

Client Alert

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OCIE Publishes Exam Priorities for 2015

By Kelley A. Howes and Jay G. Baris

The National Exam Program of the SEC's Office of Compliance Inspections and Examinations (OCIE) published its [examination priorities for 2015](#) this week. (Last week, FINRA published its priorities, discussed [here](#).) Many of the themes are consistent with OCIE's 2014 priorities and issues identified by the staff over the course of the last year. One notable new theme is OCIE's recognition that transfer agents are "gatekeepers" that warrant the staff's attention. OCIE also encouraged would-be whistleblowers to reach out to the staff with information about activities that may "violate the federal securities laws or otherwise [operate] to harm investors."

OCIE listed three key areas of focus in 2015:

Retail Investors. OCIE continues to raise concerns about retirement investing and the use of traditionally "institutional" products in the retail marketplace, including these examination priorities:

- Financial professionals that register as investment advisers or as dual registrants can offer a variety of fee structures depending upon the types of services or products offered to clients. OCIE will focus on whether advisers are making recommendations based on a client's best interests or the adviser's own self-interest. We've previously examined this issue (see our [client alert](#) regarding scrutiny of "reverse churning") and it continues to be an area of focus.
- As we recently [noted](#), the Division of Investment Management is concerned that alternative investment companies may not adequately disclose their risks to retail investors. OCIE apparently shares the Division's concern and will examine issues related to sales of alternative products to retail investors, including valuation, liquidity, leverage, a fund's internal controls, the empowerment of a fund's board and compliance staff and how the funds are marketed.
- OCIE will continue to evaluate whether fixed-income investment funds have adequate controls to ensure that their disclosure is not misleading and that their investments and liquidity profiles are consistent with such disclosure, in light of anticipated increases in interest rates. Liquidity of fixed-income funds is another recurring theme from the Division of Investment Management this year; clearly the Division has OCIE's ear.

Market-Wide Risks. One of the SEC's three missions is to maintain fair, orderly and efficient markets. In support of that mission, OCIE will focus certain examinations on structural risks and trends involving multiple firms.

- OCIE, together with the Division of Investment Management and the Division of Trading and Markets, will continue to actively monitor the largest U.S. broker-dealer and investment advisory firms, focusing not only on firm-specific issues, but on early identification of issues across the industry.
- OCIE's focus on cybersecurity will be expanded to include transfer agents.

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- OCIE will evaluate firms' use of various trading venues to determine if they appropriately reflect best execution obligations, or if firms are making trading decisions based on payments or credits for order flow.
- Like FINRA, OCIE will focus on broker-dealers' and investment advisers' supervision of registered representatives and financial adviser representatives in branch offices. See our recent [advice](#) on implementing a strong branch office supervisory program and dealing with a regulatory branch exam.

Data Analysis. Consistent with its 2014 priorities, OCIE intends to continue to develop and use its enhanced data analytics to identify firms that appear to be engaged in fraudulent or other illegal activity.

- OCIE will use its analytical capabilities to identify those firms that hire individuals with a record of misconduct. Firms should review their own hiring records to determine if they are likely to draw OCIE's attention.
- OCIE will use its data from clearing firms to identify brokers that are engaged in excessive trading.
- OCIE will also use such data to examine operations of broker-dealers and transfer agents to uncover incidences of market manipulation.
- In a novel use of reporting data, OCIE will seek to determine whether firms have failed to file Suspicious Activity Reports, or filed them late.

Other Priorities. OCIE emphasized themes covered in previous announcements:

- Newly registered municipal advisors;
- Never-before examined investment companies; and
- Fees and expenses charged by private equity firms.

In addition, OCIE identified transfer agents as "important gatekeepers to prevent violations of Section 5 of the Securities Act [of 1933] and other fraudulent activity." Transfer agents would be well-advised to carefully examine their compliance programs in anticipation of hearing from SEC examiners this year.

Our Take. Little in the 2015 examination priorities letter should come as a surprise, but the planned use of data and the broad-based review of supervisory issues will continue to create challenges for regulated entities.

In the case of broker-dealers and entities that are dually registered investment advisers/broker-dealers, these challenges can be particularly acute. For example, FINRA's increase in the amount of data it gathers and reviews could impose significant additional burdens on member firms. Are FINRA and the SEC coordinating their data gathering? Or will variations in the data requests require that multiple recordkeeping and reporting systems be implemented?

While OCIE will scrutinize transfer agents as gatekeepers, regulatory guidance for transfer agents is relatively limited. We've heard that updating and modernizing the regulatory structure around transfer agents is a priority for the SEC's policy staff, but that could take some time (and will hopefully fully involve the industry's input). In the meantime, we fear the SEC may opt to regulate by enforcement.

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Regulated entities should heed the statement of Andrew Bowden, OCIE's Director: "We have observed that when we share our areas of focus, many industry participants independently review their controls in the areas we have identified." We suggest that regulated firms do so before OCIE pays them a visit.

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