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SEC ANNOUNCES 2017 EXAM PRIORITIES

Earlier this month, the SEC announced the 2017 examination priorities of its Office of Compliance Inspections and Examinations (“OCIE”).¹ The examination priorities reflect the practices, products and services that OCIE believes present heightened risk to investors and/or to the integrity of the U.S. capital markets and focus on a wide range of issues from traditional areas such as market-wide risks to new forms of technology including automated investment advice. The three thematic areas of the examination priorities, which are similar to the 2016 focus, are:

1. Examining matters of importance to retail investors;
2. Focusing on risks specifically to elderly and retiring investors; and
3. Assessing market-wide risks.

I. Examination Priorities

1. Matters Important to Retail Investors

The financial services industry provides a broad array of information, advice, products and services to retail investors in response to their financial needs. The following examination initiatives are designed to assess risks to retail investors trying to determine how to invest their money, given the array of choices provided:

- Electronic Investment Advice. Investors increasingly are able to obtain investment advice through automated or digital platforms. OCIE will examine registered investment advisers

¹ A copy OCIE’s examination priorities for 2017 is available at <https://www.sec.gov/about/offices/ocie/national-examination-program-priorities-2017.pdf>

(“RIAs”) and broker-dealers (“B-Ds”) that offer such services, including “robo-advisers” that primarily interact with clients online and firms that utilize automation as a component of their services. Among other things, OCIE will review firms’ compliance practices for overseeing algorithms that generate recommendations.

- Wrap Fee Programs. OCIE will focus on whether RIAs and B-Ds associated with wrap fee programs are acting in a manner consistent with their both fiduciary duty and their contractual obligations to clients. Areas of interest may include wrap account suitability, effectiveness of disclosures, conflicts of interests and brokerage practices.
- Exchange Traded Funds (“ETFs”). OCIE will continue to examine ETFs for compliance with applicable exemptive relief and will review ETFs’ unit creation and redemption processes. OCIE also will focus on sales practices and disclosures involving ETFs and the suitability of recommendations to purchase ETFs.
- Never-Before Examined Investment Advisers. OCIE will expand its never-before examined adviser initiative to include selected advisers that have been registered for a longer period but never have been examined by OCIE.
- Recidivist Representatives and their Employers. OCIE will continue to identify individuals with a history of misconduct and examine the investment advisers that employ them.
- Multi-Branch Advisers. OCIE will continue to focus on RIAs that provide advisory services from multiple locations. OCIE will examine the design and implementation of compliance programs to make certain they are suitable to the branch office structure and the oversight of advisory services provided at the branch offices.
- Share Class Selection. OCIE will continue reviewing conflicts of interest and other factors that may affect registrants’ recommendations of particular share classes of mutual funds. OCIE will assess conflicts that investment advisory personnel who also are B-Ds may have that could influence recommendations in favor of share classes that have higher loads or distribution fees.

2. **Risks Specific to Elderly and Retiring Investors**

The elderly and retirees presently are very reliant on returns from their investment portfolios to fund their retirement. OCIE will examine issues affecting senior investing and investing for retirement:

- ReTIRE. OCIE will continue the multi-year Retirement-Targeted Industry Review and Examination (ReTIRE) launched in June 2015 that focuses on the services RIAs and B-Ds offer to investors with retirement accounts. Under this initiative, OCIE will examine recommendations for and sales of variable insurance products, as well as the sale and management of target date funds. OCIE also will assess controls surrounding cross-transactions, particularly with respect to fixed income securities.

- Public Pension Advisers. OCIE will examine investment advisers to pension plans of government entities to assess how they are managing conflicts of interest and fulfilling their fiduciary duty. OCIE will focus on the risks specific to these advisers, including pay-to-play, undisclosed gifts and entertainment practices.
- Senior Investors. OCIE will evaluate how firms manage their interactions with senior investors, including their ability to identify financial exploitation of seniors.

3. **Assessing Market-Wide Risks**

OCIE's examination program is risk-based. In striving to detect risk, OCIE will examine for structural risks and trends that may involve multiple firms or entire industries. OCIE will focus on the following initiatives:

- Money Market Funds. In 2014, the SEC adopted amendments to rules governing money market funds that require structural and operational reforms to address redemption risks in such funds. OCIE will examine money market funds for compliance with those rule amendments, which became effective in October 2016. Examinations likely will include assessments of boards' oversight of funds' compliance with these new amendments, as well as review of compliance policies and procedures.
- Payment for Order Flow. OCIE will examine select B-Ds to assess how they are complying with their duty of best execution when routing customer orders for execution.
- Clearing Agencies. OCIE will continue to conduct annual examinations of clearing agencies designated systemically important. Areas for review will be determined through a risk-based approach, in collaboration with other regulators.
- FINRA. OCIE will enhance its oversight of FINRA. In addition to continuing to conduct inspections of FINRA's operations and regulatory programs, OCIE will focus resources on assessing the quality of FINRA's examinations of individual B-Ds.
- Regulation Systems Compliance and Integrity ("SCI"). OCIE will continue to examine SCI entities to evaluate whether they have established, maintained, and enforced written policies and procedures designed to maintain operational capacity and promote maintenance of fair and orderly markets. OCIE also will review, among other things, how systems synchronize with other systems, as well as how they collect and disseminate market data. Examinations also will assess entities' enterprise risk management.
- Cybersecurity. OCIE will continue its initiative to examine for cybersecurity compliance procedures and controls, including testing the implementation of those procedures and controls.

- National Securities Exchanges. OCIE will continue to conduct risk-based inspections of the national securities exchanges.
- Anti-Money Laundering (“AML”). OCIE will continue to examine B-Ds to assess whether their AML programs are tailored to the specific risks that the firm faces, including money laundering and terrorist financing risks. OCIE also will review how B-Ds are monitoring for suspicious activity at the firm and whether they are complying with suspicious activity report (“SAR”) requirements.

II. Other Initiatives

In addition to the foregoing, OCIE expects to allocate examination resources to other priorities, including: examining municipal advisors to evaluate their compliance with SEC and Municipal Securities Rulemaking Board rules; examining transfer agents to evaluate their timely turnaround of items and transfers, recordkeeping, and their safeguarding funds and securities; examining transfer agents that service microcap issuers that may be engaging in unregistered, non-exempt offerings of securities; and examining private fund advisers, focusing on conflicts of interest.

III. Conclusion

This description of OCIE’s examination priorities is not exhaustive, but provides insight into the anticipated focus of examinations throughout 2017. In addition to the priorities described above, OCIE also will conduct examinations focused on issues that arise from market developments, new information learned from examinations or other sources and coordination with other regulators, as well as regulatory developments.

You should assess your compliance risks, especially in the areas that OCIE has designated priorities. Please call Meryl Wiener, any member of the corporate department listed below or your regular Warshaw Burstein attorney if you have any questions concerning your risk profile or if you would like assistance in assessing your risk profile.

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