

Chapman Client Alert

January 14, 2016

Current Issues Relevant to Our Clients

SEC Examination Priorities for 2016

The Securities and Exchange Commission's ("SEC") Office of Compliance Inspections and Examinations ("OCIE") recently released its Examinations Priorities for 2016. 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 and investors saving for retirement, assessing market-wide risks and using data analytics to identify signals of potential illegal activity. Firms should review their policies, procedures and business activities in light of OCIE's stated 2016 priorities. Firms should also review the Financial Industry Regulatory Authority, Inc.'s ("FINRA") 2016 Regulatory and Examinations Priorities Letter which is described in our Client Alert available [here](#).

Retail Investor Protection

Protecting retail investors and retirement savers remains a priority for OCIE in 2016, 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 2016 examinations:

- **Retirement Accounts.** OCIE will continue its multi-year examination initiative of SEC-registered investment advisers and broker-dealers and the services they offer to investors with retirement accounts. This initiative focuses on examining the reasonable basis for recommendations made to investors, conflicts of interest, supervision and compliance controls and marketing and disclosure practices.
- **Exchange-Traded Funds ("ETFs").** OCIE will 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 strategies, trading practices and disclosures involving ETFs, including excessive portfolio concentration, primary and secondary market trading risks, adequacy of risk disclosure, and suitability, particularly in niche or leveraged/inverse ETFs.
- **Branch Offices.** OCIE will continue to focus on supervision of registered representatives and investment adviser representatives in branch offices.

- **Fee Selection and Reverse Churning.** OCIE will focus on recommendations of account types and whether they are in the best interest of clients, including looking at fees charged, services provided and disclosure about fee arrangements.
- **Variable Annuities.** OCIE will assess the suitability of sales of variable annuities to investors as well as the adequacy of disclosure and supervision of such sales.
- **Advisers to Public Pensions.** OCIE will examine advisers to municipalities and other government entities, focusing on pay-to-play, identification of undisclosed gifts and entertainment and certain other key risk areas.

Assessing Market-Wide Risks

In 2016, OCIE will focus on the following initiatives related to assessing market-wide risks:

- **Cybersecurity.** OCIE will continue its cybersecurity examination initiative, which will focus on testing and assessments of firms' implementation of cybersecurity procedures and controls in 2016.
- **Regulation Systems Compliance and Integrity ("SCI").** OCIE will 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.

- **Liquidity Controls.** OCIE will examine advisers to mutual funds, ETFs and private funds that have exposure to potentially illiquid fixed income securities. OCIE will also examine broker-dealers in connection with liquidity concerns. These examinations will include a review of controls over market risk management, valuation, liquidity management, trading activity and regulatory capital.
- **Clearing Agencies.** OCIE will continue to examine certain clearing agencies as required by the Dodd-Frank Wall Street Reform and Consumer Protection Act.

Use of Data Analytics

OCIE will utilize its data analytic capabilities to focus on:

- Recidivist representatives and the firms that employ them;
- Anti-money laundering (“AML”) programs of clearing and introducing broker-dealers with a focus on firms that have not filed the number of suspicious activity reports (“SARs”) that would be consistent with their business models or have filed incomplete or late SARs;
- 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;
- Operations of broker-dealers and transfer agents that may be engaged in or aiding and abetting “pump-and-dump schemes” or other market manipulation particularly in connection with microcap securities;

- Firms and representatives engaged in excessive or otherwise inappropriate trading activities; and
- The promotion of new, complex and high risk products to identify potential suitability issues and potential breaches of fiduciary obligations.

Other Exam Initiatives

OCIE will also focus examination efforts on:

- Newly registered municipal advisors;
- Private placements;
- Never-before-examined investment advisers and investment company complexes;
- Advisers to private funds with a focus on fees and expenses; and
- Transfer agents including examining transfer agents providing paying agent services for their issuers, focusing on the safeguarding of security-holder funds.

Conclusion

Firms should consider the SEC examination priorities along with recently released FINRA 2016 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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