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SEC's National Examination Program Publishes Its Examination Priorities for 2015

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TO: INTERNAL SALES MANAGERS ROUNDTABLE No. 2-15
SALES FORCE MARKETING COMMITTEE No. 1-15 RE: SEC'S NATIONAL EXAMINATION PROGRAM PUBLISHES ITS EXAMINATION PRIORITIES FOR 2015

For the third year in a row, the SEC's Office of Compliance Inspections and Examinations (OCIE) has published the examination priorities of the SEC's National Examination Program for the coming year. [\[1\]](#) This year's list of priorities is significantly shorter than those previously published and the document's format has been revised. [\[2\]](#) OCIE's priorities for the coming year will focus on three thematic areas involving investment advisers, broker-dealers, and transfer agents: (1) examination matters of importance to retail investors and investors saving for retirement; (2) assessing issues relating to market-wide risks; and (3) using data and analytics to determine whether registrants are engaging in illegal activities (e.g., penny stock pump-and-dump schemes). Their focus in each of these three areas is briefly described below.

I. Protecting Retail Investors and Investors Saving For Retirement

According to the Priorities, the staff is planning various examination initiatives to assess risks to retail investors that can arise from industry efforts to (1) develop and sell alternative products (e.g., private funds, illiquid investments, and structured products intended to generate higher yield in a low-interest rate environment) and (2) provide products and services to retail investors to help them plan for and live in their retirement years. Among other things, the staff's focus will be on:

- **Fee Selection and Reverse Churning** – The Priorities discuss the trend among financial professionals to operate as an investment adviser or a dually-registered investment adviser and broker-dealer and utilize fees structures not typically available to broker-dealers, such as those based on assets under management, hourly fees, performance-based fees, wrap fees, and utilized fees. Where an adviser offers a variety of fee arrangements, the staff will be reviewing whether they are in the best interest of the client. [This issue was also a focus of the staff during 2014.]

- Sales Practices in Connection with Retirement Accounts – The staff will be assessing whether registrants are using improper or misleading practices when recommending the movement of retirement assets from employer-sponsored defined contribution plans into other investments and accounts, “particularly when they pose greater risks and/or charge higher fees.” [This issue was also a focus of the staff during 2014.]
- Suitability of Recommendations Relating to Retirement Assets – The staff will be evaluating registrants’ recommendations or determinations to invest retirement assets into complex or structured products and higher yield securities. Their focus will be on the due diligence around these determinations, disclosures made to investors, and the suitability of recommendations. [This issue was also a focus of the staff during 2014.]
- Branch Offices – Part of the staff’s focus will be on branch office supervision. It plans to use data analytics to identify branches that may be deviating from the home office’s compliance practices.
- “Alternative” Investment Companies – As in 2014, the staff will again focus on those funds offering alternative investments and using alternative investment strategies. In particular, the staff will continue to review such funds’: leverage, liquidity, and valuations policies and practices; factors relevant to the adequacy of the funds’ internal controls, including staffing, funding, and empowerment of boards, compliance personnel, and back-offices; and the manner in which such funds are marketed to investors.
- Fixed Income Investment Companies – As with their 2014 priorities, the staff will continue to focus on those mutual funds with significant exposure to interest rate increases. Their focus will continue to be on disclosure issues – i.e., whether such funds have implemented compliance policies and procedures and investment trading controls that are sufficient to ensure that their funds’ disclosures are not misleading and that their investments and liquidity profiles are consistent with those disclosures.

II. Assessing Market-Wide Risks

Consistent with the SEC’s mission to maintain fair, orderly, and efficient markets, the staff plans to: monitor the largest broker-dealers and asset managers to assess their risks and consider any potential industry-wide risks; conduct an annual inspection of all clearing agencies that are designated as systemically important pursuant to the Dodd-Frank Act; continue to review broker-dealers’ and investment advisers’ cybersecurity compliance and controls and expand the review to include transfer agents; and assess whether firms are prioritizing trading venues on payments or credits for order flow, contrary to their best execution duties.

III. Using Data Analytics to Identify Signals of Potential Illegal Activity

The staff plans to use the data analytics available to them to focus on registrants that may be engaged in fraudulent or illegal activity. Their focus in this area will include recidivists representatives, microcap fraud (i.e., aiding and abetting pump-and-dump schemes or market manipulation), excessive trading of customer accounts, and AML programs, particularly of those firms that have not filed any suspicious activity reports (SARs) or that have filed incomplete or late SARs. With respect to AML, they will also focus on those firms that allow customers to deposit and withdraw cash and/or provide customers direct access to the markets from higher-risk jurisdictions.

IV. Other Initiatives

In addition to the above, the staff also hopes “to allocate examination resources to other priorities.” These other priorities include: inspections of newly-registered municipal advisers; proxy services (i.e., how proxy advisory service firms make recommendations and disclose and mitigate their potential conflicts of interest and how investment advisers comply with their fiduciary duty in voting investors’ proxies); never-before examined investment company complexes; fees and expenses in private equity funds; and transfer agents, particularly those that are involved with microcap securities and private offerings.

As in previous years, this list is not exhaustive and OCIE will continue to conduct examinations throughout 2015 that arise from market developments, new information learned from examinations or other sources (e.g., the SEC’s Tips, Complaints, and Referrals program), and coordination with other regulators.

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endnotes

[1] The priorities are available at <http://www.sec.gov/about/offices/ocie/national-examination-program-priorities-2014.pdf> (the “Priorities”).

[2] Last year’s list of priorities was 11 pages. This year’s is 4½ pages. With respect to format, last year’s priorities were divided into NEP-Wide Initiatives; Program-Area Specific Initiatives (which included subsections on investment advisers and investment companies and broker-dealers); Market Oversight Exams; and Clearance and Settlement Exams (which included, among other matters, a discussion of transfer agents).