

SEC Announces 2015 Examination Priorities

On Jan. 13, 2015, the Office of Compliance Inspections and Examinations released its annual list of examination priorities for 2015. A copy of the examination priorities letter is available [here](#). The examination priorities are a mixture of OCIE's examination priorities and risk areas first identified in 2014 (or before) and new initiatives. Most securities industry participants – registered investment advisers, broker-dealers, registered investment companies and transfer agents – are impacted. However, unlike past years, the 2015 examination priorities letter does not address the examination priorities for exchanges and self-regulatory organizations, which the letter indicates will be addressed separately.

Purpose and Thematic Focus

The 2015 examination letter recites OCIE's role as the "eyes and ears" of the SEC and notes that OCIE's examinations of registered entities are designed to promote compliance and inform policy, in addition to preventing fraud and identifying risk. The letter highlights three thematic areas:

1. Examining matters of importance to retail investors and retirement savings;
2. Assessing market-wide risks; and
3. Utilizing OCIE's data analytics abilities to identify signals of potential illegal activity.

In this *GT Alert*, we've summarized the items addressed by OCIE, sorted by registrant type.

Investment Advisers and Broker-Dealers

More than half of the listed examination priorities in the 2015 examination priorities letter focus on the activities of investment advisers and/or broker-dealers. The following are the areas of focus:

Fee Selection, Reverse Churning, Investment Suitability and Proxy Voting. As more financial professionals servicing retail investors choose to register as investment advisers (as opposed to broker-dealers) and offer a variety of fee arrangements, OCIE intends to focus on recommendations of investor account types, whether they are in the best interest of the client – both at inception and thereafter – and the fees charged, services provided and disclosures made. Similarly, OCIE intends to review the suitability of recommendations by broker-dealers and investment advisers to invest retirement assets into complex or structured products and high-yield securities, and the due diligence conducted and disclosures made relating to riskier securities. Finally, OCIE intends to examine investment advisers' compliance with their fiduciary duties in voting clients' proxies.

Sales Practices and Excessive Trading. Expanding on a priority from 2014, OCIE intends to focus on the propriety of practices used by investment advisers and broker-dealers related to the movement of retirement assets from employer-sponsored plans to other investment types, especially if the other investments are riskier or subject to higher fees. OCIE also intends to examine registrants that appear to engage in excessive trading.

Potential Equity Order Routing Conflicts. OCIE will examine whether firms are choosing trading venues for reasons in conflict with their duties of best execution.

Branch Offices. The 2015 examination priorities letter indicates that OCIE intends to broaden its focus on branch office supervision to include investment advisers as well as broker-dealers and to use data analytics to identify branches deviating from their home office compliance practices.

Large Firm Monitoring. Identifying it as a market-wide risk area, OCIE indicates it will continue to work with the Divisions of Investment Management and Trading and Markets to monitor the largest broker-dealers and investment advisers to assess firm-level risks and maintain an awareness of industry-wide developments.

Cybersecurity. Following the 2014 examination priorities letter identifying cybersecurity as a focus area for broker-dealers, the SEC hosted a Cybersecurity Roundtable (the materials from which are [here](#)). OCIE later published a Risk Alert on Cybersecurity (available [here](#)) in which OCIE declared it would be conducting examinations of more than 50 broker-dealers and investment advisers, focusing on various cybersecurity initiatives. The 2015 examination priorities letter indicates that OCIE plans to continue efforts in this area.

Private Equity Advisers – Fees and Expenses. Citing a high rate of deficiencies observed among investment advisers to private equity funds in connection with the fees charged and expense allocations, OCIE intends to continue to conduct examinations in this area.

Data Analytics. In addition, the 2015 examination priorities letter indicates OCIE intends to utilize the data analytics enhancements developed over the past several years to focus on registrants and firms that appear to be engaged in fraudulent or illegal activity. Specifically, OCIE intends to use data analytics to identify individuals with a track record of misconduct and examine their firms, to examine the operations of broker-dealers and transfer agents for signs they are engaged in or aiding and abetting pump-and-dump schemes or other market manipulation, and to examine broker-dealers' AML programs – specifically focusing on firms that have not filed suspicious activity reports (SARs) or have filed late or incomplete SARs and on firms that allow customers to deposit and withdraw cash and/or provide direct access to markets from high-risk jurisdictions.

Investment Companies

In its monthly study for November 2014 (available [here](#)), the Investment Company Institute reports that the U.S. mutual fund industry has over \$15.9 trillion dollars of assets under management. The ICI also estimated that, as of June 30, 2014, retirement accounts represented 43 percent of total mutual fund assets (\$6.8 trillion as of that date), and that 64 percent of 401(k) plan assets were invested in mutual funds (the foregoing information is available [here](#)). The 2015 examination priorities letter has identified the following as focus areas:

“Alternative” Investment Companies. Citing the “rapid and significant growth compared to other categories of mutual funds,” the 2015 examination priorities letter indicates that the prior focus on funds

holding “alternative” investments will continue. Specifically, OCIE indicated it will focus on leverage, liquidity and valuation policies and procedures of such funds, the adequacy of their internal controls, and the marketing of such funds.

Fixed Income Investment Companies. Expanding on another prior focus area, OCIE intends to review the compliance policies and procedures and trading controls of mutual funds with significant exposure to interest rate increases to ensure their disclosures are not misleading and their investments are consistent with such disclosures.

Never-Before-Examined Investment Companies. The 2015 examination priorities letter indicates that OCIE intends to use a risk-based approach to examine registered investment company complexes that have not yet been examined by OCIE.

Transfer Agents, Clearing Agencies and Other Industry Participants

Citing their position as “important gatekeepers to prevent violations of Section 5 of the Securities Act of 1933 and other fraudulent activity,” OCIE indicated that it intends to allocate more resources to the examination of transfer agents, particularly with respect to microcap securities and private offerings. In addition, OCIE intends to extend the cybersecurity initiative discussed above to include transfer agents.

OCIE indicated it will continue to apply a risk-based approach to conducting annual examinations of systemically important clearing agencies, as required by the Dodd-Frank Wall Street Reform and Consumer Protection Act.

Finally, although not directly linked to the three thematic areas of focus, the 2015 examination priorities letter indicates that OCIE will (i) continue to examine newly-registered municipal advisors to assess compliance with recent SEC and MSRB rules, and (ii) examine select proxy advisory firms, including how they make recommendations and disclose and mitigate potential conflicts of interest.

This *GT Alert* was prepared by **Richard M. Cutshall** and **Arthur Don**. Questions can be directed to:

- > [Richard M. Cutshall](mailto:cutshallr@gtlaw.com) | +1 312.476.5121 | cutshallr@gtlaw.com
- > [Arthur Don](mailto:dona@gtlaw.com) | +1 312.456.8438 | dona@gtlaw.com
- > [Steven M. Felsenstein](mailto:felsensteins@gtlaw.com) | +1 215.988.7837 | felsensteins@gtlaw.com
- > [William B. Mack](mailto:mackw@gtlaw.com) | +1 212.801.2230 | mackw@gtlaw.com
- > [Scott R. MacLeod](mailto:macleods@gtlaw.com) | +1 407.254.2636 | macleods@gtlaw.com
- > [Carl A. Fornaris](mailto:fornarisc@gtlaw.com) | +1 305.579.0626 | fornarisc@gtlaw.com
- > Or your [Greenberg Traurig](#) attorney

Albany +1 518.689.1400	Denver +1 303.572.6500	New York +1 212.801.9200	Shanghai +86 (21) 6391.6633
Amsterdam +31 (0) 20 301 7300	Fort Lauderdale +1 954.765.0500	Northern Virginia +1 703.749.1300	Silicon Valley +1 650.328.8500
Atlanta +1 678.553.2100	Houston +1 713.374.3500	Orange County +1 949.732.6500	Tallahassee +1 850.222.6891
Austin +1 512.320.7200	Las Vegas +1 702.792.3773	Orlando +1 407.420.1000	Tampa +1 813.318.5700
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Boston +1 617.310.6000	Los Angeles +1 310.586.7700	Phoenix +1 602.445.8000	Tokyo[‡] +81 (0)3 3216 7211
Chicago +1 312.456.8400	Mexico City+ +52 (1) 55 5029 0000	Sacramento +1 916.442.1111	Warsaw[~] +48 22 690 6100
Dallas +1 214.665.3600	Miami +1 305.579.0500	San Francisco +1 415.655.1300	Washington, D.C. +1 202.331.3100
Delaware +1 302.661.7000	New Jersey +1 973.360.7900	Seoul[∞] +82 (0) 2 369 1000	Westchester County +1 914.286.2900 West
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