

Chapman Client Alert

January 24, 2017

Current Issues Relevant to Our Clients

SEC Examination Priorities for 2017

The Securities and Exchange Commission's ("SEC") Office of Compliance Inspections and Examinations ("OCIE") recently released its Examinations Priorities for 2017. A copy of the examination priorities letter is available [here](#). While it does not provide an exhaustive list of examination focuses, OCIE's letter focuses on issues involving investment advisers, broker-dealers, municipal advisors and transfer agents with a particular emphasis on protecting retail investors, senior investors and investors saving for retirement and assessing market-wide risks. Firms should review their policies, procedures and business activities in light of OCIE's stated 2017 priorities. Firms should also review the Financial Industry Regulatory Authority, Inc.'s ("FINRA") 2017 Regulatory and Examinations Priorities Letter which is described in our Client Alert available [here](#).

Retail Investor Protection

Protecting retail investors remains a priority for the OCIE in 2017, and it will likely continue to be a focus for the foreseeable future. In this respect, OCIE has indicated that it will focus on the following areas, among others, in conducting its 2017 examinations:

- **Electronic Investment Advice:** OCIE will examine registered investment advisers and broker-dealers that offer robo-advisor and similar automated or digital services as a component of their services while also offering clients access to financial professionals. The examinations will focus on registrants' compliance programs, marketing, formulation of investment recommendations (including compliance practices for overseeing algorithms that generate recommendations), data protection, and disclosures relating to conflicts of interest.
- **Wrap Fee Programs:** OCIE will expand its focus on registered investment advisers and broker-dealers associated with wrap fee programs. OCIE will review whether investment advisers are acting in a manner consistent with their fiduciary duty and whether they are meeting their contractual obligations to clients. OCIE will focus on wrap fee program suitability, effectiveness of disclosures, conflicts of interest, and brokerage practices.
- **Exchange-Traded Funds ("ETFs"):** OCIE will continue to examine ETFs for compliance with applicable exemptive relief and with other regulatory requirements, as well as review ETFs' unit creation and redemption processes. Examinations will also focus on sales practices and disclosures involving ETFs, including suitability and recommendations to purchase ETFs with niche strategies.
- **Never-Before Examined Investment Advisers:** OCIE is expanding its Never-Before Examined Adviser initiative to include examinations of newly registered advisers as well as of selected advisers that have been registered for a longer period but have never been examined by OCIE.
- **Recidivist Representatives and their Employees:** OCIE will continue to identify individuals with a track record of misconduct and examine the investment advisers that employ them.
- **Multi-Branch Advisers:** OCIE will continue to focus on registered investment advisers that provide advisory services from multiple locations.
- **Share Class Selection:** OCIE will continue to review conflicts of interest and other factors that may affect registrants' recommendations to invest, or remain invested, in particular share classes of mutual funds. OCIE will also assess the formulation of investment recommendations and the management of client portfolios.

Focusing on Senior Investors and Retirement Investments

In 2017, OCIE will devote increased attention to the following initiatives related to senior investors and those investing for retirement.

- **ReTIRE:** OCIE will continue its multi-year ReTIRE initiative, focusing on investment advisers and broker-dealers and the services they offer to investors with retirement accounts. These examinations will focus on

registrants' recommendations and sales of variable insurance products as well as the sales and management of target date funds.

- **Public Pension Advisers:** OCIE will continue to examine advisers to pension plans of municipalities and other government entities, focusing on pay-to-play, identification of undisclosed gifts and entertainment and certain other key risk areas.
- **Senior Investors:** OCIE will evaluate how firms manage their interactions with senior investors, including their ability to identify financial exploitation of seniors. OCIE's examinations will focus on registrants' supervisory programs and controls relating to products and services directed at senior investors.

Assessing Market-Wide Risks

In 2017, OCIE will focus on the following initiatives related to assessing market-wide risks:

- **Money Market Funds:** OCIE will examine money market funds for compliance with the SEC's 2014 amendments (which became effective in October 2016) to the rules governing those funds. Examinations will include assessments of the boards' oversight of the funds' compliance with the new amendments as well as a review of compliance policies and procedures relating to stress testing and funds' periodic reporting of information to the SEC.
- **Payment for Order Flow:** OCIE will examine select broker-dealers to assess how they are complying with their duty of best execution when routing customer orders for execution
- **Clearing Agencies.** OCIE will continue to examine certain clearing agencies as required by the Dodd-Frank Wall Street Reform and Consumer Protection Act.
- **FINRA:** OCIE will enhance its oversight of FINRA. In addition, OCIE will focus on assessing the quality of FINRA's examinations of individual broker-dealers.
- **Regulation Systems Compliance and Integrity ("SCI"):** OCIE will continue to examine SCI entities (which include self-regulatory organizations such as FINRA, clearing agencies and certain alternative trading systems) to evaluate whether they have established written policies and procedures reasonably designed to ensure the

capacity, integrity, resiliency, availability and security of their technology systems that relate to the U.S. securities market.

- **Cybersecurity:** OCIE will continue its cybersecurity examination initiative, which will focus on testing and assessing firms' implementation of cybersecurity procedures and controls in 2017.
- **National Securities Exchanges:** OCIE will continue to conduct risk-based inspections of the national securities exchanges. These will focus on selected operational and regulatory programs.
- **Anti-Money Laundering ("AML").** OCIE will continue to examine broker-dealers AML programs with a focus on the adequacy of the independent testing obligation, to ensure that these programs are robust and are targeted to each firm's specific business model, and the extent to which firms consider and adapt their programs to current money laundering and terrorist financing risks

Other Exam Initiatives

OCIE will also focus examination efforts on:

- Municipal advisors;
- Transfer agents including examining transfer agents providing paying agent services for their issuers, focusing on the safeguarding of security-holder funds; and
- Advisers to private funds with a focus on conflicts of interest.

Conclusion

Firms should consider the SEC examination priorities along with the recently released FINRA 2017 Regulatory and Examination Priorities Letter as they conduct their annual reviews of policies, procedures and business activities. Where firms observe deficiencies in their own practices, adjustments should be made before they find themselves the subject of a FINRA or SEC investigation, examination or enforcement action.

For More Information

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.

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