

Breaking Down the SEC Examinations Process: Key Considerations for Registrants, Part 1

In a two-part legal update, we will discuss key information SEC registrants should know going into the upcoming review cycle conducted by the Division of Examinations (the Division). This first update attempts to demystify the SEC examination process and addresses the common questions and concerns that arise during such a review. The next update, which is forthcoming, discusses the Division's 2025 examination priorities report published in October 2024, particularly what risk areas SEC registrants can expect the staff to focus on over the next fiscal year. We hope this series will better prepare firms for an SEC examination and, in that same vein, inspire a proactive approach toward securities compliance.

Selecting Firms Using a Risk-Based Methodology

Firms often ask why they have been selected for examination. While the staff's basis for selection is non-public information and not typically shared with the firm, it is important to recognize the examination program is risk-based and that there are various factors driving the Division to focus on one firm over another. Apart from fulfilling its statutory mandate to conduct examinations, the Division's considerations include a firm's disciplinary history, prior regulatory settlements, a lack of examination history for a particular firm (e.g., never examined advisers), and various compliance risk areas (i.e., practices, products and services that have been determined to present a heightened risk to investors or the markets) along with any customer complaints, whistleblower tips, and other regulator referrals.

Cooperating Effectively During an Exam

Once selected, firms often fail to follow a few small but crucial steps that help build credibility and confidence with the staff throughout the examination process. First, firms should appoint a single point of contact for the staff to communicate with during the review. When communication is centralized in this manner, the exchange of information is streamlined, and the staff is not left to guess who to contact on a particular issue. Second, a firm should diligently respond to all the staff's requests with complete and accurate information. As such, at the outset of an examination, firms should outline a reasonable response timetable and prioritize for the staff which items will be handled earlier in the process and which will require additional time.

As the examination progresses, firms should raise any questions or concerns about the staff's requests and continue to offer periodic check-ins with the staff. These check-ins will provide the firm with an opportunity to offer updates about what progress has been made toward open items and what key remedial actions have been or will be taken in response to definite issues of concern either already identified or previously self-reported. Firms may compromise their credibility and be viewed as uncooperative if they fail to provide updates to the staff during the examination process and later submit a delayed response without any explanation or justification. Finally, where appropriate, firms should involve their key stakeholders in meetings with the staff to help the Division better understand the firm's business, operations, and compliance process.

Managing the Final Stages of an Exam

As the examination draws towards a close, firms sometimes miss important opportunities to finish the process on a positive and forward-looking note. In certain cases, the staff will coordinate a preliminary exit conference where they will discuss any outstanding requests for information with the firm and raise the issues of potential concern identified during the review. If the staff does not ask for a meeting, but the firm recognizes it needs to address specific issues before the completion of the examination, the firm should proactively reach out to the staff and request a



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meeting at an appropriate time to avoid misunderstandings or confusion later on in the process. In addition, it is still quite common for the staff to provide the firm with a forum to address any issues of potential concern through a final exit conference procedure. The purpose of the final exit conference (or perhaps more aptly described as an interview) is to facilitate an open dialogue around whether the firm agrees with the observed deficiencies, what remediation plans it intends to adopt in response to them, and the timing for implementing those remedial actions. The guiding light for firms is a strategy that stays ahead on issues of key import for the staff through clear and articulate messaging that either assuages any regulatory concerns or addresses those concerns through open acknowledgment and thoughtful remedial responses.

The staff is required to provide written notification to the firm upon completion of an exam, which, in the event there are issues of concern, is regularly issued in the form of a deficiency letter. The firm should methodically address each identified deficiency in its reply letter to the staff and explain how its remedial response is comprehensive and corrective and will not allow the issue or a derivative of it to occur again. The staff will not indicate to the firm in a deficiency letter or otherwise whether items have been referred to the SEC's Division of Enforcement (Enforcement) or another regulatory agency. But the Division does not refer every one of its findings to Enforcement and instead makes a referral decision based on a number of factors which include:

- i. the seriousness of the findings,
- ii. the impact to customers in terms of the dollar amount,
- iii. the type of customer groups impacted,
- iv. the length of time customers were impacted,
- v. whether the issue was systemic or isolated in nature, and
- vi. whether the firm self-identified the issue and what the firm's response has been/will be to the issue.

Ultimately, enforcement referrals are more of the exception rather than the rule, and at the end of the day, firms should understand that both the scope and outcome of an examination depend upon the specific facts and circumstances of a review.

The Division's Staff publishes and periodically updates a brochure to provide registrants with additional information about the examination process. It covers, among other areas, the purpose of an examination, the risk-based selection methodology, the staff's coordination with other SEC Divisions and regulators, the process for requesting documents and information, the opportunities to interact with the staff during the review, and how to close an examination and raise questions during the review process. The brochure represents the personal views of the staff with no legal force or effect and should not be treated as Commission rules, regulations, or official statements. Please see more information [here](#).
