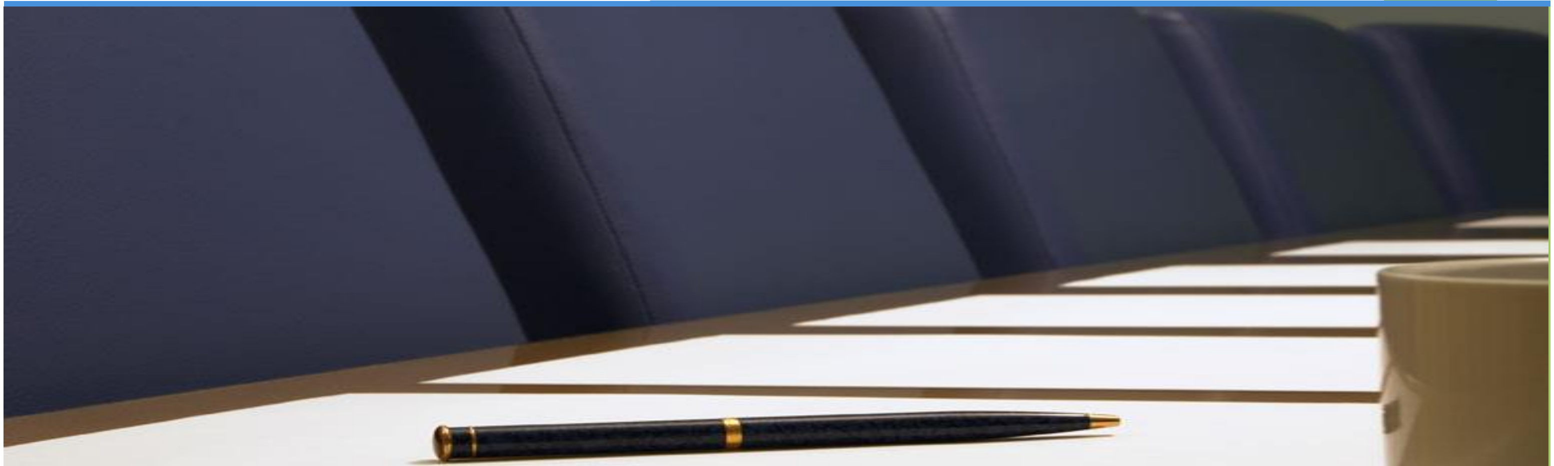

Financial Regulatory and Compliance/Securities Litigation | Alert

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2017 SEC Exam Priorities for Securities Industry Registrants

The Office of Compliance Inspections and Examinations (OCIE) of the U.S. Securities and Exchange Commission (SEC) released its annual list of examination priorities for 2017 on Jan. 12, 2017. The examination priorities were previously summarized in the Greenberg Traurig *Financial Services Observer*.

Similar to prior years, the examination priorities are a combination of OCIE's examination priorities and risk areas that have been previously identified in prior iterations of the letter as well as new initiatives.

Most securities industry participants -- registered investment advisers, broker-dealers, registered investment companies, municipal advisors and transfer agents -- are affected. Therefore, securities industry participants will benefit from reviewing the priorities to assess the impact on their business and any necessary action. Please note that OCIE's 2017 priorities are by no means exhaustive. Examinations will include inquiries into a variety of other areas not necessarily broadcast as part of OCIE's 2017 priorities.

In addition, these priorities were developed during calendar year 2016 with the input of the current Commission and senior leadership. Given the post-election turnover in personnel at the Commission (with more likely to come), it is difficult to assess what (if any) impact a new Chairman and new senior leadership may have on these priorities and their implementation.

Purpose and Thematic Focus

OCIE has continued its practice of organizing the priorities around three thematic areas, none of which will come as surprise to those who have read previous years' priorities. This year's areas are:

1. Examining matters of importance to retail investors;

2. Focusing on risks specific to elderly and retiring investors; and

3. Assessing market-wide risks.

In this *GT Alert*, we've summarized the items addressed by OCIE, sorted by thematic area.

Protecting Retail Investors

Electronic Investment Advice.

OCIE will focus on automated and digital platforms such as robo-advisers. FinTech generally has been a point of emphasis in the last year at the SEC. OCIE's examinations will likely focus on compliance programs, marketing, formulation of investment recommendations, data protection, and disclosures relating to conflicts of interest. OCIE will also review firms' compliance practices for overseeing algorithms that generate recommendations.

Wrap Fee Programs.

Wrap fee programs have been under continued scrutiny by OCIE and the Division of Enforcement.[1] OCIE has indicated that it plans to continue to look closely at this area. Wrap fee programs generally refer to programs wherein the investor is charged a single fee for both advisory and brokerage services. OCIE has indicated that it will examine whether investment advisers are acting in a manner consistent with their fiduciary duty and whether they are meeting their contractual obligations to clients. OCIE also noted additional areas of interest such as wrap account suitability, effectiveness of disclosures, conflicts of interest, and brokerage practices, including best execution and trading away.

Exchange-Traded Funds (ETFs).

ETFs remain a priority for OCIE. OCIE will continue to examine for compliance with the various regulatory and exemptive relief requirements under the securities laws, as well as review the creation and redemption process. OCIE will also look at related sales practices and disclosures involving ETFs and the suitability of broker-dealers' recommendations to purchase ETFs with niche strategies.

Never-Before-Examined Investment Advisers.

Never-Before Examined Investment Advisers appear again this year.[2] OCIE notes that it is expanding this initiative to include focused, risk-based examinations of newly registered advisers as well as of selected advisers that have been registered for a longer period but have never been examined.

Recidivist Representatives and their Employers.

OCIE will continue to use analytics to target recidivist advisory personnel and the firms that employ them. OCIE will assess compliance oversight and the controls of investment advisers that have employed such individuals, including those who have been subject to a regulatory action or barred from associating with a broker-dealer.

Multi-Branch Advisers.

OCIE announced earlier this year a Multi-Branch Adviser Initiative[3] and will continue to examine in this area. OCIE is concerned that the branch office model can pose certain unique risks and challenges, particularly around the compliance program and oversight at branch offices.

[1] See, *e.g.,* In the Matter of Riverfront Investment Group, LLC, https://www.sec.gov/litigation/admin/2016/ia-4453.pdf.
[2] See OCIE's prior letter on this issue, https://www.sec.gov/about/offices/ocie/nbe-final-letter-022014.pdf.
[3] https://www.sec.gov/ocie/announcement/risk-alert-multi-branch-adviser-initiative.pdf.

Share Class Selection.

Mutual fund share class selection has also been an emphasis of OCIE recently. OCIE will continue to look at conflicts of interest and other factors potentially affecting investment recommendations of particular mutual fund share classes.

Focusing on Senior Investors and Retirement Investments

ReTIRE.

OCIE expects to continue its multi-year ReTIRE[4] initiative, continuing to focus on investment advisers and broker-dealers and the services they offer to retirement accounts. Registrants' recommendations and sales of variable insurance products and target date funds, as well as assessing controls around cross-transactions, are expected to be this year's focus of the ReTIRE program.

Public Pension Advisers.

It is no secret that pension plans hold a significant percentage of U.S. retirement assets. As a result, OCIE intends to examine investment advisers to state, municipal, and other government entity pension plans, focusing on the management of conflicts of interest and the advisers' fiduciary duties, as well as reviewing specific risk areas like pay-to-play and gifts and entertainment practices and policies.

Senior Investors.

While OCIE has been concerned with examinations related to the protection of Americans' retirement assets,[5] the 2017 list marks the first time that OCIE has specifically identified registrants' interactions with, and the management and identification of the financial exploitation of, seniors in its examination priorities. Supervisory programs and controls relating to products and services directed at seniors are expected to be key focuses of this initiative.

Assessing Market-Wide Risks

Money Market Funds.

The SEC adopted dramatic money market fund reforms in 2014,[6] which rules went into effect in the Fall of 2016. OCIE intends to begin examining money market funds for compliance with these rule amendments, including the oversight of money market funds by their boards as well as the implementation of stress testing and periodic SEC reporting requirements.

Payment for Order Flow.

The SEC has long been focused on issues related to the execution of client transactions by investment advisers, including several cases involving best execution shortcomings brought in the early 2000-teens. OCIE intends to continue this focus and expand it to broker-dealers, particularly market-makers and retail BDs, to assess compliance with their best execution duties in customer order routing and execution.

[4] Retirement-Targeted Industry Reviews and Examinations Initiative. See the related release, http://www.sec.gov/about/offices/ocie/retirement-targeted-industry-reviews-and-examinations-initiative.pdf.

[5] See, for example, OCIE's 2015 (http://www.sec.gov/about/offices/ocie/national-examination-program-priorities-2015.pdf) and 2016 (http://www.sec.gov/about/offices/ocie/national-examination-program-priorities-2016.pdf) examination priority letters.

[6] See the adopting release, https://www.sec.gov/rules/final/2014/33-9616.pdf.

Clearing Agencies.

OCIE has been conducting annual examinations of clearing agencies designated systemically important and subject to SEC supervision under Dodd-Frank for several years, and that will continue to be a priority in 2017. OCIE intends to use a risk-based approach, in collaboration with the Division of Trading and Markets and other regulators, to identify areas for review, and will examine compliance with the SEC's Standards for Covered Clearing Agencies,[7] where applicable.

FINRA.

In early 2016, it was widely reported that the SEC intended to shift a significant number of examiners from the examination of broker-dealers to focus on the examination of investment advisers and investment companies, and that the SEC would more heavily rely on FINRA for the continued oversight of broker-dealers. In discussing this initiative in a keynote address in October,[8] OCIE's Director indicated that OCIE was creating a dedicated FINRA inspection team to oversee FINRA's operations. The 2017 list underscores this development, and indicates that OCIE will focus not only on FINRA's operations, but also on assessing the quality of FINRA's examinations of individual broker-dealers.

Regulation Systems Compliance and Integrity (SCI).

Examining SCI entities remains a priority for OCIE in 2017. This year, OCIE's focus will be on controls relating to how systems record the time of transactions or events, how they synchronize with other systems, and the collection, analysis and dissemination of market data. Enterprise risk management is also expected to be a focus.

Cybersecurity.

Cybersecurity has been a focus area for OCIE and the SEC as a whole for several years,[9] and OCIE's interest in cybersecurity issues is not expected to wane any time soon, as OCIE intends to continue its cybersecurity initiative examining procedures and controls, and testing their implementation.

National Securities Exchanges.

Risk-based exams of select operational and regulatory programs of national securities exchanges will continue to be a priority of OCIE in 2017.

Anti-Money Laundering (AML).

The examination of broker-dealers' compliance with AML obligations continues to be a risk area of interest to OCIE. In 2017, OCIE expects to assess whether broker-dealers' programs are tailored to the risks their firms face, including adapting programs to current money laundering and terrorist financing risks. BDs' monitoring for suspicious activities, the effectiveness of independent testing, and compliance with suspicious activity report (SAR) requirements and timely and complete SAR filings are also highlights of OCIE's AML focus in 2017.

Other Initiatives

OCIE noted the following three areas in addition to the themes described above as areas to which it expects to allocate resources: (i) Municipal Advisors; (ii) Transfer Agents; and (iii) Private Fund Advisers. All three of these were previously mentioned in the 2016 priorities.

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[7] See https://www.sec.gov/rules/final/2016/34-78961.pdf.

[8] See Marc Wyatt, Director of OCIE, Keynote Address: National Society of Compliance Professionals 2016 National Conference, https://www.sec.gov/news/speech/inside-the-national-exam-program-in-2016.html.

[9] See our *GT Alerts* from May 2015, "New SEC Cybersecurity Guidance for Investment Advisers and Fund Managers" and September 2015, "OCIE Issues new Cybersecurity Risk Alert."

Advisers to private funds (*i.e.*, private equity, hedge, real estate, venture capital) in particular have experienced enhanced scrutiny as the SEC has significantly expanded its expertise and resources devoted to this asset class. A string of enforcement cases in 2015 and 2016 focused on fees and expenses, conflicts of interest and disclosure. We would expect scrutiny on these areas to continue, along with a focus on side by side management issues, valuation, trade allocation, insider trading, zombie funds (stapled secondaries) and in-sourcing activities, among others.

Conclusion

As mentioned above, OCIE's 2017 priorities are by no means exhaustive. While OCIE expects to allocate significant resources in 2017 to these priorities, examinations will include inquiries into a variety of other areas not necessarily discussed above. We expect developments during the 2017 calendar year may prompt OCIE to expand or modify its focus on these and other issues facing the securities industry, and it remains unclear and difficult to assess what the post-election turnover in personnel at the Commission and a new Chairman and senior leadership may have on these priorities and their implementation.

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