

THIS MONTH'S RESOURCE: 2020 SEC Exam Priorities

On January 7, 2020, the Securities and Exchange Commission's Office of Compliance Inspections and Examinations (OCIE) released its 2020 examination priorities. OCIE is prioritizing practices, products, and services that it believes present heightened risks to investors or market integrity. 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 examination priorities this year are organized around seven themes, many of which build on OCIE's priorities from prior years:

1. Retail investor protection, including seniors and those saving for retirement;
2. Market infrastructure;
3. Information security;
4. Focus areas relating to investment advisers, investment companies, broker-dealers, and municipal advisors;
5. Anti-money laundering programs (AML);
6. Financial technology (Fintech) and innovation, including digital assets and electronic investment advice; and
7. Financial Industry Regulatory Authority (FINRA) and the Municipal Securities Rulemaking Board (MSRB).

In this month's TMR, our team wanted to focus on the priorities that would be most beneficial for our Investment Advisory clients. Below are best practices for exam readiness and further developing a culture of compliance in 2020. Refer to the complete article [\(click here\)](#) for the areas not addressed in the TMR such as *Market Infrastructure, Select areas and programs of FINRA and MSRB, Digital Assets*.

Retail Investor Protection, Including Seniors and Those Saving for Retirement

Continuing with the trend in recent years, OCIE will focus on recommendations and advice given to retail investors, with a particular focus on seniors and those saving for retirement. The examinations will focus on intermediaries that serve retail investors—namely, registered investment advisers (RIAs), broker-dealers, and dually-registered firms—and on investments marketed to, or designed for retail investors, such as mutual funds and exchange-traded funds (ETFs), municipal securities and other fixed income securities, and microcap securities. OCIE will also focus on **higher risk products, 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.**

The first identified priority is the **protection of retail investors**. Let's look at some areas of focus as firm's prepare to update the Firm's ADV and Disclosures.

STANDARD OF CARE

OCIE acknowledged the impact that Regulation Best Interest and Form CRS will have on retail investors. With regard to RIAs as fiduciaries, OCIE will focus on whether they have fulfilled their duties of care and loyalty by providing advice in the best interests of their clients and eliminating—or at least exposing—conflicts of interest which might incline RIAs, consciously or unconsciously, to render advice which is not disinterested. Fees and expenses, as well as undisclosed—or inadequately disclosed—compensation arrangements, will likely continue as focus areas.

CCO TIP - Refer back to June 2019 This Month's Resource and stay tuned later this Quarter for more on Form CRS, related conflicts of interest and how CRP will assist with getting you in Compliance by June 30, 2020!

FEE DISCLOSURES

Examiners will continue to review whether fees and expenses are calculated and charged in accordance with disclosures provided to investors. 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.

CCO TIP – Conduct a thorough review of Part 2A Brochure’s Item 5 “Fees and Compensation” section.

- ✓ Review how the firm’s ADV reflects advisory fee maximums and third party billing arrangements.
- ✓ **Review Financials** – Does any of the firm’s revenue IN or OUT from a third-party trigger concerns for any conflicts NOT currently disclosed in your ADV.
- ✓ **Disclosure on ADV and/Agreements** – Are all current revenue sharing arrangements disclosed on your ADV? Check your firm’s books and records to make sure all revenue sharing agreements are current and on file for quick reference, if examined.

CONFLICTS OF INTEREST

Examiners will review policies and procedures that address potential conflicts of interest such as the use of affiliated service providers and products, securities-backed non-purpose loans and lines of credit, and borrowing funds from clients.

CCO TIP – In preparation for our FORM CRS in 2nd Quarter – Conflicts of Interest must be reviewed and disclosed to client. Some common conflicts to consider for full disclosure to clients:

- ✓ Registered Representative of a broker dealer
- ✓ IAR or other staff Member that sells Insurance products
- ✓ Participation in a firm’s adviser platform.
- ✓ Affiliated service providers – Broker-dealer, Insurance company, Accounting Firm
- ✓ Soft dollar arrangements
- ✓ Referral arrangements (paid out or received)
- ✓ Managing a Private fund or registered mutual fund
- ✓ Government entity clients – play to play?
- ✓ Proxy Voting Conflicts?
- ✓ Service by any Advisory Affiliate on a Board
- ✓ Sponsoring a Wrap Fee Program
- ✓ Block Trading (employees included in block trades, partial trade allocations?)
- ✓ Trade error procedures (Clients made whole? Adviser net out gain and loss errors?)

SENIOR INVESTORS AND RETIREMENT ACCOUNTS AND PRODUCTS

OCIE will continue to review how firms oversee their interactions with senior investors. OCI will inquire on what services and products are offered to seniors and review the manner of how they are offered to seniors.

CCO TIP – Review your Manual for separate policies and procedures when dealing with Senior Investors!

- ✓ Is the firm able to oversee its interactions with seniors?
- ✓ Does the firm have the ability to identify financial exploitation of seniors?
- ✓ Does the firm properly supervise its advisers who sell services directed at seniors?
- ✓ What training is provided to your IARs when dealing with Senior Investors?

MUTUAL FUNDS AND EXCHANGE TRADED FUNDS (ETFs)

Examiners will continue to focus on mutual funds and ETFs and whether advisers are properly disclosing investment risks to investors and the oversight practices of management. The SEC staff will also focus on mutual funds managed by advisers that have little experience managing registered investment companies.

CCO TIP – Not anything new to firms as Mutual Fund Share Class Review was highlighted several times in 2019. Be sure to continue your review of Share class each month or quarter in 2020!

Information Security

As in past years, this focus area will allow OCIE to prioritize cyber and other information securities risks. Examinations will focus on proper configuration of network storage devices, information security governance, retail trading information security, and RIAs' protection of clients' personal financial information. With respect to third-party and vendor risk management, OCIE will focus on oversight related to certain service providers. In 2020, OCIE examiners will focus on:

- ✓ Governance and risk management especially use of cloud based storage;
- ✓ Access controls;
- ✓ Data loss prevention;
- ✓ Vendor management;
- ✓ Training; and
- ✓ Incident response and resiliency.

In the area of third-party and vendor risk management OCIE will focus on oversight practices related to certain service providers and network solutions, including those using cloud-based storage. OCIE will continue to review for compliance with Regulations S_P and S-ID. Other focus areas include controls surrounding online access and mobile application access for customer information, safeguards around the proper disposal of retire hardware that may contain client information and network information.

CCO TIP – Make CyberSecurity a FOCUS this year!

- **Review your CyberSecurity policies and procedures.** Revise annually or as needed throughout the year. If you have no resources dedicated to Cyber – please contact our firm to provide some names for a Cybersecurity Vendor.
- Regulators want advisers to have **an inventory of everyone who can access their data**, including both third-party technology vendors and independent contractors. **Create your list of vendors and due diligence.** This is on the SEC Exam request list!
- Regulators want firms to have checks and balances in place to ensure they are doing the best they can **to prevent breaches**. More importantly, regulators want firms to have an **up-to-date and battle-tested plan for an effective and timely response to a breach**.
- It's not enough to just have a cybersecurity plan in place. Regulators want to see **firms continually testing, reviewing and updating cybersecurity policies and procedures to ensure they remain effective as threats evolve**. For example, the policy may say advisers can only access the firm's network using a secure connection such as a virtual private network, but there are no checks that the policy is actually followed.
- **Employee training** – What is your firm doing to assist in the ongoing training and awareness with your employees?

Fintech and Innovation, Including Digital Assets and Electronic Investment Advice

In the digital asset space, OCIE will continue to assess: (1) 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. With regard to “robo-advisers” or automated investment tools and platforms, OCIE will continue its focus on: (1) SEC Registration eligibility; (2) Cybersecurity policies and procedures; (3) Marketing Practices; (4) Fiduciary duty, including adequacy of disclosures; and (5) Effectiveness of compliance programs.

CCO TIP –

- **Crypto** - For firms recommending digital assets to clients, the SEC will be targeting your firm first this year! Are clients aware of the differences between these assets and more traditional products? Most likely not.
- **“Robo Accounts”** - Most of our clients are using the approved Custodian platform for “robo-accounts”. Review your ADV to ensure proper disclosure is reflected and revisit the Firm’s Cyber policies and procedures for robo accounts.

RIA Compliance Programs

OCIE will continue to prioritize exams 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 RIA’s due diligence practices, policies and procedures.

FINAL THOUGHTS....

In light of this guidance, it is never too early for an investment advisor to be prepared for an SEC examination. In the end, prior preparation will cause fewer disturbances to business operations when an examination notice letter is received from the SEC. If you have not done so in connection with year-end reviews, now is a perfect time to review and assess your policies and procedures, the implementation of your policies and procedures, and need to correct any deficiencies.

NEEDING A MORE ENHANCED COMPLIANCE SOLUTION?

Contact CRP if your firm is in need of a more enhanced services! Our team will tailor and customize a Compliance Action Plan and Proposal specific to your Firm’s needs.

Enhanced services would include but not limited to: assistance with tailoring the annual compliance manual updates to your firm, scheduled monthly and/or quarterly training calls with CRP staff to keep your team on track with Compliance tasks, conducting the required Annual Review, spearheading the Risk Assessment.