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The SEC's National Exam Program 2019

Related Capabilities

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The SEC's Office of Compliance Inspections and Examinations ("OCIE" or the "Office") announced its 2019 Examination Priorities just before Christmas and the current Government partial-shutdown (here). While nonemergency inspections and exams are currently at a standstill, once the shutdown ends OCIE will resume its regular activity. We advise registrants to remain vigilant in their compliance programs and stay prepared for OCIE exams as the shutdown may be lifted at any time. Furthermore, OCIE may still review emergency matters during the shutdown.

The focus of the 2019 Program differs from that of 2018, although its risk-based essence and key points are similar. As the glossy brochure discussing the program makes clear, the Office "measures performance in multiple ways . . ." that are tied to four key points or "pillars:" Promoting compliance; preventing fraud; identifying and monitoring risk; and informing policy. While not identical to the five key principles or building blocks of last year's program of risk, data, transparency, resources and technology, they inform and drive the program in a similar manner (last year's program is discussed here):

Promoting Compliance is a critical goal of the entire OCIE program. The concept is built on transparency, identifying weaknesses and education. To that end, over the last year the Office has issued five risk alerts discussing best execution, fee and expense compliance issues, exams and registered investment companies, adviser compliance issues tied to the cash solicitation rule and observations related to electronic messaging.

Preventing fraud is another key goal of the overall inspection program. Last year OCIE conducted targeted exams on brokers and advisers engaged in high-risk retail practices aimed at preventing harm and fraud. These exams generally resulted in enhancements to oversight practices and led to more than 160 enforcement referrals, a small fraction of the over 3,000 exams conducted in 2018.

Identifying and monitoring risk is the underlying predicate for all of the inspections. As the Brochure makes clear "OCIE will continue to stay abreast of changes in the SEC's registrant base, the markets, and investor needs and preferences, and will adjust its risk-based program in response to these changes." This translates to a focus on matters such as Regulation SCI, fixed income best execution obligations and advisers recommending digital assets.

Informed policy is an outgrowth of the inspection program since it enables the Office to provide "further insight to other SEC Divisions and Offices regarding how registered entities have implemented the SEC's rules, the practical difficulties and challenges faced . . ." and common areas of noncompliance thus complementing the overall compliance focus.

The five 2019 pillars of the National Exam inspection program translate into six focal points for the National Exam Program:

1) Retail Investors: This includes "seniors and those saving for retirement." This focus mirrors that of the Enforcement Division, which formed a special task force to foster the protection of retail investors. Indeed, SEC Chairman Jay Clayton has repeatedly emphasized the protection of retail investors and seniors since the beginning of his tenure. To implement this goal the OCIE program will concentrate on:

a. Fees and expenses and, in particular, business models which have or create a risk of inadequate disclosure; b. Conflicts of interest, including those from the use of affiliated service providers, securities-backed non-purpose loans and borrowings from clients and products directed at seniors; c. Portfolio management and trading; d. Securities professionals such as municipal advisers and broker-dealers holding customer assets; and e. Microcap securities.

2) Registrants responsible for critical market infrastructure: This includes clearing agencies, transfer agents and national securities exchanges.

3) FINRA and MSRB: Each organization serves as a regulator, monitoring and assessing critical market infrastructure and market professionals.

4) Digital assets: These assets have grown rapidly and are frequently volatile as recent market action reflects. Chairman Clayton has repeatedly addressed the risks associated in these assets. Congress has held hearings and, the Division of Enforcement has initiated a series of fraud and registration violation actions.

5) Cybersecurity: The protection of the financial markets and participants is crucial. The Office intends to prioritize this area in each of its exam programs. The threat to, and impact on, market participants is well illustrated by recent breaches at public companies.

6) Anti-Money Laundering: OCIE intends to continue prioritizing AML programs at broker-dealers, assuring compliance with the Bank Secrecy Act while scrutinizing policies and procedures governing the filing of suspicious activity reports with FinCEN which are critical in detecting and combating terrorist financing and corruption.

Collectively these points represent the core of the OCIE 2019 inspection program, emphasizing the importance of retail investors while focusing on market professionals charged with protecting them as well as segments of the market and examining high risk matters rather than investment vehicles such as private funds. They also reflect the goals of the Commission in its administration of the federal securities laws while counseling careful exam preparation as discussed at the recent Federal Enforcement Forum (here).