exchange Act, and require most registered clearing agencies to, among other things, maintain sufficient financial resources, protect against credit risks, manage member defaults, and manage operational and other risks. Examinations of SEC registered clearing agencies will focus on, where applicable: (1) compliance with the SEC's Standards for Covered Clearing Agencies and other federal securities laws applicable to registered clearing agencies; (2) whether clearing agencies have taken timely appropriate corrective action in response to prior examinations; and (3) other areas identified in collaboration with the SEC's

Division of Trading and Markets and with other regulators. Areas of focus will include liquidity risk management, collateral and investment risk management, default risk management, cyber security and resiliency, and recovery and wind down procedures more generally, among other things.

As part of its examinations, OCIE will also examine registered clearing agencies' governance, legal, compliance and risk management frameworks by reviewing these entities' efforts to escalate deficiencies identified by OCIE and internal auditors and whether they have taken timely and appropriate action to correct those deficiencies and mitigate the risks associated with those deficiencies.

Finally, OCIE consults with the Federal Reserve Board each year on the scope and methodology of the SEC's Dodd-Frank examinations, as required by that Act, and routinely consults with the SEC's Division of Trading and Markets concerning risks it observes in its supervisory role over the above clearing agencies. These risks are incorporated into the risk-based planning of the examinations discussed above.

### **National Securities Exchanges**

National securities exchanges provide marketplaces for facilitating securities transactions and, under the federal securities laws, serve as self-regulatory organizations responsible for enforcing compliance by their members with the federal securities laws and rules and the exchanges' own rules. OCIE will examine the operations of national securities exchanges, especially how they react to market disruptions. OCIE will also examine how the national securities exchanges monitor member activity for compliance with the federal securities laws and rules and will focus on exchange efforts concerning abusive, manipulative, and illegal trading practices to protect the integrity of the marketplace.

### **Regulation Systems Compliance and Integrity (SCI)**

Regulation SCI was adopted by the Commission to strengthen the technology infrastructure of the U.S. securities markets. Among other things, it requires SCI entities, which include national securities exchanges, registered and certain exempt clearing agencies, FINRA, MSRB, plan processors, and alternative trading systems that meet certain volume thresholds, to establish, maintain, and enforce written policies and procedures designed to ensure that their systems' capacity, integrity, resiliency, availability, and security is adequate to maintain their operational capability and promote the maintenance of fair and orderly

markets. When certain personnel at these entities have a reasonable basis to conclude that certain events have occurred, these entities are required to begin to take appropriate corrective action to remedy the event as soon as reasonably practicable and immediately notify the SEC of the occurrence.

OCIE will continue to evaluate whether SCI entities have established, maintained, and enforced written SCI policies and procedures as required. Areas of focus will include IT inventory management, IT governance, incident response, and third party vendor management, including the utilization of cloud services. OCIE will also continue to perform examinations to review whether SCI entities have taken appropriate action in response to past examinations.

### **Transfer Agents**

Transfer agents serve as agents for securities issuers and play a critical role in the settlement of securities transactions. Among their key functions, transfer agents are responsible for maintaining issuers' securityholder records, recording changes of ownership, canceling and issuing certificates, distributing dividends and other payments to securityholders, and facilitating communications between issuers and securityholders.

OCIE will continue to examine transfer agents' core functions, including: the timely turnaround of items and transfers, recordkeeping and record retention, and safeguarding of funds and securities. OCIE examinations will also focus on the requirement for transfer agents to annually file a report by an independent accountant concerning the transfer agent's system of internal accounting controls, as well as compliance with obligations to search for lost securityholders and provide notice to unresponsive payees.

Examination candidates will include transfer agents that serve as paying agents for issuers, transfer agents developing blockchain technology, and transfer agents that provide services to issuers of microcap securities, private offerings, crowdfunded securities, or digital assets.

## FOCUS ON FINRA AND MSRB

### FINRA

FINRA oversees approximately 3,600 brokerage firms, 156,000 branch offices, and 630,000 registered representatives through examinations, enforcement, and surveillance. In addition, FINRA, among other things, provides a forum for securities arbitration and mediation, conducts market regulation, including by contract for a majority of national securities exchanges, reviews broker-dealer advertisements, administers the testing and licensing of registered persons, and operates industry utilities such as Trade Reporting Facilities.

OCIE conducts risk-based oversight examinations of FINRA. It selects areas within FINRA to examine through a risk assessment process designed to identify those aspects of FINRA's operations important to the protection of investors and market integrity. The analysis is informed by collecting and analyzing extensive information and data, regular meetings with key functional areas within FINRA, and outreach to various stakeholders, including broker-dealers and investor groups. Based on the outcome of this 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. From its observations during all of these inspections and examinations, OCIE makes detailed recommendations to improve FINRA's programs, its risk assessment processes, and its future examinations.

### MSRB

MSRB regulates the activities of broker-dealers that buy, sell, and underwrite municipal securities, and municipal advisors. MSRB establishes rules for municipal securities dealers and municipal advisors, supports market transparency by making municipal securities trade data and disclosure documents available, and conducts education and outreach regarding the municipal securities market. OCIE, along with FINRA, conducts examinations of registered firms to ensure compliance with MSRB rules. OCIE also applies a risk assessment process, similar to the one it uses to oversee FINRA, to identify areas to examine at MSRB. Examinations of MSRB evaluate the effectiveness of MSRB's policies, procedures, and controls.

## CONCLUSION

These priorities reflect OCIE's assessment of certain risks, issues, and policy matters arising from market and regulatory developments, information gathered from examinations, and other sources, including tips, complaints, and referrals, and coordination with other Divisions and Offices at the SEC as well as other regulators. OCIE welcomes comments and suggestions regarding how it can better fulfill its mission to promote compliance, prevent fraud, identify and monitor risk, and inform SEC policy. Our contact information is available at <https://www.sec.gov/ocie>. If you suspect or observe activity that may violate the federal securities laws or otherwise operates to harm investors, please notify SEC Staff at <https://www.sec.gov/tcr>.





U.S. Securities and  
Exchange Commission  
100 F Street NE  
Washington, DC 20549  
[SEC.gov](http://SEC.gov)