OCIE's 2019 Examination Priorities and 2018 Enforcement Actions: Practice Points for Advisers to Consider

The US Securities and Exchange Commission's ("SEC") Office of Compliance Inspections and Examinations ("OCIE") released its 2019 examination priorities on December 20, 2018, a few weeks earlier than in past years and just in time for the holidays.[1] A number of the 2019 priorities are continuations from the exam priorities for 2018, and others have been informed by OCIE Risk Alerts published during 2018. As was the case in prior years, OCIE's examination priorities cover investment advisers and registered investment companies as well as market participants such as broker-dealers and transfer agents.[2] This Legal Update gives an overview of the exam priorities for investments advisers, briefly describes certain key SEC enforcement actions brought in 2018 applicable to advisers and offers certain practice points that advisers may want to consider in response to those priorities and enforcement actions.

General OCIE Examination Principles

OCIE made it clear that its announced exam priorities are not exhaustive and will not be the only issues OCIE addresses in the upcoming year. Although the priorities generally drive OCIE examinations, OCIE selects registered entities to examine, and determines the scope of its examinations, through a flexible, risk-based approach. To assess risk, OCIE considers the registrant's operations and service/product offerings and continuously evaluates market conditions, industry practices and investor behavior. OCIE stated, however, that its activities remain grounded in its four pillars: promoting compliance, preventing fraud, identifying and monitoring risk and informing policy.[3]

Retail Investors: Disclosure of the Costs of Investing

OCIE stated that it is critically important that investors are provided with proper disclosures of the fees and expenses they pay for products and services and that financial professionals accurately calculate and charge fees in accordance with these disclosures. Consistent with its 2018 priorities, OCIE will continue to review fees charged to advisory accounts to make sure that the fees are assessed in accordance with client agreements and firm disclosures.[4] In 2018, OCIE specifically referenced fees that are based on account value and related valuation practices.[5]

Also consistent with its 2018 priorities, OCIE plans to select firms with practices or business models that may create increased risks of inadequately disclosed fees, expenses or other charges. Although OCIE did not elaborate on these practices or business models this year, it did so in its 2018 priorities, explaining that such practices or models include:

- advisory personnel that receive financial incentives to recommend that investors invest, or remain invested, in particular share

classes of mutual funds that impose higher sales loads or distribution fees without adequate disclosure of the financial conflicts of interest;

- accounts where investment advisory representatives have departed from the firms, and the accounts have not been assigned a new representative to properly oversee them;
- advisers that changed the manner in which fees are charged from a commission on executed trades to a percentage of client assets under management; and
- private fund advisers that manage funds with a high concentration of investors investing for the benefit of retail clients, including non-profit organizations and pension plans.[6]

With respect to mutual fund share classes, OCIE will continue to evaluate financial incentives paid to financial professionals that may influence their recommendations of particular share classes. It should be noted that the SEC's Division of Enforcement (the "Enforcement Division") previously launched a self-reporting share class disclosure initiative in February 2018 (the Share Class Selection Disclosure Initiative or "SCSD Initiative"), in which Enforcement agreed not to recommend financial penalties against investment advisers who self-report violations from January 2014 through the expiration of the initiative (June 12, 2018) relating to certain mutual fund share class selection issues. Under the SCSD Initiative, the Enforcement Division recommended "standardized, favorable settlement terms" to investment advisers that self-reported failures to disclose conflicts of interest associated with the receipt of 12b-1 fees by the adviser, its affiliates or its supervised persons for investing advisory clients in a 12b-1 fee paying share class when a lower-cost share class of the same mutual fund was available for the advisory clients. As part of such settlement, eligible investment advisers were required to disgorge ill-gotten gains and pay those amounts to harmed clients but did not face civil monetary penalties.[7] We cover some of the 2018 enforcement settlements involving mutual fund share classes later in this Update.

In addition, echoing its 2018 exam priorities, OCIE stated that it remains focused on investment advisers participating in wrap fee programs, with particular interest in the adequacy of disclosures and brokerage practices.[8]

On a related note, on April 12, 2018, OCIE published a Risk Alert outlining the most frequent advisory fee and expense compliance issues identified in adviser examinations.[9] In this Risk Alert, OCIE described frequently identified advisory fee-related issues cited in OCIE exam deficiency letters, which included:

- **Fee Billing Based on Incorrect Account Valuations** - OCIE observed that certain investment advisers incorrectly valued certain assets in clients' accounts resulting in overbilled advisory fees.
- **Billing Fees in Advance or with Improper Frequency** - OCIE observed issues with certain investment advisers' billing practices relating to the timing and frequency for which advisory fees were billed, such as advisers billing fees on a monthly basis instead of the disclosed quarterly basis and billing for an entire period instead of pro-rating for partial periods.
- **Applying Incorrect Fee Rate** - OCIE observed that certain investment advisers applied an incorrect fee rate when calculating the advisory fees charged to certain clients (e.g., the charged fee was higher than the fee in the client's advisory agreement).
- **Omitting Rebates and Applying Discounts Incorrectly** - OCIE observed that certain investment advisers failed to apply certain discounts or rebates to their clients' advisory fees, as specified in the advisory agreements, causing the clients to be overcharged (e.g., advisers did not reduce fees according to the disclosed fee breakpoint levels).

- **Disclosure Issues Involving Advisory Fees** - OCIE staff observed several issues with respect to certain investment advisers' disclosures of fees or billing practices, such as inconsistent maximum advisory fee practices, failure to disclose additional fees and markups from outside clearing brokers, imposition of brokerage fees in addition to wrap fees (that presumably cover cost of brokerage services in a single, bundled fee), and failures to disclose revenue sharing arrangements with affiliates.
- **Adviser Expense Misallocations** - OCIE observed that certain investment advisers to private and registered funds misallocated expenses to the funds. This included instances where such investments advisers improperly allocated distribution and marketing expenses, regulatory filing fees, and travel expenses to their fund clients instead of paying such expenses directly.[10]

PRACTICE POINTS:

- Advisers would be wise to take note of the 2018 expense-related enforcement actions, which demonstrate, painfully, the importance of the above principles.[11]
- To that end, consider periodically reviewing onboarding and fee billing practices. Sample testing contractual terms against actual fee invoices, and disclosed allocation promises against actual allocation practices, should provide a good sense of potential regulatory exposure.
- Incorporate the above testing and reviews in your compliance risk assessment, as well as your annual review for purposes of the Rule 206(4)-7 under the Investment Advisers Act of 1940 ("Advisers Act").

Retail Investors: Use of Affiliated Service Providers and Products

New this year, OCIE specifically mentioned examining an adviser's use of services or products provided by affiliates in connection with their investment advisory services, with a particular focus on the impact to clients and the adequacy of conflicts of interest disclosure.[12]

PRACTICE POINTS:

- 2018 enforcement actions against advisers involved use of, and payments to/from, affiliated service providers.[13]
- Advisers should review their use of affiliated service providers in connection with their investment advisory services and should:
  - Find out how affiliated service providers are used;
  - Try to document and support the quality of the services provided by the affiliates as compared to those provided by unaffiliated service providers;
  - Find out how affiliated service providers are paid;
  - Evaluate whether the compensation paid to affiliates for those services is comparable to, less than or greater than the compensation that unaffiliated service providers would charge for comparable services; and
  - Evaluate the disclosures to clients/investors regarding the adviser's use of affiliated service providers.
- The primary purpose of this review is to document a robust process of evaluating, at inception and periodically thereafter, both the quality and cost of the affiliate's services as compared to unaffiliated service providers.
- It may be that the most effective way to mitigate the risks of using affiliated service providers is for clients and investors (or LPACs/advisory committees) to affirmatively approve the use of, or continued use of, affiliated service providers after fully disclosing the conflict and disclosing how the adviser selects and pays them.

Retail Investors: Borrowing Funds from Clients

As a new exam priority, OCIE stated that where its examiners observe an adviser borrowing funds from clients, examiners will evaluate whether adequate disclosures, including the potentially poor or failing financial condition of the investment adviser, are made to the client and whether the investment adviser has acted consistently with these disclosures.[14]

PRACTICE POINTS:

- Presumably OCIE also would be interested in advisory personnel borrowing funds from clients.
- Many investment advisers simply prohibit borrowing from clients, period, and we agree with that approach.

Senior Investors and Retirement Accounts and Products

Continuing this exam priority from prior years, OCIE stated that it will review the services and products that investment advisers offer to seniors and those saving for retirement. Differing slightly from 2018, however, OCIE's examinations in 2019 will focus on, among other things, compliance programs of investment advisers, the appropriateness of certain investment recommendations to seniors and the supervision by firms of their employees and independent representatives.[15]

PRACTICE POINTS:

- Given this continued exam focus, advisers that have or could have senior advisory clients might consider adding a senior advisory client component to their policies and procedures.
- These policies could include: (i) reviewing and updating onboarding and account review practices for senior clients; (ii) evaluating the sufficiency and adequacy of disclosures in communications geared towards senior clients (or strategies of interest to those clients); and (iii) evaluating the suitability and appropriateness of investment strategies and products for seniors.

Portfolio Management and Trading

In this new exam priority for 2019, OCIE will review advisory firms' practices for executing investment transactions on behalf of clients, fairly allocating investment opportunities among clients, ensuring consistency of investments with the objectives obtained from clients, disclosing critical information to clients and complying with other legal restrictions.

OCIE will also examine investment adviser portfolio recommendations to assess, among other things, whether investment or trading strategies of advisers are (1) suitable for and in the best interests of investors based on their investment objectives and risk tolerance; (2) contrary to, or have drifted from, disclosures to investors; (3) venturing into new, risky investments or products without adequate risk disclosure; and (4) appropriately monitored for attendant risks.[16]

PRACTICE POINTS:

- Issues related to the allocation of investment opportunities (and trades) continue to be heavily scrutinized by the SEC staff, including OCIE.[17]
- Advisers should continue to monitor allocations to client accounts as well as cross trades[18] to seek to ensure that all clients are treated fairly and equitably (including regular oversight by the adviser's compliance personnel).
- A possible sign of allocation favoritism can be found in accounts that are performance outliers. Higher performing accounts should be reviewed for possible allocation issues. Advisers also should periodically review their risk disclosures in their Form ADV Part 2A brochures, Fund documents or other marketing materials to evaluate whether they sufficiently describe and explain risks that

may arise from the advisers' investment strategies and products, including new, novel or recently developed products and services.

Mutual Funds and Exchange Traded Funds

OCIE will continue to prioritize examinations of mutual funds and exchange traded funds ("ETFs"), the activities of their advisers, and oversight practices of their boards of directors. Examinations will assess industry practices and regulatory compliance in various areas that may have significant impact on retail investors.[19]

Consistent with a November 2018 OCIE Risk Alert, OCIE will focus on risks associated with the following: (1) index funds that track custom-built or bespoke indexes; (2) ETFs with little secondary market trading volume and smaller assets under management; (3) funds with higher allocations to certain securitized assets; (4) funds with aberrational underperformance relative to their peer groups; (5) funds managed by advisers that are relatively new to managing registered investment companies (RICs); and (6) advisers that provide advice to both RICs and private funds with similar investment strategies.[20] Areas (1) through (5) were also mentioned in OCIE's 2018 exam priorities.[21]

PRACTICE POINTS:

- In the past year, the SEC and its staff have emphasized protecting "Main Street" investors, so it is unsurprising that OCIE will continue to prioritize examinations of mutual funds and ETFs, investment products traditionally owned by retail investors.[22]
- Given the recent focus on retail investors, advisers to mutual funds and ETFs should consider reviewing their compliance risk monitoring policies to evaluate whether certain risk areas should be heightened (such as, for example, policies and procedures and risk disclosures related to non-traditional investment strategies and products that may be novel, or unfamiliar, to retail investors).[23]

Never-Before or Not-Recently-Examined Advisers

Consistent with prior years, OCIE will continue to conduct risk-based examinations of investment advisers that have never been examined, including newly-registered investment advisers as well as those registered for several years but that have yet to be examined. OCIE will also prioritize examinations of certain investment advisers that have not been examined for a number of years and may have substantially grown or changed business models.[24]

OCIE also will continue to conduct select examinations of municipal advisors ("MAs") that have never been examined, concentrating on whether these MAs have satisfied their registration requirements and professional qualifications as well as continuing education requirements.[25]

PRACTICE POINTS:

- An excellent way to prepare for this priority, if it applies, is to undergo a mock SEC examination.
- A mock exam should be as close to an actual SEC examination as possible.
- We recommend that any mock examination be performed with the benefit of attorney-client privilege by either having the law firm perform the mock examination or having that law firm hire the third-party consultant to perform the examination subject to the privilege.[26]

Digital Assets

Continuing a 2018 exam priority, OCIE will monitor the offer and sale, trading and management of digital assets, and where the products are securities, examine for regulatory compliance. In particular, through "high level inquiries," OCIE will take steps to identify market participants offering, selling, trading and managing these products or considering or

actively seeking to offer these products and then assess the extent of their activities.[27]

Also consistent with its 2018 exam priorities, OCIE will conduct examinations of firms actively engaged in the digital asset market, focusing on, among other things, portfolio management of digital assets, trading, safety of client funds and assets, pricing of client portfolios, compliance and internal controls.[28]

PRACTICE POINT:

- Cryptocurrencies, initial coin offerings, and related assets markets and activities have been of particular interest to Chair Clayton, the SEC and the Enforcement Division.[29]

Cybersecurity

As was the case in 2018, OCIE states that it continues to work with firms to identify and manage cybersecurity risks and to encourage firms to actively and effectively engage in this effort, and that it will continue to prioritize cybersecurity in its examinations. Differing slightly from 2018, however, examinations in 2019 will focus on, among other things, proper configuration of network storage devices, information security governance generally and policies and procedures related to retail trading information security.[30]

New for 2019, OCIE stated that it will emphasize cybersecurity practices at advisory firms with multiple branch offices (including those that have recently merged with other investment advisers) and will focus on, among other areas, governance and risk assessment, access rights and controls, data loss prevention, vendor management, training and incident response.[31]

PRACTICE POINTS:

- Cybersecurity continues to be an important hot topic, not just for OCIE but also the Enforcement Division.
- In 2018, the Enforcement Division brought its first enforcement action against an investment adviser for violation of the identity theft prevention program requirements in Regulation S-ID (the settlement also involved violations of the "safeguards rule" in Regulation S-P).[32]
  - An important takeaway from this settlement is for advisers to carefully review their system access rights controls and related procedures, which should cover not only regular employees but also any independent contractors that may have access to its systems.
- Given OCIE's new emphasis on "branch" locations, investment advisers also should review their cybersecurity policies and procedures to evaluate whether such procedures adequately address cybersecurity events not only at the adviser's main offices but also at any applicable branch office.
- Advisers might want to consider having a periodic audit of their cybersecurity program, conducting penetration tests and vulnerability scans on critical systems and making sure they have customized and up-to-date response plans in place for addressing cybersecurity incidents and data breaches.

Other 2018 OCIE Risk Alerts

In addition to the 2018 OCIE Risk Alerts mentioned above, OCIE published the following Risk Alerts, which, although not specifically mentioned in the 2019 exam priorities, are nevertheless worthy of attention in 2019:

- Most Frequent Best Execution Issues Cited in Adviser Exams, OCIE Risk Alert dated July 11, 2018.[33]
- Investment Adviser Compliance Issues Related to the Cash Solicitation Rule, OCIE Risk Alert dated October 31, 2018.[34]
- Observations from Investment Adviser Examinations Relating to Electronic Messaging, OCIE Risk Alert dated December 14, 2018.[35]

PRACTICE POINTS:

- Although the above topics were not included in OCIE's examination priorities, OCIE Risk Alerts set out OCIE staff expectations regarding certain aspects of regulatory compliance.
- Advisers should treat OCIE Risk Alerts as "fair warning." As such, an adviser's Chief Compliance Officer and legal staff should carefully review each Risk Alert to evaluate whether changes or enhancements are needed to the firm's relevant compliance policies and procedures.

Other Notable Regulatory Matters

In addition to the settlements noted above, the Enforcement Division also settled other actions in 2018 against investment advisers on various issues, including:

- **Mutual Fund Share Class Enforcement**. As mentioned above, during the 2018 SCSD Initiative period (February – June 2018), the Enforcement Division announced several enforcement settlements against mutual fund sponsors in connection with certain share class-related matters. In these actions, the SEC alleged that these advisers (and in certain cases their respective broker-dealer affiliates) invested advisory clients in mutual fund shares with 12b-1 fees instead of available lower-cost share classes of the same funds that did not impose 12b-1 fees. The SEC also alleged that these advisers did not adequately disclose to clients that they financially benefited from investing clients in share classes with 12b-1 fees.[36]
- **Pay-to-Play**. Similar to the 10 pay-to-play enforcement settlements announced in early 2017, the SEC brought three additional enforcement actions against certain investment advisers involving the play-to-play rule (Rule 206(4)-5 under the Advisers Act). The 2018 pay-to-play settlements all largely mirror the same types of violations identified by the SEC in its 2017 set of pay-to-play settlements: the contributions were in some cases relatively small (sometimes barely over the de minimis contributions permitted by the rule), and in some cases the individuals that made the contributions promptly requested that they be returned. Notably, while in the 2017 set of enforcement actions no fine was greater than $100,000, this latest set of enforcement actions saw fines ranging from $100,000 to $500,000, which may indicate that the SEC is ratcheting up the fines. Notably, the SEC has yet to seek disgorgement of fees received by investment advisers from "government entity" clients/investors related to impermissible contributions in either the first set of actions or the more recent set.[37]
- **Robo-adviser Enforcement**. During the latter portion of 2018, the Enforcement Division announced the first set of actions involving robo-advisers, specifically alleging that these robo-advisers utilized false and misleading marketing materials.
  - In the first settlement, the SEC alleged that a robo-adviser posted performance comparisons on its website and social media that were misleading because the robo-adviser used a performance composite that included less than 4 percent of its client accounts, which had higher-than-average returns, and compared it with rates of return that were not based on competitors' actual trading models.[38]
  - In a second settlement, the SEC alleged that a robo-adviser failed to live up to its advertised promises regarding wash sales in connection with its proprietary tax loss harvesting program ("TLH") and also alleged that the robo-adviser paid bloggers for client referrals. From October 2012 through mid-May 2016, the SEC alleged that the robo-adviser falsely stated in a whitepaper describing its TLH that the robo-adviser monitored all client accounts to avoid any transactions that might trigger

a wash sale. In fact, until mid-May 2016, the SEC alleged that this robo-adviser did not monitor client accounts to avoid any transaction that might trigger a wash sale. The SEC also alleged that this robo-adviser paid bloggers for new client referrals, based on the amount of assets the new client initially deposited, without complying with applicable disclosure and documentation requirements.[39]

- **Testimonials**. In 2018, the SEC announced five settlements involving the use of testimonials in violation of Rule 206(4)-1(a)(1) under the Advisers Act) that generally prohibits the use of testimonials in investment adviser's marketing materials. What is unique about these cases is that they involve social media, an area that OCIE continues to focus on in its examinations of investment advisers.
  - Four of these cases were interrelated, stemming from "reputation services" wherein a service provider would post positive reviews on popular social media platforms and other websites. The service provider claimed that the program was "100% compliant for investment advisers," though that was clearly not the case. One recipient of the service eventually identified the potential issue, flagged it for the service provider and requested that the testimonials be taken down, but the service provider ignored the request for over six months, and continued to take on other investment adviser clients. That first (unnamed) investment adviser was not the subject of the enforcement actions, but the service provider and three of its other investment adviser clients (and/or their principals) were. One important note here is that the service provider was found to have "caused" the violations by the other investment advisers, though the service provider itself was not directly subject to the Advisers Act.[40]
  - The fifth enforcement action related to a 31-minute video created by a dual-registrant broker-dealer/investment adviser in celebration of the firm's 50th anniversary. The video, originally created for use at the firm's anniversary party, contained statements from 27 advisory clients regarding their experiences with the firm. The firm later posted the video on its public website and on a popular social media platform (where it garnered 291 views over a nearly five-year period). They also later created a shorter, eight-minute version of the video (containing many of the same statements from the first video), and similarly posted it on the firm's website and on the social media platform (yielding a more modest 117 views over a three-year period).[41]

- **Use of Hypothetical and Back-Tested Performance**. In the latter half of 2018, the Enforcement Division announced certain settlements against investment advisers that utilized back-tested performance in its marketing materials, but failed to, among other things, provide adequate or accurate disclosures to clients.
  - In one settled action, the SEC alleged that an adviser misled its actual and prospective clients about the efficacy of its blended research strategy. This adviser developed a blended research strategy that combined research ratings from its fundamental analysts and quantitative models and then published advertisements analyzing a hypothetical portfolio that used the blended research strategy. The SEC alleged that the adviser's advertisements were misleading because the materials failed to disclose that some of the quantitative ratings used to create the hypothetical portfolio were determined using a retroactive, back-tested, application of the adviser's quantitative model. The SEC also found that the

misleading advertisements were due, in part, to the failure of the adviser to adopt and implement effective compliance policies and procedures that could have prevented these violations.[42]

  - In a separate action, the SEC alleged that an investment adviser made material misstatements and omissions to its clients and prospective clients in advertising the back-tested performance of its Tactical Rotation Index (the "Index"). The adviser's advertisements from 2010 to 2018 showed back-tested performance results from January 2000 through June 2010 that significantly outperformed the S&P 500 Index; however the SEC alleged that the back-tested performance calculations contained material errors and deviated from the pricing methodology utilized during the live period that began in June 2010. First, the SEC alleged that the back-tested performance failed to implement a two-day lag between signal and investment, consistent with the approach used during the live period. Second, the SEC alleged that the adviser failed to ensure that the hypothetical portfolio's holdings were in accordance with the Index's model rules. The SEC alleged that on a cumulative basis, the adviser's failure to implement the lag and the portfolio holding errors inflated the Index's advertised performance by approximately 41.2 percent for the period from 2000 to June 2010.[43]

- **Anti-Money Laundering and Foreign Corrupt Practices Act Enforcement**. The Enforcement Division also announced certain AML and FCPA-related enforcement actions involving asset management firms.

  - In one action, the SEC alleged that a dually registered broker-dealer/investment adviser failed to file suspicious activity reports ("SARs") and to properly monitor its customers' use of wire transfer, ACH transfer and check writing services. From 2011 to 2013, the dual registrant had an anti-money laundering program that the SEC alleged was not reasonably designed to account for the risks associated with these additional services used by customers in their retail brokerage accounts. Because of the deficiencies, the SEC alleged that the dual registrant did not adequately monitor for, detect and report suspicious activity for certain transactions or patterns of transactions occurring in non-resident alien customer accounts in a branch office.[44]
  - In another action, the SEC alleged that a subsidiary of a publicly traded asset management firm violated provisions of the Foreign Corrupt Practices Act by paying bribes to Libyan government officials through a Libyan middleman in order to secure investments. As a result of the corrupt scheme, the SEC alleged that the subsidiary was awarded business tied to $1 billion of investments for the Libyan financial institutions; and that the middleman used the term "cooking" to describe his ability to cause Libyan government officials to invest (including through the use of bribes).[45]

PRACTICE POINT:

- The above settled enforcement actions provide hints at other potential areas that OCIE may focus on during adviser examinations in 2019. Accordingly, we recommend that advisers review and revise (as needed) their practices, policies and procedures related to the above enforcement topics (to the extent relevant to the adviser's business), and consider holding employee training sessions on those topics, covering, among other things, the lessons to be learned.

Concluding Thoughts

In light of the exam priorities described above as well as the recent enforcement actions from the SEC, advisers should review their compliance program and evaluate whether further enhancements or possible revisions are needed to their program or underlying policies and procedures. Now may be the opportune time to perform such an evaluation given that the SEC staff likely remains focused on the avalanche of work following the conclusion of the recent government shutdown. As President Kennedy said, "The time to repair a roof is when the sun is shining."

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[1] See OCIE, National Exam Program, Examination Priorities for 2019 (Dec. 20, 2018) [hereinafter "OCIE 2019 Exam Priorities"], available at https://www.sec.gov/files/OCIE%202019%20Priorities.pdf.

[2] Id. at 1.

[3] Id. at 5. OCIE noted that in Fiscal Year 2018, OCIE examined approximately 17 percent of registered investment advisers, an increase of 9 percent from 5 years prior.

[4] Id. at 6.

[5] See OCIE, National Exam Program, Examination Priorities for 2018 (February 7, 2018) [hereinafter "OCIE 2018 Exam Priorities"], available at https://www.sec.gov/about/offices/ocie/national-examination-program-priorities-2018.pdf.

[6] Id. at 5.

[7] SEC Enforcement Division, Share Class Selection Disclosure Initiative (February 9, 2018), available at https://www.sec.gov/enforce/announcement/scsd-initiative.

[8] OCIE 2019 Exam Priorities at 6.

[9] OCIE, "Most Frequent Advisory Fee and Expense Compliance Issues Identified in Examinations of Investment Advisers," OCIE Risk Alert (April 12, 2018), available at https://www.sec.gov/ocie/announcement/ocie-risk-alert-advisory-fee-expense-compliance.pdf.

[10] Id. at 2-4.

[11] See, e.g., Release No. IA-4975 (July 20, 2018), available at https://www.sec.gov/litigation/admin/2018/ia-4975.pdf (the SEC alleged that an adviser and its employees improperly withheld prepaid, unearned advisory fees totaling $131,000 from 63 departing clients that had requested termination of their advisory relationship); Release No. IA-5065 (November 19, 2018), available at https://www.sec.gov/litigation/admin/2018/ia-5065.pdf (the SEC alleged that an adviser failed to apply advisory fee discounts to certain client accounts contrary to its disclosures, representations to clients and advisory agreements); Litigation Release No. 24206 (July 18, 2018), available at https://www.sec.gov/litigation/litreleases/2018/lr24206.htm (the SEC alleged that an adviser steered clients and other investors into four risky, illiquid private offerings

and concealed high commissions as well as grossly overbilled some of their advisory clients); Release No. IA-4951 (June 29, 2018), available at https://www.sec.gov/litigation/admin/2018/ia-4951.pdf (the SEC alleged that an adviser failed to offset consulting fees against management fees paid by certain advised funds resulting in such funds overpaying around $780,000 in management fees); and Release No. IA-5096 (December 26, 2018) available at https://www.sec.gov/litigation/admin/2018/ia-5096.pdf (the SEC alleged that the adviser failed to properly allocate fees and expenses among co-investors and employee funds).

[12] OCIE 2019 Exam Priorities at 6.

[13] Release No. IA- 5002 (Sept. 7, 2018), available at https://www.sec.gov/litigation/admin/2018/ia-5002.pdf, in which the SEC alleged that an adviser failed to adequately disclose material conflicts of interest arising out of a compensation arrangement with an affiliated adviser (the adviser in question recommended to its clients that they invest in wrap fee programs sponsored by three other investment advisers, one of which was an affiliate of the adviser). See also Release No. IA-4932 (June 4, 2018), available at https://www.sec.gov/litigation/admin/2018/ia-4932.pdf, in which an adviser entered into agreements with two affiliated investment advisers ("Affiliated Advisers"), calling for the Affiliated Advisers to make payments to the adviser based upon the total amount of its clients' assets the adviser placed or maintained in funds advised by the Affiliated Advisers. The SEC alleged that the adviser failed to disclose these agreements or the payments, which were in contravention of investment management agreements with two of the adviser's clients. The SEC alleged that the adviser also lacked policies and procedures reasonably designed to detect and prevent such conflicts and failed to account on its books and records for the amounts owed and ultimately paid.

[14] OCIE 2019 Exam Priorities at 7.

[15] Id.

[16] Id.

[17] The Enforcement Division settled several actions in 2018 involving allocation issues, including those involving trade allocation and cross trades. See Release No. IA-4957 (August 17, 2018), available at https://www.sec.gov/litigation/admin/2018/ia-4987.pdf. In this action, the SEC alleged that an adviser and one of its investment adviser representatives engaged in fraudulent trade allocation or "cherry-picking" by unfairly allocating purchases of securities between favored accounts (including personal and family accounts of an investment adviser representative of the adviser) and other client accounts of the adviser. The SEC alleged that the investment adviser representative disproportionately allocated profitable trades to the favored accounts (and disproportionately allocated unprofitable trades to the accounts of certain advisory clients) by buying the securities in an omnibus account and then waiting to allocate until after he had an opportunity to see whether the securities had increased in price. See also Release No. IA-4983 (August 10, 2018) available at https://www.sec.gov/litigation/admin/2018/ia-4983.pdf. In this settlement, the SEC alleged that an adviser engaged in cross trades that favored certain advisory client accounts over others (the adviser executed the cross trades at the securities' bid price, instead of the midpoint between the bid and the ask price, resulting in the undisclosed allocation of all market savings on these trades to the adviser's buying clients). In addition, the SEC alleged that the adviser persuaded certain broker-dealers to adjust their price quotations for seven municipal bonds held in client portfolios to levels substantially above where the bonds had most recently traded in the market and that the adviser did not document any rationale for these upward adjustments.

[18] Advisers should also review their cross trade policies and procedures to ensure that cross trades are executed at the appropriate price and that such processes are appropriately disclosed to clients. See Section 17(a) of the Investment Company Act of 1940 and Rule 17a-7 thereunder. In addition, special focus and care needs to be applied anytime cross trades occur between client accounts and accounts subject to the Employee Retirement Income Security Act of 1974 ("ERISA"), which generally prohibits plan fiduciaries from causing a plan to enter (direct or indirect) transactions involving the plan or its assets that have the potential for conflicts of interest.

[19] OCIE 2019 Exam Priorities at 8.

[20] Id; See also Risk-Based Examination Initiatives Focused on Registered Investment Companies, OCIE Risk Alert dated November 8, 2018, available at https://www.sec.gov/files/OCIE%20Risk%20Alert%20-%20RIC%20Initiatives_0.pdf [hereinafter "OCIE RIC Risk Alert"]

[21] OCIE 2018 Exam Priorities at 6.

[22] See, e.g., Remarks by Chair Jay Clayton to SEC Investment Advisory Committee (June 14, 2018), available at https://www.sec.gov/news/public-statement/clayton-statement-investor-advisory-committee-061418; Keynote Address by Dalia Blass, Director of SEC's Division of Investment Management at the Investment Company Institute's ("ICI") 2018 Mutual Funds Conference (March 19, 2018), available at https://www.sec.gov/news/speech/speech-blass-2018-03-19;

Remarks by Ms. Blass at the Independent Directors Council's 2018 Fund Directors Conference (Oct. 16, 2018), available at https://www.sec.gov/news/speech/speech-blass-101618; Keynote Address by Ms. Blass at the 2018 ICI Securities Law Developments Conference (Oct. 25, 2018), available at https://www.sec.gov/news/speech/speech-blass-102518.

[23] See, e.g., OCIE RIC Risk Alert at 3, noting that mutual funds investing in certain securitized assets should adequately disclosure the risks in such investments to retail investors.

[24] OCIE 2019 Exam Priorities at 7.

[25] Id. OCIE also will evaluate whether MAs have provided appropriate disclosures regarding their conflicts of interest or otherwise violated their fiduciary duty to a municipal entity, and have complied with recently-effective MSRB rules (including those relating to advertisements by MAs and the standards of conduct for MAs obtaining CUSIP numbers on behalf of issuers).

[26] In the latter case, the ability to assert the privilege over findings of a mock examination is lessened unless the consultant actually works with the law firm in advising the client. Simply having a law firm hire a consultant to perform a mock audit, but have no involvement in the mock audit, will put into question the assertion of the privilege. In addition, we advise, if at all possible, that findings not be put into a written report. It is always best to avoid any circumstance in which the privilege needs to be asserted in the first place.

[27] OCIE 2019 Exam Priorities at 11.

[28] Id.

[29] See How to Deal With the SEC's Cryptocurrency Blitz, National Law Journal (March 28, 2018), available at https://www.mayerbrown.com/How-to-Deal-With-the-SECs-Cryptocurrency-Blitz-03-28-2018/ (quoting Matthew Rossi, Securities Enforcement and Regulation Partner at Mayer Brown's Washington, DC office).

[30] OCIE 2019 Exam Priorities at 11.

[31] Id. These latter focus areas were included in OCIE's 2018 exam priorities but were not made specific to investment advisers as is the case this year. See OCIE 2018 Exam Priorities at 9.

[32] In the action, the SEC alleged that the dual registered investment adviser/broker-dealer failed to adopt written policies and procedures reasonably designed to protect customer records and information prior to a cybersecurity breach that resulted in a third-party cyber intruder obtaining certain personal information of approximately 5,600 clients. See Release No. IA-5048 (Sept. 26, 2018), available at https://www.sec.gov/litigation/admin/2018/34-84288.pdf. According to the order, cyber intruders impersonated contractors of an adviser over a six-day period in 2016 by calling the adviser's support line and requesting password resets for such contractors' passwords. The intruders subsequently used the reset passwords to gain access to client personal information, which was utilized to create new online customer profiles and obtain unauthorized access to account documents for three customers. The SEC alleged that the dual registrant's failure to terminate the intruders' access stemmed from weaknesses in its cybersecurity procedures, particularly its procedures governing system access by the firm's independent contractors, who make up a sizable portion of the firm's workforce.

[33] Available at https://www.sec.gov/files/OCIE%20Risk%20Alert%20-%20IA%20Best%20Execution.pdf. In this Risk Alert, OCIE staff cited examples of the most commonly identified deficiencies associated with investment advisers' best execution obligations, which included: not performing best execution reviews; not considering materially relevant factors during best execution reviews (e.g., no qualitative factors, no input from portfolio managers/traders); not seeking comparisons from other broker-dealers; not fully disclosing best execution practices (e.g., sequencing and impact on clients); not fully disclosing soft dollar arrangements; not properly administering mixed-use soft dollar allocations; inadequate best execution policies and procedures; and not following best execution policies and procedures.

[34] Available at https://www.sec.gov/files/OCIE%20Risk%20Alert%20-%20Cash%20Solicitation.pdf. In this Risk Alert, OCIE staff cited some of the most frequently identified deficiencies pertaining to Rule 206(4)-3 under the Advisers Act, which related to solicitor disclosure documents, client acknowledgments, solicitation agreements and bona fide efforts to ascertain solicitor compliance.

[35] Available at https://www.sec.gov/files/OCIE%20Risk%20Alert%20-%20Electronic%20Messaging.pdf. Prior to publishing this Risk Alert, OCIE had conducted a limited-scope examination initiative of registered investment advisers that was designed to obtain an understanding of the various forms of electronic messaging used by advisers and their personnel, the risks of such use and the challenges in complying with certain provisions of Advisers Act. OCIE's examination initiative focused on whether and to what extent advisers complied with Rule 204-3 and Rule 206(4)-7 relative to electronic messaging. In this Risk Alert, OCIE staff described examples of practices that it believed could assist advisers in meeting their obligations under these rules. These practices related to the following

areas: policies and procedures; employee training and attestations; supervisory reviews; and controls over devices.

[36] See, e.g., In re Release No. IA-4862 (February 28, 2018), available at https://www.sec.gov/litigation/admin/2018/33-10462.pdf.; Release No. IA-4877 (April 6, 2018), available at https://www.sec.gov/litigation/admin/2018/34-83003.pdf; and Release No. IA-4878 (April 6, 2018), available at https://www.sec.gov/litigation/admin/2018/34-83004.pdf.

[37] See, e.g., In re Release No. IA-4960 (July 10, 2018), available at https://www.sec.gov/litigation/admin/2018/ia-4960.pdf; Release No. IA-4959 (July 10, 2018), available at https://www.sec.gov/litigation/admin/2018/ia-4959.pdf; and Release No. IA-4958 (July 10, 2018), available at https://www.sec.gov/litigation/admin/2018/ia-4958.pdf.

[38] Release No. IA-5087 (Dec. 21, 2018), available at https://www.sec.gov/litigation/admin/2018/ia-5087.pdf.

[39] Release No. IA-5086 (Dec. 21, 2018), available at https://www.sec.gov/litigation/admin/2018/ia-5086.pdf. In this action, the robo-adviser designed its TLH to create tax benefits for clients by selling certain assets at a loss that, if realized, can be used to offset income or gains on other transactions, thereby reducing clients' tax liability in a given year. Generally, a wash sale occurs when an investor sells a security at a loss and, within 30 days of this sale, buys the same or a substantially identical security. A wash sale prevents the tax benefit of having sold the asset to realize a loss.

[40] See, e.g., Release No. IA-4961 (Jul. 10, 2018), available at https://www.sec.gov/litigation/admin/2018/ia-4961.pdf; Release No. IA-4962 (Jul. 10, 2018), available at https://www.sec.gov/litigation/admin/2018/ia-4962.pdf; Release No. IA-4963 (Jul. 10, 2018), available at https://www.sec.gov/litigation/admin/2018/ia-4963.pdf; and Release No. IA-4964 (Jul. 10, 2018), available at https://www.sec.gov/litigation/admin/2018/ia-4964.pdf.

[41] Release No. IA-4965 (Jul. 10, 2018), available at https://www.sec.gov/litigation/admin/2018/34-83613.pdf.

[42] Release No. IA-4999 (August 31, 2018), available at https://www.sec.gov/litigation/admin/2018/ia-4999.pdf.

[43] Release No. IA-5085 (December 20, 2018), available at https://www.sec.gov/litigation/admin/2018/ia-5085.pdf.

[44] Release No. IA-5075 (Dec. 17, 2018), available at https://www.sec.gov/litigation/admin/2018/34-84828.pdf.

[45] Release No. 34-83948 (August 27, 2018), available at https://www.sec.gov/litigation/admin/2018/34-83948.pdf.