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SEC's Office of Compliance Inspections and Examinations Announces 2018 Examination Priorities

By: Rich May

In fiscal year 2017, the SEC examined approximately 15 percent of all federally registered investment advisers, up from 8 percent just five years ago.

As the SEC ramps up the frequency (and intensity) of its examinations, registered entities must be aware of their obligations and the regulators' key areas of focus.

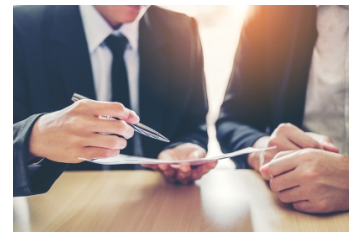
The SEC's Office of Compliance Inspections and Examinations ("OCIE"), which describes itself as the "eyes and ears" of the SEC, recently announced its examination priorities for 2018. The priorities for 2018 are organized into five themes:

1. Matters of importance to retail investors, including seniors and those saving for retirement;
2. Compliance and risks in critical market infrastructure such as clearing agencies, national securities exchanges and transfer agents;
3. Examination of the Financial Industry Regulatory Authority ("FINRA") and Municipal Securities Rulemaking Board ("MSRB");
4. Cybersecurity; and
5. Anti-money laundering programs.

While their priority list identifies critical areas, OCIE makes it clear that the list is not comprehensive and that OCIE remains flexible. Below are a few highlights of the areas OCIE says it will focus on in 2018.

NEVER-BEFORE-EXAMINED INVESTMENT ADVISERS

OCIE continues to focus on newly registered advisers and those advisers that have not been examined recently. If such advisers are determined to have elevated risk profiles they are more likely be examined.



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DISCLOSURE OF THE COST OF INVESTING

Recently, OCIE has been focused on the disclosures made to retail investors when a financial professional is hired. The 2018 priorities are no exception. OCIE examiners will continue to focus on proper disclosure and calculation of fees, expenses, and other charges investors pay, as well as on the proper disclosure of any conflicts of interest 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.

This renewed attention on proper disclosure comes at the same time as the SEC announced its [Share Class Selection Disclosure Initiative](#), in which the SEC's Division of Enforcement agrees to recommend reduced penalties and favorable settlement terms for investment advisers that self-report to the Division possible securities law violations relating to their failure to make necessary disclosures concerning mutual fund share class selection.

ELECTRONIC INVESTMENT ADVICE

OCIE repeats its commitment to examine investment advisers and broker-dealers that offer investment advice through automated or digital platforms, otherwise known as "robo-adviser" programs. Examinations will focus on registrants' compliance programs, marketing materials, investor data protection, and disclosure of conflicts of interest.

OCIE states that it will also examine the actual algorithms used to generate recommendations. However, this initiative could be affected by a proposed law in Congress that would prohibit the SEC from obtaining such source code without a subpoena.

SENIOR INVESTORS AND RETIREMENT ACCOUNT PRODUCTS

Given that individuals saving for retirement are increasingly reliant on their investment returns, OCIE will focus on identifying financial exploitation of seniors and on investment advisers and broker-dealers that offer services and products to investors with retirement accounts.

WRAP FEE PROGRAMS

OCIE will continue to examine the appropriateness of wrap fee programs. Areas of interest will include whether (i) the recommendations to invest in a wrap fee program and to continue in the program are reasonable, (ii) conflicts of interests are disclosed in compliance with applicable regulatory requirements, and (iii) investment advisers are obtaining best execution and disclosing costs associated with executing trades through another broker-dealer

CRYPTOCURRENCY, INITIAL COIN OFFERINGS, SECONDARY MARKET TRADING, AND BLOCKCHAIN

OCIE notes the rapid growth and the number of risks associated with cryptocurrency and initial coin offering markets. Where the products are securities, OCIE will examine for regulatory compliance including a focus on proper safeguards against theft and proper disclosure about risks.

It is worth noting that the SEC has previously warned market professionals that it believes many initial coin offerings likely should be treated as, and registered as, securities offerings.

CYBERSECURITY

A successful cyber attack can have far-reaching market consequences, and, therefore, OCIE continues to focus on and expand examinations in this area. Specifically, OCIE examinations focus on, among other things, governance and risk assessment, access rights and controls, data loss prevention, vendor management, training, and incident response.

ANTI-MONEY LAUNDERING PROGRAMS

Certain financial institutions (such as broker-dealers and investment companies) are required to, among other things, have written programs to identify their customers, perform customer due diligence, and monitor accounts for suspicious activity. Where suspicious activity is noted, covered institutions must file suspicious activity reports. Given how much the SEC relies on these suspicious activity reports, OCIE will focus on ensuring that institutions: (i) conduct proper customer due diligence, (ii) file timely, complete and accurate suspicious activity reports, and (iii) conduct independent tests of anti-money laundering programs.

Anyone with questions on OCIE's examination priorities, or on rules and regulations affecting investment advisers and financial institutions generally, can contact Rich May, P.C. attorneys [Thomas Bilodeau](#), [Scott Stokes](#), [David Glod](#), and [Nathaniel Donoghue](#).

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Disclaimer: This summary is provided for educational and informational purposes only and is not legal advice. Any specific questions about these topics should be directed to attorneys Thomas Bilodeau, Scott Stokes, David Glod, and Nathaniel Donoghue.