

# Chapman Client Alert

July 14, 2016

Current Issues Relevant to Our Clients

## SEC's OCIE Announces Share Class Examination Initiative

The Securities and Exchange Commission's ("SEC") Office of Compliance Inspections and Examinations ("OCIE") recently issued a Risk Alert announcing that they will be undertaking an examination initiative focused on the risk that registered advisers may be making conflicted recommendations to their clients. OCIE announced that their examinations will likely focus on the following in connection with advisers' mutual fund and 529 Plan share class recommendation practices: (1) fiduciary duty and best execution; (2) disclosures; and (3) compliance programs. A copy of OCIE's Risk Alert is available [here](#).

### Background

OCIE's Examination Priorities for 2016 include examining matters of importance to retail investors. For a summary of OCIE's 2016 Examination Priorities see our Client Alert available [here](#). OCIE indicated in its Risk Alert that this share class examination initiative is being undertaken pursuant to this priority.

### Share Class Examination Initiative

The OCIE staff intends to focus its examination on certain investment advisers and their associated persons that may be receiving undisclosed compensation or other financial incentives. Specifically, OCIE is seeking to identify conflicts of interest tied to advisers' compensation or financial incentives for recommending mutual fund and 529 Plan share classes that have substantial loads and/or distribution fees. OCIE notes two examples of potential conflicts of interest related to share class recommendations:

- Where an adviser is also a broker-dealer (or affiliated with a broker-dealer) that receives fees from the sale of certain share classes; and
- Where an adviser recommends that clients purchase more expensive share classes of funds for which an affiliate of the adviser receives greater fees.

The OCIE staff will focus its examination on adviser practices related to:

- **Fiduciary duty and best execution.** OCIE expects that examiners will review advisers' investment practices to determine whether they are acting in their clients' best interest and seeking best execution when recommending or selecting mutual fund and 529 Plan investments to clients. OCIE also expects that examiners will review advisers' books and records to identify share classes held and purchased in client accounts and associated compensation received by their advisers and associated persons.
- **Disclosures (e.g. Form ADV).** OCIE expects that examiners will review advisers' practices surrounding their selection of mutual fund and 529 Plan investments for their client accounts with a focus on assessing the accuracy, adequacy and effectiveness of their disclosures regarding compensation for the sale of shares and associated conflicts of interest.
- **Compliance Programs.** OCIE expects that examiners will review advisers' practices surrounding their selection of mutual fund and 529 Plan share class investments in client accounts along with the adequacy and effectiveness of advisers' corresponding written policies and procedures.

While these are the primary focus items for the examinations, the Risk Alert notes that examiners may select additional topics based on other risks identified during the examinations.

### For More Information

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To discuss any topic covered in this Client Alert, please contact a member of the Investment Management Group or visit us online at [chapman.com](http://chapman.com).

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