



## **EXAMINATION PRIORITIES FOR 2015**

### **I. Introduction**

This document identifies selected 2015 examination priorities of the Office of Compliance Inspections and Examinations (“OCIE,” “we” or “our”) of the Securities and Exchange Commission (“SEC” or “Commission”). In general, the priorities reflect certain practices and products that OCIE perceives to present potentially heightened risk to investors and/or the integrity of our capital markets.<sup>1</sup>

OCIE serves as the “eyes and ears” of the SEC. We conduct examinations of registered entities to promote compliance, prevent fraud, identify risk, and inform policy.<sup>2</sup> We selected our 2015 examination priorities in consultation with the five Commissioners, senior staff from the SEC’s eleven regional offices, the SEC’s policy-making and enforcement divisions, the SEC’s Investor Advocate, and our fellow regulators.

This year, our priorities focus on issues involving investment advisers, broker-dealers, and transfer agents and are organized around three thematic areas:

1. Examining matters of importance to retail investors and investors saving for retirement, including whether the information, advice, products, and services being offered is consistent with applicable laws, rules, and regulations;
2. Assessing issues related to market-wide risks; and
3. Using our evolving ability to analyze data to identify and examine registrants that may be engaged in illegal activity, such as excessive trading and penny stock pump-and-dump schemes.

This document does not address OCIE’s examination priorities for exchanges and SROs, which we are addressing separately.

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<sup>1</sup> This document was prepared by SEC staff, and the views expressed herein are those of OCIE. The Commission has expressed no view on this document’s contents. It is not legal advice; it is not intended to, does not, and may not be relied upon to create any rights, substantive or procedural, enforceable at law by any party in any matter civil or criminal.

<sup>2</sup> The registered entities that OCIE examines include investment advisers, investment companies, broker-dealers, exchanges, self-regulatory organizations (“SROs”), clearing agencies, municipal advisors, and transfer agents.

## II. Protecting Retail Investors and Investors Saving for Retirement

Retail investors of all ages face a complex and evolving set of options when determining how to invest their money, including retirement funds. Registrants are developing and offering to retail investors a variety of new products and services that were formerly characterized as alternative or institutional, including private funds, illiquid investments, and structured products intended to generate higher yields in a low-interest rate environment. Additionally, as investors are more dependent than ever on their own investments for retirement,<sup>3</sup> the financial services industry is offering a broad array of information, advice, products, and services to retail investors to help them plan for, and live in, their retirement years. We are planning various examination initiatives to assess risks to retail investors that can arise from these trends.

- **Fee Selection and Reverse Churning.** Financial professionals serving retail investors are increasingly choosing to operate as an investment adviser or as a dually registered investment adviser/broker-dealer, rather than solely as a broker-dealer. Unlike broker-dealers, which typically charge investors a commission or mark-up on purchases and sales of securities, investment advisers employ a variety of fee structures for the services offered to clients, including fees based on assets under management, hourly fees, performance-based fees, wrap fees, and unified fees. Where an adviser offers a variety of fee arrangements, we will focus on recommendations of account types and whether they are in the best interest of the client at the inception of the arrangement and thereafter, including fees charged, services provided, and disclosures made about such relationships.
- **Sales Practices.** We will assess 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, especially when they pose greater risks and/or charge higher fees.
- **Suitability.** We will evaluate registered entities' recommendations or determinations to invest retirement assets into complex or structured products and higher yield securities, including whether the due diligence conducted, the disclosures made, and the suitability of the recommendations or determinations are consistent with existing legal requirements.
- **Branch Offices.** We will focus on registered entities' supervision of registered representatives and financial adviser representatives in branch offices, including using data

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<sup>3</sup> For decades, employers have shifted from offering defined benefit pensions to defined contribution plans, such as 401(k) accounts, that place funding and investment risk directly on participants. Today, it is estimated that approximately \$15.8 trillion is invested in defined contribution plans (including individual retirement accounts and annuity reserves), while approximately \$8.3 trillion is invested in defined benefit plans. See Nari Rhee, "Retirement Savings Crisis: Is it Worse than We Think" (June 2013), a publication of the NATIONAL INSTITUTE ON RETIREMENT SECURITY, available at: [http://www.nirsonline.org/index.php?option=com\\_content&task=view&id=768&Itemid=48](http://www.nirsonline.org/index.php?option=com_content&task=view&id=768&Itemid=48); see also "Retirement Assets Total \$24 Trillion in Second Quarter 2014" (Sept. 2014), a publication of the INVESTMENT COMPANY INSTITUTE, available at: [http://www.ici.org/research/stats/retirement/ret\\_14\\_q2](http://www.ici.org/research/stats/retirement/ret_14_q2).

analytics to identify branches that may be deviating from compliance practices of the firm's home office.

- **“Alternative” Investment Companies.** Funds holding “alternative” investments, or those offering returns uncorrelated with the stock market, have experienced rapid and significant growth compared to other categories of mutual funds. We will continue to assess funds offering alternative investments and using alternative investment strategies, with a particular focus on: (i) leverage, liquidity, and valuation policies and practices; (ii) factors relevant to the adequacy of the funds' internal controls, including staffing, funding, and empowerment of boards, compliance personnel, and back-offices; and (iii) the manner in which such funds are marketed to investors.
- **Fixed Income Investment Companies.** With interest rates expected to rise at some point in the future, we will review whether mutual funds with significant exposure to interest rate increases have implemented compliance policies and procedures and investment and trading controls sufficient to ensure that their funds' disclosures are not misleading and that their investments and liquidity profiles are consistent with those disclosures.

### **III. Assessing Market-Wide Risks**

The SEC's mission includes not only investor protection and capital formation, but also maintaining fair, orderly, and efficient markets. With examination authority over a wide variety of registrants, we intend to examine for structural risks and trends that may involve multiple firms or entire industries. In 2015, we will focus on the following initiatives:

- **Large Firm Monitoring.** We will continue to collaborate with our colleagues in the Division of Trading and Markets and the Division of Investment Management to monitor the largest U.S. broker-dealers and asset managers for the purpose of assessing risks at individual firms and maintaining early awareness of developments industry-wide.
- **Clearing Agencies.** We will continue to conduct annual examinations of all clearing agencies designated systemically important, pursuant to the requirements of the Dodd-Frank Wall Street Reform and Consumer Protection Act. Areas for review will be determined through a risk-based approach in collaboration with the Division of Trading and Markets and other regulators, as applicable.
- **Cybersecurity.** Last year, we launched an initiative to examine broker-dealers' and investment advisers' cybersecurity compliance and controls. In 2015, we will continue these efforts and will expand them to include transfer agents.
- **Potential Equity Order Routing Conflicts.** We will assess whether firms are prioritizing trading venues based on payments or credits for order flow in conflict with their best execution duties.

#### IV. Using Data Analytics to Identify Signals of Potential Illegal Activity

Over the last several years, OCIE has made significant enhancements in data analytics that enable us to efficiently and effectively analyze the data to which we have access. We will use these capabilities to focus on registrants and firms that appear to be potentially engaged in fraudulent and/or other potential illegal activity, including the following examination initiatives:

- **Recidivist Representatives.** We will continue to use our analytic capabilities to identify individuals with a track record of misconduct and examine the firms that employ them.
- **Microcap Fraud.** We will continue to examine the operations of broker-dealers and transfer agents for activities that indicate they may be engaged in, or aiding and abetting, pump-and-dump schemes or market manipulation.
- **Excessive Trading.** We will continue to analyze data obtained from clearing brokers to identify and examine introducing brokers and registered representatives that appear to be engaged in excessive trading.
- **Anti-Money Laundering (“AML”).** We will continue to examine clearing and introducing broker-dealers’ AML programs, using our analytic capabilities to focus on firms that have not filed suspicious activity reports (“SARs”) or have filed incomplete or late SARs. Additionally, we will conduct examinations of the AML programs of broker-dealers that allow customers to deposit and withdraw cash and/or provide customers direct access to the markets from higher-risk jurisdictions.

#### V. Other Initiatives

In addition to examinations related to the themes described above, we expect to allocate examination resources to other priorities, including:

- **Municipal Advisors.** We will continue to conduct examinations of newly registered municipal advisors to assess their compliance with recently adopted SEC and Municipal Securities Rulemaking Board rules. This initiative will include industry outreach and education.
- **Proxy Services.** We will examine select proxy advisory service firms, including how they make recommendations on proxy voting and how they disclose and mitigate potential conflicts of interest. We will also examine investment advisers’ compliance with their fiduciary duty in voting proxies on behalf of investors.
- **Never-Before-Examined Investment Companies.** We will conduct focused, risk-based examinations of selected registered investment company complexes that we have not yet examined.
- **Fees and Expenses in Private Equity.** Given the high rate of deficiencies that we have observed among advisers to private equity funds in connection with fees and expenses, we will continue to conduct examinations in this area.

- **Transfer Agents**. Transfer agents serve as important gatekeepers to prevent violations of Section 5 of the Securities Act of 1933 and other fraudulent activity. We intend to allocate more resources to examine transfer agents, particularly those that are involved with microcap securities and private offerings.

## **VI. Conclusion**

This description of OCIE priorities is not exhaustive. While we expect to allocate significant resources throughout 2015 to the examination issues described herein, our staff will also conduct examinations focused on risks, issues, and policy matters that arise from market developments, new information learned from examinations or other sources, including tips, complaints, and referrals, and coordination with other regulators.

OCIE welcomes comments and suggestions about how we can better fulfill our mission to promote compliance, prevent fraud, monitor risk, and inform SEC policy. If you suspect or observe activity that may violate the federal securities laws or otherwise operates to harm investors, please notify us at [http://www.sec.gov/complaint/info\\_tipscomplaint.shtml](http://www.sec.gov/complaint/info_tipscomplaint.shtml).