

**On June 15<sup>th</sup>, Washington DC Compliance Roundtable met with Mark J. Dowdell, Assistant Regional Director, Securities and Exchange Commission (Philadelphia Regional Office) to discuss SEC Examinations priorities**

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Mark Dowdell shared his insights about SEC examination priorities and the focus of OCIE inquiries with our members.

We discussed the following types of SEC/OCIE inquiries, which include Risk Assessment-based, Initiative-based, and Custody Rule-based exams for 2017.

Other highlights included a discussion about the Form ADV Changes, which come into effect on October 1<sup>st</sup>, 2017<sup>1</sup>, SEC and the State regulators update, and Exam statistics. We concluded our meeting with a review of the top SEC exam deficiencies.

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<sup>1</sup> Form ADV and Investment Advisers Act Rules: <https://www.sec.gov/rules/final/2016/ia-4509.pdf>

## • **Risk Assessment-based OCIE exams**

The process of selecting firms for Risk Based examinations consists of the following components:

1. Headquarters of the SEC (Office of Risk Analysis and Oversight at OCIE) runs specifically designed risk metrics to rate the firms on a regional basis.
2. Each region receives the list of rated firms.
3. Next step is for each region to conduct a deeper level of analysis to determine whether the list of firms provided to them from the main office is consistent with their (regional office) conclusions. As a result of this step, some firms may be deselected, and other firms may be added to the exam list.

## • **Initiative-based OCIE exams**

### ***Radio Shows and Blogs***

- Philadelphia regional office is currently focusing on Investment Advisers and Broker Dealers using radio shows and blogging (i.e., Dawn Bennett case). These exams are focused on false advertisement as well as other relevant issues.

### ***Whistleblower Tips***

In the world of RIAs, about 30 exams a year originate as a result of tips, complaints and/or referrals.

The SEC, in general, receives a large number of tips and complaints against large firms.

### ***ReTIRE initiative<sup>2</sup>***

As part of this initiative, the SEC is focusing on funds in the fixed income arena at a National level. The agency created a tool to analyze share classes. This tool takes the

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<sup>2</sup> For more information about ReTIRE initiative please visit the SEC website at the following links: (a) <https://www.sec.gov/about/offices/ocie/retirement-targeted-industry-reviews-and-examinations-initiative.pdf> and (b) <https://www.sec.gov/news/pressrelease/2017-7.html>

initial information from sources like Bloomberg and then helps with analyzing BDs and IARs share classes<sup>3</sup>.

### ***Orphaned Accounts***

Examination findings reveal that some firms continue to charge advisory fees after the Investment Advisory Representative (IAR) leaves the firm; whereas the SEC's position is that the advisory fees should be cut off at that point.

### ***Public Pension Fund Initiative***

SEC initiative focuses on those certain funds that are managing pensions for municipalities.

### ***Cyber-Security Initiative***

A Cyber-Security initiative has been added to the list after a meeting with Chairman Clayton at the SEC Philadelphia Regional Office; the new Chairman is very interested in this area. Accordingly, the SEC expects to focus on the following issues in 2017:

- Instant Messaging apps (IM)
- Use of outside e-mail accounts for conducting firm business

### ***Internet Advisers***

The SEC has recently noticed certain Robo advisers, who have registered and have a website, but are not doing business so that they are essentially shelf-registrations ... which are being de-registered.

### ***Recidivist Representatives***

Representatives who were previously banned from the industry by FINRA, are now moving to the SEC as IAs, and will be identified and their registration status will be reviewed by the SEC.

### ***EB-5 Immigrant Investor Programs***

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<sup>3</sup> For more information about Share classes please refer to the SEC Investor Bulletin: Mutual Fund Classes: [https://www.sec.gov/oiea/investor-alerts-bulletins/ib\\_mutualfundclasses.html](https://www.sec.gov/oiea/investor-alerts-bulletins/ib_mutualfundclasses.html)

Immigration/visa programs reviewed via a correspondence exam. SEC is considering whether such programs should register as a BD or IA.

### **Seniors**

There is an uptick in senior citizen complaints and referrals. The SEC will be reviewing client accounts with firms selected for OCIE exams to review their practices with respect to senior investors.

### **Miscellaneous**

In addition, Mr. Dowell referenced the following areas of focus for the SEC:

- Money market fund initiative
- Wrap fee program (i.e., RiverFront case)<sup>4</sup>
- Suitability reviews
- Best practices

### **• Custody Rule OCIE exams**

Broad authority in a custody arrangement in the Standing Letter of Authorization (SLOA) will be cited as a custody issue by the SEC. Currently the SEC is allowing a certain level of leeway related to the custody disclosure. Only a client can change the SLOA, however if the RIA or IAR can make the changes, it will be viewed as custody.

### **• Form ADV Changes come into effect on October 1st, 2017<sup>5</sup>**

Among the required changes to the Form ADV, the following was highlighted during our discussion:

1. Top 25 Branch Offices must be listed with a specific description of these branch office operations and business focus.
2. IARs that have accounts and are located in different geographic locations are considered to be a branch office.
3. Social Media related issues.

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<sup>4</sup> SEC Charges Investment Adviser With Failing to Clearly Disclose Additional Costs to Investors  
<https://www.sec.gov/news/pressrelease/2016-143.html>

<sup>5</sup> Form ADV and Investment Advisers Act Rules: <https://www.sec.gov/rules/final/2016/ia-4509.pdf>

4. Outsourced CCOs will be required to be identified by the RIA.
5. Derivatives disclosures will be monitored as well as AUM.
6. Umbrella registrations for IAs of private funds.

These and other issues may trigger a surprise examination for certain RIAs.

## • **SEC and the State regulators**

SEC signed a Memorandum of Understanding (MOU)<sup>6</sup> with NASAA in February 2017, which allows the SEC to work closely with the State regulators. As a result of this new development, State-registered firms can expect a stronger regulatory oversight going forward, especially in Delaware and Pennsylvania, as well as in other states.

## • **SEC Exam Statistics**

- 1,450 exams in IA space
- 184 exams IA/IC
- 30% clean exams
- 74% deficiency letters
- 8.5% referred to enforcement
- 50% increase in exams for the year

## • **Top SEC Exam Deficiencies**

1. Compliance Procedures Manuals are not reflective of the firms' operations and business (purchased off-the shelf) and therefore deemed inaccurate by the SEC.
2. Annual reviews are inadequate and not performed at all. Attorneys who provide the annual review service cannot claim the privilege.
3. Deficient surprise custody examinations.

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<sup>6</sup> SEC, NASAA Sign Info-Sharing Agreement for Crowdfunding and Other Offerings  
<https://www.sec.gov/news/pressrelease/2017-50.html>

4. Code of Ethics issues related to access persons. These persons are not properly identified and no analysis of access person transactions has been done by the firms.
5. Books and Records General Ledger entries contain contradicting information (not supported by the reconciliation analysis or lacking support completely).