

OCIE Announces 2018 Exam Priorities

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On February 7, 2018, the SEC's Office of Compliance Inspections and Examinations (OCIE) announced its 2018 examination priorities for regulated entities, including funds and investment advisers. The examination priorities are organized in five categories: (1) matters of importance to retail investors; (2) compliance and risks in critical market infrastructure; (3) Financial Industry Regulatory Authority (FINRA) and Municipal Securities Rulemaking Board (MSRB); (4) cybersecurity; and (5) anti-money laundering programs. Within these groupings are several issues of potential interest to funds and their investment advisers, including the following:

Mutual Funds: OCIE will focus on mutual funds "(i) that have experienced poor performance or liquidity in terms of their subscriptions and redemptions relative to their peer groups, (ii) that are managed by advisers with little experience managing registered investment companies, or (iii) that hold securities which are potentially difficult to value during times of market stress, including securitized auto, student, or consumer loans, or collateralized mortgage-backed securities."

ETFs: OCIE will focus on ETFs that have "little secondary market trading volume and that face the risk of being delisted from an exchange and having to liquidate assets." OCIE noted that it will analyze whether investment risks are adequately disclosed to investors.

Index Funds: OCIE noted that it will focus on ETFs and mutual funds that are designed to track custom-built indexes and will focus on the potential for conflicts between the adviser and index provider, including "the adviser's role with respect to the selection and weighting of index components."

Cybersecurity: OCIE will continue to prioritize cybersecurity in its exam programs, with a focus on "governance and risk assessment, access rights and controls, data loss prevention, vendor management, training, and incident response," among other things.

Inadequately Disclosed Fees, Expenses or Other Charges: OCIE will be on the lookout for instances in which an adviser is incentivized to recommend that "investors invest, or remain invested, in particular share classes of mutual funds that are subject to higher sales loads or distribution fees and the conflict of interest may not be disclosed to investors."

Electronic Investment Advice: OCIE will continue to examine advisers and broker-dealers that offer investment advice through automated or digital platforms, including "robo-advisers." Examinations

will focus on “compliance programs, including the oversight of computer program algorithms that generate recommendations, marketing materials, investor data protection, and disclosure of conflicts of interest.”

Wrap Fee Programs: OCIE will continue to examine investment advisers and broker-dealers in connection with wrap fee programs. Examinations will likely focus on “whether investment advisers are acting in a manner consistent with their fiduciary duty and whether they are meeting their contractual obligations to clients.” Other areas of particular focus will be wrap account suitability, the disclosure of conflicts of interest and whether advisers are obtaining best execution and disclosing the costs of executing through another broker-dealer.

Never-Before-Examined Investment Advisers: OCIE stated that it will continue to make “risk-based assessments and select those investment advisers for examination that have elevated risk profiles.”

This list of examination priorities is not exhaustive. OCIE states that it “remains flexible in order to cover emerging and exigent risks to investors and the marketplace as they arise,” adding that “[r]apid institutional and technological change in the market landscape demands a responsive approach.”

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