

# Chapman Client Alert

February 8, 2018

Current Issues Relevant to Our Clients

## SEC Examination Priorities for 2018

The Securities and Exchange Commission's ("SEC") Office of Compliance Inspections and Examinations ("OCIE") recently released its 2018 National Exam Program Examination Priorities. Highlights from the 2018 exam priorities include:

- Disclosure of costs of investing for retail investors;
- Cryptocurrencies, including initial coin offerings ("ICOs") and secondary trading;
- Mutual funds and exchange traded funds ("ETFs") with a focus on:
  - Funds with poor performance or liquidity relative to peers,
  - Funds that hold difficult-to-value securities during stressed markets,
  - Funds with managers with little experience managing registered funds,
  - Potential conflicts for funds tracking custom-built indexes and
  - ETFs with low secondary trading volume and risk of delisting;
- Wrap fee programs, including suitability of recommending clients invest through wrap fee accounts;
- Senior investors, retirement accounts and retirement products;
- Best execution for fixed income security orders;
- Cybersecurity;
- Anti-money laundering programs; and
- Critical market infrastructure compliance and risks for clearing agencies, exchanges and transfer agents.

A more complete discussion of the exam priorities is included below. Firms should review their policies, procedures and business activities in light of OCIE's 2018 priorities. A copy of the examination priorities publication is available [here](#). Firms should also review the FINRA 2018 Regulatory and Examination Priorities Letter which is described in our Client Alert available [here](#).

### Retail Investor Protection

Protecting retail investors remains a priority for OCIE in 2018, 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 2018 examinations:

- **Disclosures of the Costs of Investing:** Examiners will focus on whether fees and expenses are calculated and charged in line with disclosures to investors, applicable agreements and firms' policies and procedures. Examiners will also focus on circumstances that may increase risks that investors will pay inadequately disclosed fees, expenses and other charges including:
  - where advisory personnel receive financial incentives relating to investment recommendations that may not be disclosed,
  - accounts where investment advisory representatives have left firms without new representatives assigned to oversee the accounts,
  - where fees have changed between commission-based and fee based, and
  - and private fund advisers with a high concentration of investors investing for the benefit of retail clients including non-profit organizations and pension plans.
- **Electronic Investment Advice:** The focus will continue to be on investment advisers and broker-dealers that offer advice through automated or digital platforms (referred to as "Robo-Advisers"). OCIE will look at compliance programs, oversight of computer program algorithms that generate recommendations, marketing materials, investor data protection and disclosure of conflicts of interest.

- **Wrap Fee Programs:** Focus areas for investment advisers and broker-dealers associated with wrap fee programs will be the reasonableness of recommendations to invest through a wrap fee program, adequacy of conflicts of interest disclosures, best execution and disclosure of costs associated with executing trades through other broker-dealers (trade-aways).
- **Never-Before Examined Investment Advisers:** OCIE will continue to make examination determinations using risk-based assessments to identify firms with elevated risk profiles for review. OCIE will also examine municipal underwriters for compliance with MSRB and SEC rules.
- **Senior Investors and Retirement Account Products:** Areas of focus will include broker-dealer oversight of interactions with senior investors and adequacy of internal controls designed to supervise representatives with respect to the sales of products and services directed at seniors. OCIE will also focus on investment advisers and broker-dealers offering services and products to investors with retirement accounts, their involvement in retirement vehicles focusing on investment recommendations, sales of variable insurance products and management of target date funds.
- **Mutual Funds and ETFs:** The focus will be on:
  - Funds with poor performance or liquidity relative to peers,
  - Funds that hold difficult-to-value securities during stressed markets including securitized loans or collateralized mortgage backed-securities,
  - Funds with managers with little experience managing registered funds,
  - Potential conflicts for funds tracking custom-built indexes and
  - ETFs with low secondary trading volume and risk of delisting.
- **Fixed Income Order Execution:** Examinations will focus on best execution policies and procedures for municipal bond and corporate bond transactions.
- **Cryptocurrency, ICOs, Secondary Market Trading and Blockchain:** ICOs and cryptocurrency continue to be an area of concern for the SEC. OCIE will continue to monitor the sale of cryptocurrency and ICOs with an emphasis on products meeting the “securities” definition. Areas of focus will include adequacy of controls and safeguards from

theft or misappropriation and adequacy of risk disclosures by financial professionals involved in recommendations or offerings of cryptocurrency and ICOs.

## Compliance and Risks in Critical Market Infrastructure

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OCIE will continue to focus on examining entities providing services critical to the proper functioning of capital markets including:

- **Clearing Agencies:** OCIE will continue annual examinations of clearing agencies designated as systematically important with a focus on compliance with SEC standards, responsiveness to comments received in prior examinations and other areas identified by the SEC’s Division of Trading and Markets and other regulators.
- **National Securities Exchanges:** The focus will be on exchanges’ internal audits, fees, governance and operation of certain National Market System (“NMS”) plans.
- **Regulation Systems Compliance and Integrity (“SCI”) Entities:** The focus will be on whether SCI entities have effectively implemented written policies and procedures reviewing controls relating to how systems record the time of transactions or events and synchronization with other systems. Examinations will also include assessment of business continuity plans, vendor risk management, and enterprise risk management.

## FINRA and MSRB

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OCIE will continue its oversight and examination of FINRA and the MSRB focusing on operations, regulatory programs, examination programs and internal policies, procedures and controls.

## Cybersecurity

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Cybersecurity continues to be an SEC priority. OCIE examinations will continue to focus on cybersecurity governance and risk assessment, access rights and controls, data loss prevention, vendor management, training and incident response.

## Anti-Money Laundering Programs

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OCIE will continue to examine whether SEC regulated entities are establishing appropriate anti-money laundering programs including engaging in sufficient customer due diligence,

understanding the nature and purpose of customer relationships in addressing risks, filing timely, complete and accurate Suspicious Activity Reports (“SARs”) and conducting independent tests of their anti-money laundering programs.

## Conclusion

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Firms should consider the SEC examination priorities along with the recently released FINRA 2018 Regulatory and Examination Priorities Letter as they conduct their annual reviews of policies, procedures and business activities. Investment advisers may also consider our recent Client Alert

providing guidance on the annual regulatory and compliance review process available [here](#). 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

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If you would like 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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