

MEMO# 31091

February 16, 2018

OCIE Publishes the Priorities of the National Examination Program for 2018

[31091]

February 16, 2018 TO: ICI Members

Investment Company Directors

ICI Global Members SUBJECTS: Advertising

Anti-Money Laundering

Compliance

Cybersecurity

Exchange-Traded Funds (ETFs)

Fixed Income Securities

Litigation & Enforcement

Municipal Securities

Variable Insurance Products RE: OCIE Publishes the Priorities of the National Examination Program for 2018

The National Examination Program of the SEC's Office of Compliance Inspections and Examinations (OCIE) has published its examination priorities for 2018.[\[1\]](#) Unlike the previous publication of their priorities, this year's is a very polished document with a glossy cover and a table of contents and a "Message from OCIE Leadership" preceding the summary of the priorities. The Priorities are divided into five substantive sections:

- Retail Investors, Including Seniors and Those Saving for Retirement;
- Compliance and Risk in Critical Market Infrastructure;
- Focus on FINRA and MSRB;
- Cybersecurity; and
- AML Programs

The discussion in the Priorities that may be relevant to the Institute's members are briefly summarized below.

Message from OCIE's Leadership Team

This section of the Priorities discusses the four "pillars" of OCIE's work: (1) promoting compliance; (2) preventing fraud; (3) identifying and monitoring risks; and (4) informing policy. It discusses how OCIE determines its annual priorities, and how, in executing its priorities, it abides by the following principles:

Principle 1: OCIE is risk-based

Principle 2: OCIE is data-driven

Principal 3: OCIE is transparent

Principle 4: OCIE strives to put its resources to their highest and best use

Principle 5: OCIE embraces innovation and new technology, both as a means to do more with less and as a necessary focal point of their analytic efforts.

With respect to Principle 2, the Priorities note that data “is integral” to OCIE’s program “and complements [its] risk-based exam approach and utilization of technology.” Cited as examples of this are OCIE’s Quantitative Analytics Unit (QAU) of the National Exam Analytics Tolls (NEAT) “to facilitate the analysis of trading blotters.” It notes that the QAU “is comprised of financial engineers who, in addition to developing tools, directly assist exam teams with quantitative analysis.” It notes that OCIE continuously looks “for ways to employ technology and data analytics to enhance [its] effectiveness in every aspect of the examination program.”

With respect to Principle 3, the Priorities discuss how OCIE views transparency as an important tool it can use to benefit the work of legal, compliance, and risk staff at registrants. It attempts to provide transparency by publishing information about its work (including its priorities) and Risk Alerts summarizing its findings and observations from reviews.

Priorities Relating to Retail Investors, Including Seniors and Those Saving for Retirement

This section of the Priorities has nine subheadings discussing the following topics:

- Disclosure of the Cost of Investing
- Electronic Investment Advice
- Wrap Fee Programs
- Never-Before Examined Investment Advisers
- Senior Investors and Retirement Accounts and Products
- Mutual Funds and Exchange Traded Funds (ETFs)
- Municipal Advisors and Underwriters
- Fixed Income Order Execution and
- Cryptocurrency, Initial Coin Offerings (ICOs), Secondary Market Trading, and Blockchain

Most of these issues have previously appeared on OCIE’s annual priorities. The new ones, and OCIE’s focus are as follows:

Disclosure of the Cost of Investing – Because “every dollar an investor pays in fees and expenses is a dollar not invested for his or her benefit,” OCIE believes it is “important for financial professionals to inform investors of any conflicts of interests that might provide incentives for the financial professionals to recommend certain types of products or services to investors, including any higher cost or riskier products.” Accordingly, OCIE plans to review, among other things, whether fees and expenses are calculated consistently with disclosures and investor agreements. They will also focus on practices that “may create increased risks that investors will pay inadequately disclosed fees, expenses, or other charges.” These business models include:

- Providing advisory personnel financial incentives to recommend that investors invest, or remain invested, in particular shares of mutual fund classes that may pay higher sales loads or distribution fees where the conflict is not disclosed to investors;
- Failing to assign existing accounts to new representatives when the representative handling the account has left the firm;
- Changing compensation models from commission-based to a percentage of client assets under management; and
- Private fund advisers that manage funds with a high concentration of investors who invest for the benefit of retail clients, including non-profit organizations and pension plans.

Senior Investors and Retirement Accounts and Products – while OCIE’s Priorities for the past few years have long included this as an area of focus, for 2018, OCIE will review, in part, the ability of firms to identify financial exploitation of seniors. Exams reviewing retirement accounts will focus on, among other things, investment recommendations, sales of variable insurance products, and sales and management of target date funds. OCIE will also examine investment adviser and broker-dealer involvement with retirement plans that primarily serve state and local government employees and non-profit employees, including 403(b) and 457 plans.

Mutual Funds and ETFs – With respect to mutual funds, OCIE’s focus will be on mutual funds that:

1. have experienced poor performance or liquidity in terms of their subscriptions and redemptions relative to their peer groups;
2. are managed by advisers with little experience managing registered investment companies; or
3. hold securities that are potentially difficult to value in times of market stress, including securitized auto, student, or consumer loans, or collateralized mortgage-backed securities.

They will also focus on those mutual funds and ETFs “that seek to track custom-built indexes to review for any conflicts the adviser may have with the index provider and the adviser’s role with respect to the selection and weighting of index components.”

With respect to ETFs, OCIE’s focus will be on those “that have little secondary market trading volume and that face the risk of being delisted from an exchange and having to liquidate assets.” Such exams will include analyzing whether the ETF’s investment risks are adequately disclosed to investors.

Cryptocurrency, ICOs, Secondary Market Trading, and Blockchain – With respect to these issues, OCIE will focus on ensuring that registrants maintain adequate controls and safeguards to protect these assets from theft or misappropriation, and ensuring that they provide investors disclosure about risks associated with these investments, including the risk of loss, liquidity risks, price volatility, and potential fraud.

Priorities Relating to Cybersecurity

After noting that the scope and severity of risks that cyber presents “have increased dramatically,” the Priorities state that OCIE “will continue to prioritize cybersecurity in each of [their] examination programs.” OCIE’s focus in this space will be on governance and risk assessment, access rights and controls, data loss prevention, vendor management, training, and incident response.

Priorities Relating to Anti-Money Laundering Programs

During the coming year, OCIE plans to continue to review on whether registrants are appropriately adapting their AML programs to address their obligations. This will include a review of customer due diligence requirements and whether entities are taking reasonable steps to understand the nature and purpose of customer relationships and to properly address risks. They will also review whether firms are filing complete, timely, and accurate SARs and whether they “are conducting robust and timely independent tests of their AML programs.”

* * * *

The Priorities conclude by noting that its description of OCIE priorities for 2018 is not exhaustive. As in the past, OCIE will continue to conduct exams focused on risks, issues, and policy matters that arise during the year from market and regulatory developments, information learned from examinations, and information received from other sources (including other regulators). They request that persons who suspect or observe violations of the Federal securities laws notify the SEC of such suspicions or observations.

Tamara K. Salmon
Associate General Counsel

endnotes

[1] See <https://www.sec.gov/about/offices/ocie/national-examination-program-priorities-2018.pdf>.