

# Examination Priorities for FY2015

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# Thematic Areas

FY2015 Priorities were distributed publicly on January 13, 2015 and are applicable for advisers, broker-dealers, and transfer agents. These priorities are organized around the following three themes:

- Retail investors and investors saving for retirement
- Market-wide risks i.e. Cybersecurity
- Data Analytics used to identify questionable conduct

Items marked with an asterisk will be discussed as part of a separate panel later today.

# Retail Investors and Investors Saving for Retirement

- Fee Selection and Reverse Churning
- Sales Practices\*
- Suitability\*
- Branch Offices
- Alternative Investment Companies\*
- Fixed Income Investment Companies\*



# Assessing Market-Wide Risks

Cybersecurity\*



# Using Data Analytics

## Recidivist Representatives

# Other Initiatives

- Municipal Advisors
- Proxy Voting
- Never-Before Examined Investment Companies\*

# Fee Selection

- RIAs offer various products and fee structures to retail clients and retirement investors raising the potential for conflicts of interest.
- These potential conflicts may be heightened when RIAs are also dually registered as a broker-dealer or affiliated with one.
- As fiduciaries, RIAs must act in the best interests of its clients.
- Exam staff will focus on how the RIA determined that the product/service best “fit” the client’s needs as compared to other products as well as review the disclosures provided.
- Areas of focus by the Staff include: mutual fund share class selection; asset based fee accounts vs. transaction based fee accounts; trading away from the wrap account sponsor; and undisclosed fees (postage and handling, mutual fund transaction fees).

# Reverse Churning

- What is reverse churning?
- RIAs that recommend wrap accounts to their advisory clients face potential conflicts of interest when they or an affiliate are the sponsor.
- Lack of trading in these accounts benefits the RIA and its affiliates.
- At low levels of trading, the question is whether the client would have been better off in a transaction based account.
- Low levels of trading also raises concerns about whether advisers are fulfilling their fiduciary and contractual obligations.
- Examiners will focus on accounts they or the RIA identify as “low trading,” “inactive accounts,” and or accounts with high cash balances. Looking for systemic issues, not one-offs.
- Examiners will review the policies and procedures in place to identify and monitor for reverse churning as well as disclosures made to clients.

# Branch Offices

- Focus on the supervision of Investment Advisory Representatives operating away from the principal office of the RIA.
- The continued migration of broker-dealers into the RIA space remains an area of focus.
- Exam staff will focus on the firm's Compliance Program to ensure adequate policies and procedures are in place to address the ongoing monitoring of these branches.
- Exam staff will focus on the technology at the firm to ensure that the RIA can effectively review, monitor, and test for compliance related matters.

# Recidivist Representatives

- Use of our enhanced data analytics to identify those firms and or individuals that look to be engaging in questionable conduct.
- Data analytics was used to identify candidates as part of a number of initiatives discussed in the FY2015 Priorities memo.
- Data analytics was used to track industry professionals with disciplinary histories as they move from one firm to another.
- Going forward, these tools will enable the Staff to better identify “outliers” for exams or other risk based initiatives.

# Municipal Advisors

- Continue the initiative that began in the Summer of 2014.
- The Municipal Advisor Initiative is being conducted primarily by the NEP's broker-dealer staff in three phases: engagement; examinations; and informing policy.
- Similar to the Presence Exam Initiative that focused on private fund advisers.
- During the Examination Phase, examiners will focus on at least one of the following areas: registration; fiduciary duty; disclosure; fair dealing; supervision; books and records; and training/qualifications.
- At the conclusion of the Examination Phase, the NEP will report on its observations, including common practices identified in high-risk focus areas, industry trends, and significant issues.

# Proxy Voting

- Clients often delegate the voting of proxies to the RIA, but clients, at times, may also want to participate in the process.
- Exam Staff will focus on the policies and procedures adopted pursuant to Rule 206(4)-6 of the IA Act by the RIA to ensure they are acting in the best interests of their clients as follows:
  - Review of policies and procedures that address any potential conflicts of interest between the clients (including any mutual funds) and the RIA or third party service providers.
  - Review disclosures made by the RIA regarding how clients can obtain a copy of their procedures, information on the RIA's process for voting proxies, as well as the RIA's proxy voting record.
- Exam Staff will also review the disclosures in client contracts and Form ADV, to ensure consistency and adequacy with the RIA's stated policies and practices.

# Additional Resources

- FY2015 Priorities –

<http://www.sec.gov/news/pressrelease/2015-3.html>

- NBE RIC Initiative -

<http://www.sec.gov/about/offices/ocie/ocie-never-before-examined-registered-investment-company-initiative.pdf>

- Cybersecurity -

<https://www.sec.gov/about/offices/ocie/cybersecurity-examination-sweep-summary.pdf>

- Muni Advisor Initiative –

<http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370542678782>

- Proxy Voting -

<https://www.sec.gov/interps/legal/cfslb20.htm>

- National Exam Program - <http://www.sec.gov/ocie>