

AN ALERT FROM THE BDO FINANCIAL SERVICES PRACTICE

ASSET MANAGEMENT INSIGHTS



SEC EXAMINATION PRIORITIES FOR 2019

The Office of Compliance Inspections and Examinations (OCIE) of the U.S. Securities and Exchange Commission (SEC) recently announced its [2019 Examination Priorities](#). 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, as well as coordination with other regulators.

OCIE has identified the following six themes for their 2019 Examination Priorities, which include perennial and emerging risk areas:

1. Retail investors covering the following areas:

- ▶ **Fees and Expenses** – OCIE will continue to review fees and expenses charged to advisory accounts, ensuring that the fees assessed and expenses charged are in accordance with the client agreements and firm disclosures. Firms with practices or business models that may create increased risks of inadequately disclosed fees, expenses, or other charges are expected to be high target candidates for selection to be examined.

BDO'S ASSET MANAGEMENT PRACTICE

BDO's Asset Management practice provides assurance, tax and advisory services to asset management entities, primarily hedge, private equity and venture capital funds. The practice services over 600 advisors nationwide with funds ranging from start-up funds to those with billions under management.

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► **Conflicts of Interest** – Examinations will review firms' policies and procedures addressing:

1. The use of affiliated service providers and products;
2. Securities-backed non-purpose loans and lines of credit¹; and
3. Borrowing funds from clients.

► **Portfolio Management and Trading** – OCIE will focus on firms' practices for executing investment transactions, allocating investment opportunities among clients and ensuring consistency of investments with the disclosed investment objectives.

► **Never-Before or Not Recently-Examined Investment Advisers** – There will be a continued focus to examine investment advisers that have never been examined; including newly-registered investment advisers, as well as those registered for several years but have yet to be examined. OCIE will also prioritize examinations of certain investment advisors that have not been examined for a number of years and may have substantially grown or changed business models.

► **Senior Investors and Retirement Accounts and Products** – These examinations will focus on, among other things, compliance programs of investment advisers, the appropriateness of certain investment recommendations to seniors, and the supervision by firms of their employees and independent representatives.

► **Mutual Funds and Exchange-Traded Funds** – Examinations will assess industry practices and regulatory compliance in various areas that may have significant impact on retail investors.

► **Municipal Advisors** – OCIE will continue to conduct select examinations of municipal advisors that have never been examined, concentrating on whether these advisors have satisfied their registration requirements, professional qualifications and continuing education requirements, as well as examining their compliance with Municipal Securities Rulemaking Board (MSRB) rules.

► **Broker-Dealers Entrusted with Customer Assets** – Examinations of select broker-dealers will focus on compliance with the Customer Protection Rule (Securities Act Exchange Rule 15c3-3), as well as procedures and controls to promote compliance.

► **Microcap Securities** – OCIE will continue examinations of broker-dealers involved in selling stocks of companies with market capitalization under \$250 million.

2. Digital Assets (including cryptocurrencies, coins and tokens)

Given the significant growth opportunities and risks in this space, OCIE will continue to monitor the offer and sale, trading and management of digital assets. Where the products are treated as securities, OCIE will also examine for regulatory compliance. For firms actively engaged in the digital asset market, OCIE will conduct examinations focused on portfolio management of digital assets, trading, safety of client funds and assets, pricing of client portfolios, compliance and internal controls.

3. Cybersecurity

Areas expected to be covered by OCIE include cybersecurity practices at investment advisers with multiple branch offices, particularly those that have recently merged with other investment advisers. OCIE will continue to focus on governance and risk assessment, access rights and controls, data loss prevention, vendor management, training and incident response, among other areas.

4. Anti-Money Laundering

Examination of broker-dealers will focus on their compliance with anti-money laundering (AML) obligations, including whether they are meeting their Suspicious Activity Report (SAR) filing obligations, implementing all elements of their AML program and conducting independent tests of their AML program in a comprehensive and timely fashion. This is a priority area for OCIE, and the goal of these examinations is to ensure that broker-dealers have policies and procedures in place that are reasonably designed to identify suspicious activity and illegal money laundering activities.

5. Compliance and Risk in Registrants Responsible for Critical Market Infrastructure

OCIE continues to focus on certain firms that are essential to facilitating, maintaining and/or operating the integrity and functioning of the financial markets (e.g., clearing agencies, transfer agents, national securities exchanges and entities subject to Regulation Systems Compliance and Integrity).

6. Focus on Financial Industry Regulatory Authority (FINRA) and MSRB

OCIE continues to focus on the effectiveness of operations and regulatory programs, and the quality of examinations performed by FINRA and MSRB.

¹ A non-purpose loan or line of credit allows borrowers to use the securities in their brokerage or advisory accounts as collateral to obtain a loan; the proceeds of which cannot be used for purchasing or trading securities. OCIE has observed that advisers, broker-dealers, and their employees receive certain financial incentives to recommend these products to clients and/or customers. OCIE will assess this practice to determine whether registrants are, among other things, adequately disclosing the risks to clients and any conflicts of interest presented by recommending these loans.

BDO INSIGHTS

The 2019 Examination Priorities provide a preview of key areas where OCIE intends to focus its limited resources, but they do **not** encompass an exhaustive list. While the priorities drive many of OCIE's examinations, the selection of registrants and the scope / extent of the areas examined is based on OCIE's risk-based approach that includes analysis of the registrant's operations, products offered, and other factors. This risk-based approach often results in examinations that address key aspects of the SEC's regulatory oversight, such as the disclosure of services, fees, expenses, conflicts of interest for investment advisers, and trading and execution quality issues for broker-dealers.

Additionally, OCIE will continue to evaluate changes in market conditions, industry practices, and investor preferences to assess risks to both investors and the markets, and will adjust its risk-based program in response to these changes.

Firms should ensure that their disclosures, policies and procedures are adequate in reflecting the actual practices of the firm. Quite frequently, OCIE identifies issues at organizations whose practices are not aligned with their business and operations, or are inconsistent with expected processes and controls.

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