



# ASSET MANAGEMENT **INSIGHTS**

INSIGHTS FROM THE BDO FINANCIAL SERVICES PRACTICE

## **SEC EXAMINATION PRIORITIES FOR 2020**

By Suzette Murray, Assurance Senior Manager

The Office of Compliance Inspections and Examinations (OCIE) of the U.S. Securities and Exchange Commission (SEC) recently announced its [2020 Examination Priorities](#). While these priorities provide an overview of key areas where OCIE intends to focus its limited resources, it does not encompass all of the perennial risk areas OCIE routinely evaluates in order to improve compliance.

While not an exhaustive list, the following is an overview of eight examination focus areas for OCIE that serve to protect investors.

### **1. THE LIBOR TRANSITION EFFECT**

OCIE will track and evaluate the impact of the asset management industry's transition away from LIBOR. This includes reviewing registered investment advisers' (RIAs) preparations and disclosures regarding their readiness, particularly in relation to the transition's effects on investors. Additionally, an RIA should evaluate its own and its clients' exposure to LIBOR, not just in the context of fallback language in contracts, but also its use in benchmarks and indices, accounting systems, risk models and client reporting, among other areas.

## 2. RETAIL INVESTORS COVERING THE FOLLOWING AREAS:

### RIAs' client management approach as it relates to fraud, sales practices and conflicts

- ▶ Recommendations and advice RIAs give to retail investors, particularly seniors, teachers and military personnel.
- ▶ Higher-risk products offered by RIAs such as private placements and securities of issuers in new and emerging risk areas. The latter category includes securities that are complex, non-transparent, have high fees and expenses or where the issuer is related to the RIA making the recommendation.
- ▶ Disclosures and supervision of outside business activities of RIAs' employees and associated persons, and any conflicts that may arise from those activities.
- ▶ Whether RIAs provide advice in the best interests of their clients and eliminate, or at least disclose, all conflicts of interest which might incline RIAs, consciously or unconsciously, to render advice which is not disinterested.
- ▶ Risks associated with fees and expenses, and undisclosed, or inadequately disclosed, compensation arrangements.

OCIE is also interested in the accuracy and adequacy of disclosures provided by RIAs that offer clients new types of emerging investment strategies, such as strategies that incorporate environmental, social and governance (ESG) criteria.

### Retail targeted investments

OCIE will continue to prioritize examinations of issues related to mutual funds and ETFs, such as financial incentives provided to financial services firms and professionals that may influence the selection of particular mutual fund share classes, as well as mutual fund fee discounts that should be passed on to investors.

### Standards of care

OCIE will evaluate RIAs compliance with the package of rules and interpretations adopted by the SEC in June 2019, that are designed to enhance the quality and transparency of retail investors' relationships with financial professionals. Specifically, OCIE will assess the implementation of the requirements of Regulation Best Interest<sup>1</sup>, including policies and procedures regarding conflicts, disclosures and the content and delivery of the Form CRS Relationship Summary<sup>2</sup>.

## 3. 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 administer separately managed accounts side-by-side with private funds. OCIE will also review these RIAs to assess compliance risks, including:

- ▶ controls to prevent the misuse of material, non-public information,
- ▶ conflicts of interest, such as undisclosed or inadequately disclosed fees and expenses, and
- ▶ the use of RIA affiliates to provide services to clients.

## 4. RIA COMPLIANCE PROGRAMS

As part of its examinations, OCIE typically assesses an RIA's compliance programs in core areas, such as:

- ▶ 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.

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 RIAs 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 examinations of RIAs that utilize the services of third-party asset managers to advise clients. OCIE will assess, among other things, RIAs' due diligence practices, policies and procedures.

## 5. 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. For RIAs that have not been examined for a number of years, the focus will be to evaluate whether their compliance programs have been updated in the event of substantial changes in the business model.

<sup>1</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> and 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>.

<sup>2</sup> See 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>.

## 6. INFORMATION SECURITY

OCIE will continue to prioritize information security through examinations by assessing RIAs' protection of clients' personal financial information, particularly:

- ▶ governance and risk management,
- ▶ access controls,
- ▶ data loss prevention,
- ▶ vendor management,
- ▶ training, and
- ▶ incident response and resiliency.

With respect to vendor risk management, OCIE will also focus on oversight practices related to certain service providers and network solutions, including those leveraging cloud-based storage.

Additionally, OCIE will continue to conduct examinations of RIAs, mutual funds and ETFs for compliance with Regulations S-P and S-ID. That includes a focus on the: (i) controls surrounding online access and mobile application access to customer account information, (ii) safeguards around the proper disposal of retired hardware that may contain client information, and (iii) potential network information that could create an intrusion vulnerability.

## 7. FINANCIAL TECHNOLOGY AND INNOVATION

Due to the growth of digital assets (such as cryptocurrencies), and the lack of understanding of those investment vehicles by retail investors, OCIE will also continue to identify and examine RIAs engaged in the digital assets space in order to evaluate: (i) investment suitability, (ii) portfolio management and trading practices, (iii) safety of client funds and assets, (iv) valuation, and (v) effectiveness of compliance programs and controls.

Additionally, 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," particularly around: (i) SEC registration eligibility, (ii) cybersecurity policies and procedures, (iii) marketing practices, (iv) adherence to fiduciary duty, including adequacy of disclosures, and (v) effectiveness of compliance programs.

## 8. MUTUAL FUNDS AND ETFs

OCIE will prioritize examinations of mutual funds and ETFs, the activities of their RIAs, and oversight practices of their boards of directors. Examinations will focus on: (i) RIAs that use third-party administrators to sponsor the mutual funds they advise or are affiliated with, (ii) mutual funds or ETFs that have not previously been examined, and (iii) RIAs to private funds that also manage a registered investment company with a similar investment strategy.

### TO SUMMARIZE

While the stated 2020 priorities drive many of OCIE's examinations, the focus on expansive examinations of the operations and product offerings of RIAs, mutual funds and ETFs (outlined above), reinforces OCIE's risk-based approach. This approach often results in examinations that address key aspects of the SEC's regulatory oversight, such as the adequacy of disclosures concerning services, fees and expenses, conflicts of interest and valuation of assets.

Additionally, OCIE will continue to monitor industry developments and market events to assess the impact on retail investors and SEC-registered firms, and continue to tailor its risk-based program to respond.

As a result, 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.

**For more information about how your firm can comply with future OCIE examinations, please contact Suzette Murray, Assurance Senior Manager at [snmurray@bdo.com](mailto:snmurray@bdo.com).**



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