

Financial Services Update

SEC OCIE 2020 Examination Priorities

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The U.S. Securities and Exchange Commission (SEC), through the Office of Compliance Inspections and Examinations (OCIE), has issued its **2020 Examination Priorities**. The OCIE publishes its examination priorities annually. The report is designated to promote compliance, prevent fraud, identify and monitor risk and inform policy.

In fiscal year 2019, the OCIE completed over 3,089 examinations, representing a 2.7% decrease from the prior year. The 2020 examination priorities focus on six topics which are outlined in this e-newsletter.

I. Matters of Importance to Retail Investors

Priorities include:

- **Required Disclosures:** It is critically important that registered firms provide investors with the disclosures required by federal securities law. Specifically, the OCIE will review disclosures relating to fees and expenses, ensuring that these fees are assessed in accordance with client agreements and firm disclosures. In addition, disclosures relating to conflicts of interest or related party transactions will be scrutinized. Registered firms must effectively implement controls and systems to ensure required disclosures are made, which will help enable the investing public to make better informed investment decisions.
- **Advice to Retail Investors:** These examinations will focus on recommendations and advice given to retail investors, with a particular focus of 1) seniors and retirement communities, and 2) teachers and military personnel.
- **High Risk Products:** Products, such as private placements or securities or issuers in new and emerging risk areas, that are 1) complex or non-transparent; 2) have high fees; or 3) where an issuer is affiliated with or related to the registered firm making an investment recommendation will be examined and scrutinized for adequate disclosures.
- **Fiduciary Duties:** OCIE will continue to examine registered investment advisors to ensure they have fulfilled their duties of care and loyalty. Firms must act in the best interests of their clients and review practices for executing investment transactions on behalf of clients, fairly allocating investment opportunities among clients, disclosing critical information and complying with other legal restrictions.
- **Retail-Targeted Investments:** Examinations will focus on risks associated with:
 - Mutual Funds and Exchange Traded Funds – OCIE will examine financial incentives that may influence the selection of a particular investment.
 - Municipal Securities and Other Fixed Income Securities – OCIE will examine compliance with best execution practices, fairness of pricing mark-ups and mark-downs, commissions and disclosure requirements.
 - Microcap Securities – OCIE will examine broker dealers and transfer agents for aiding and abetting, pump and dump schemes, market manipulation and illegal distributions of securities.

- **Standards of Care:** Broker dealers must act in the best interest of their retail customer when making recommendations of any security transaction or investment strategy. The standard of conduct draws from key fiduciary principles and cannot be satisfied through disclosure alone.

II. Information Security

Information security is a cornerstone of the effective operation of financial markets and is key to investor confidence. The OCIE will focus on implementing controls and systems at firms to identify and address security risks and implement best practices. Areas of specific focus include: proper configuration of network storage devices, information security governance, cloud-based storage, and retail trading information security.

III. Financial Technology and Innovation

Innovations and advancements in financial technologies, methods of capital formation, market structures and investor interfaces play an integral and continuously growing role in the investment decision-making process. The OCIE will assess the financial technology's effectiveness and the related compliance and control functions. Financial technology identified to be examined include:

- **Digital Assets:** Retail investors may not adequately understand the difference between digital assets and more traditional products. As such, the OCIE will examine the following related to digital assets: 1) investment stability, 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.
- **Electronic Investment Advice:** The OCIE will focus on firms that provide automated investment tools and platforms to retail investors (often referred to as "robo-advisors"). The examinations will focus on: 1) SEC registration eligibility, 2) cybersecurity, 3) marketing practices, 4) adherence to fiduciary duty, and 5) effectiveness of compliance programs.

IV. Additional Focus Areas for Registered Investment Advisors and Investment Companies

Additional priorities include:

- **RIA Compliance Programs:** The OCIE will review the compliance programs of registered investment advisors and examine the programs' policies and procedures to ensure they are reasonably designed, implemented and maintained.
- **Never-Before and Not Recently-Examined Registered Investment Advisors:** Examinations will be prioritized for certain registered investment advisors that have not been examined for several years or for registered investment advisors that have never been examined.
- **Mutual Funds and Exchange Traded Funds (ETFs):** The OCIE will prioritize examinations of mutual funds and ETFs, the activities of their registered investment advisors and oversight practices of those charged with governance.
- **Registered Investment Advisors to Private Funds:** OCIE will assess compliance risks and controls to prevent the misuse of material non-public information, conflicts of interest and the use of registered investment advisors' affiliates to provide services to client.

V. Additional Focus Areas for Broker Dealers and Municipal Advisors

Additional priorities include:

- **Broker-Dealer Financial Responsibility:** Examiners will focus on broker-dealer compliance with the Customer Protection Rule and Net Capital Rule. In particular, examiners will be reviewing broker-dealers implementation of Regulation Best Interest, which will become effective June 30, 2020.
- **Trading and Broker-Dealer Risk Management:** The OCIE will examine the firm's trading and risk management practices, which includes examination of: small retail investor orders, controls

around automated trading algorithms and a firm's internal procedures, practices and controls to manage risk.

VI. Anti-Money Laundering (AML)

Financial institutions and broker-dealers are required to establish AML programs which should include policies and procedures reasonably designed to identify customer due diligence, monitor suspicious activity and file suspicious activity reports (SARs) when appropriate.

Conclusion

We are here to help advise you on questions you may have regarding your business's best practices and compliance with the SEC's priorities. You can view the complete 2020 Examination Priorities [here](#).

Contact Us

Let us know if you have any questions. Please contact the partner in charge of your account or:

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