

OCIE EXAMINATIONS IN 2020 TO FOCUS ON DIGITAL ASSETS, CYBERSECURITY, AND PROTECTING VULNERABLE RETAIL INVESTORS

January 15, 2020 -- Concerns over how investment managers and brokers make use of an expanding array of new technologies while preserving their relationship of trust with their clients lead this year's list of issues on which the SEC said it will focus in its planned compliance examinations.

The SEC's Office of Compliance Inspections and Examinations ("OCIE"), in publishing its annual list of compliance objectives, said it would explore how regulated businesses manage the growing availability of cryptocurrencies and other digital assets, use technology to provide customized investment advice, and protect their operations from increasingly sophisticated cyberintrusions and possible loss of customer data.

OCIE, in its January 7 announcement, said that it will particularly focus on the relationship between the investment community and its retail clients, especially senior citizens and retirees.

Digital Assets and Robo-Advisers. The past few years have seen an explosion in the utilization of technology to create new financial products and to affect how investment services are provided to clients. The SEC and other federal agencies have struggled with the implications of investments based on blockchain technologies that exist only as lines of computer code distributed across cyberspace, including cryptocurrencies and interests that simultaneously have characteristics traditionally associated with investment securities or commodities. OCIE said it will continue to both identify and examine SEC-registered market participants that engage in this "digital assets" space, particularly in light of their obligation to demonstrate how custody of these assets is maintained.

Technology is similarly expanding the ways in which RIAs can offer algorithmically-automated investment tools and platforms (colloquially known as "robo-advisers"), and OCIE will be focusing on the disclosures given to investors, as well as the controls, policies and procedures employed in providing these services.

Information Security. OCIE is focused on working with firms to identify and address information security risks, including cyber-related, and to encourage market participants to actively and effectively engage regulators and law enforcement in this effort. With respect to the information technology systems of RIAs, examinations will focus specifically on governance and risk management, access controls, data loss prevention, vendor management, training, and incident response and resiliency. With respect to third-party and vendor risk management, the OCIE will generally focus on practices that leverage cloud-based storage, compliance with Regulations S-P and S-ID (which require the adoption of written policies and procedures for the protection of customer records and prevention of identity theft), online and mobile application access to customer brokerage account information, and the proper disposal of retired hardware that may contain client information and potential network information.

Broker-Dealers. Broker-dealers that hold customer cash and securities have a responsibility to ensure that those assets are safeguarded in accordance with regulations protecting customers, e.g. the avoidance of delays in the return of such assets in the event of a broker-dealer failure and the requirement that broker-dealers to value their securities at market prices and apply a risk-based valuation discount to such securities; examinations of broker-dealers will continue to focus on compliance with these regulations. OCIE will also examine firms' trading and risk management practices, such as those around the use of automated trading algorithms and activities in "odd" lots trades.

Anti-Money Laundering Programs. The AML programs of financial institutions, including broker-dealers, will be under review to ensure that entities are properly adapting their programs as issues evolve. OCIE will continue to prioritize examining broker-dealers in order to ensure that their programs are able to reasonably identify and verify the identity of customers and beneficial owners of legal entity customers, monitor for suspicious activity and file required Suspicious Activity Reports with the Treasury Department's Financial Crimes Enforcement Network where appropriate, and understand the nature and purpose of customer relationships to develop customer risk profiles.

RIA Compliance Programs. OCIE will continue to focus on whether RIAs maintain effective compliance programs to address the risks associated with best execution, prohibited transactions, fiduciary advice, or disclosure of conflicts regarding such arrangements. OCIE will prioritize examining firms that utilize the services of third-party asset managers to advise clients' investments to assess, among other things, the extent of these RIAs' due diligence practices, policies, and procedures. OCIE also expressed specific interest in the accuracy and adequacy of disclosures provided by RIAs offering clients new types or emerging investment strategies, such as strategies focused on sustainable and responsible investing, which incorporate environmental, social, and governance (ESG) criteria.

As the OCIE has stated in the past, it will continue to focus on those registered investment advisers that have not been previously examined, those that are dually registered, and those that advise private funds which have a greater impact on retail investors, such as firms that provide management to separately managed accounts side-by-side with private funds. With respect to RIAs to private funds, OCIE will have a particular focus on controls to prevent the misuse of material non-public information and conflicts of interest, such as undisclosed or inadequately disclosed fees and expenses and the use of affiliates to provide services to clients.

The published priorities for FY 2020 are not exhaustive and will not be the only areas OCIE focuses on in its examinations, risk alerts, and investor and industry outreach. If you would like any further information concerning the SEC's OCIE 2020 examination priorities or related compliance issues, please feel free to contact:

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