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SEC Releases Exam Priorities for 2015

On January 12, 2015, the SEC's Office of Compliance Inspections and Examinations ("OCIE") released its *Examination Priorities for 2015 (available here)* outlining the issues that it will focus on this year in examining investment advisers, broker-dealers and other financial industry participants. This year's exam priorities are broken down into three thematic areas: (1) protecting retail investors and investors saving for retirement, (2) market-wide risk areas (such as cybersecurity), and (3) using data analytics to identify illegal activity. These themes, as well as the specific compliance/legal issues identified by OCIE as falling under these themes, are outlined below.

PROTECTING RETAIL INVESTORS AND INVESTORS SAVING FOR RETIREMENT

OCIE's top priority for 2015 appears to be protecting retail investors. Not surprisingly, this theme is echoed in FINRA's 2015 Examination Priorities Letter for broker-dealers, released last week ([click here](#) for our update on FINRA's exam priorities). According to the letter, OCIE is planning various examination initiatives for 2015 to assess the potential risk to retail investors arising from the increase in popularity of products, services and investment strategies that have traditionally only been accessible to institutional investors, such as private funds, illiquid investments, and structured products intended to generate

higher yields in a low-interest rate environment. The specific products and associated issues highlighted by OCIE are discussed below.

Fee Selection and Reverse Churning

OCIE's examination of fees will look at investment advisers (and dual-registrants) that offer a variety of fee structures in addition to fees based on assets under management, such as hourly fees, performance-based fees, wrap fees, and unified fees, and scrutinize whether such arrangements are in the best interest of the client at the inception of the arrangement and thereafter.

Sales Practices & Suitability

OCIE will review whether investment advisers and broker-dealers are improperly recommending the movement of retirement assets from employer-sponsored defined contribution plans into complex products that may pose greater risks and/or charge higher fees. OCIE will also examine disclosures in this area.

Branch Offices

OCIE will scrutinize the supervision of representatives in branch offices. Additionally, OCIE will focus on branch offices on a stand-alone basis, using data analytics to identify branches that may be deviating from compliance practices of the firm's home office.

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Alternative Funds (“Liquid Alts”)

In conjunction with its industry sweep launched in 2014, OCIE will continue to assess alternative mutual funds (i.e., registered funds that employ hedge-fund-like strategies) in 2015. OCIE’s examinations will emphasize: (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 funds are marketed to investors.

Fixed-Income Funds

OCIE will be reviewing whether registered funds with significant exposure to interest rate increases have implemented policies, procedures and controls sufficient to ensure that their funds’ disclosures are not misleading and that their investments and liquidity profiles are consistent with those disclosures. Advisers to fixed-income funds should review the SEC’s Division of Investment Management’s 2014 IM Guidance, which sets forth several suggested fixed income securities risk management practices (available by [clicking here](#)).

MARKET-WIDE RISKS

In terms of market-wide risk areas, OCIE will be assessing the following issues, among others:

Cybersecurity

OCIE announced that it will continue to examine investment advisers’ and broker-dealers’ cybersecurity compliance and controls and will expand these examinations

to include transfer agents. Firms that are currently assessing their cybersecurity efforts should be familiar with OCIE’s 2014 cybersecurity risk alert ([available here](#)) and the sample document request attached to the alert, which identifies certain cybersecurity processes and procedures that the SEC will be looking for. Additionally, firms should be looking out for the results of the SEC and FINRA’s recent cybersecurity sweeps, based on FINRA’s recent announcement that it will make its results public soon and the SEC at least suggesting that its results may be publicly available at some point.

Best Execution

OCIE will assess whether firms are prioritizing trading venues based on payments or credits for order flow in conflict with their best execution duties.

USING DATA ANALYTICS TO IDENTIFY ILLEGAL ACTIVITY

OCIE will continue to utilize its recently enhanced data analytics capabilities, including its recently developed national exam analytics tool (“NEAT”), which allows examiners to rapidly analyze voluminous trade data. Some of the activities that OCIE intends to monitor include:

Recidivist Representatives

OCIE will use analytics to identify individuals with a track record of misconduct and examine the firms that employ them.

Excessive Trading

OCIE will analyze data obtained from clearing brokers to identify and examine introducing brokers and registered reps for patterns of excessive trading.

Anti-Money Laundering (“AML”)

OCIE will continue to focus on clearing and introducing broker-dealers’ AML programs, using data to focus on firms that have not filed suspicious activity reports (“SARs”) or have filed incomplete or late SARs. Additionally, OCIE will scrutinize broker-dealers that allow customers to deposit and withdraw cash and/or provide customers direct access to the markets from higher-risk jurisdictions.

OTHER INITIATIVES

In addition, OCIE identified other examination priorities for 2015, including:

- Fees and Expenses in Private Equity;
- Never-Before-Examined Investment Companies;
- Municipal Advisors;
- Proxy Services;
- Transfer Agents;
- Large Firm Monitoring;
- Clearing Agencies; and
- Microcap Fraud.

Please feel free to contact us if you have any questions regarding OCIE’s 2015 examination priorities or any related matter.