



# NATIONAL EXAM PROGRAM

OFFICE OF COMPLIANCE INSPECTIONS AND EXAMINATIONS

## EXAMINATION PRIORITIES FOR 2017

### I. INTRODUCTION

This document identifies selected 2017 examination priorities of the Office of Compliance Inspections and Examinations (“OCIE,” “we,” or “our”) of the Securities and Exchange Commission (“SEC” or “Commission”). In general, the priorities reflect certain practices, products, and services that OCIE perceives to present potentially heightened risk to investors and/or the integrity of the U.S. capital markets.<sup>1</sup>

OCIE serves as the “eyes and ears” of the SEC. We conduct examinations of regulated entities to promote compliance, prevent fraud, identify risk, and inform policy.<sup>2</sup> We selected our 2017 examination priorities in consultation with the Commissioners, senior staff from the SEC’s regional offices, the SEC’s policy-making divisions, the enforcement division, the SEC’s Investor Advocate, and our fellow regulators.

Our 2017 priorities are organized around three thematic areas:

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

With the objectives of being data-driven and risk-based, we have incorporated data analytics into the vast majority of our examination initiatives to identify industry practices and/or registrants that appear to have elevated risk profiles.

### II. PROTECTING RETAIL INVESTORS

Retail investors face an evolving set of choices when determining how to invest their money. At the same time, the financial services industry continues to offer an ever widening array of information, advice, products,

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<sup>1</sup> This document was prepared by SEC staff, and the views expressed herein are those of OCIE. The Commission has expressed no view on this document’s contents. It is not legal advice; it is not intended to, does not, and may not be relied upon to create any rights, substantive or procedural, enforceable at law by any party in any matter civil or criminal.

<sup>2</sup> The population of registered entities that OCIE oversees consists of more than 4,000 broker-dealers (including approximately 162,000 branch offices and 640,000 registered representatives), more than 12,000 investment advisers (with nearly \$67 trillion in assets under management), approximately 850 fund complexes (representing close to 11,000 mutual funds and exchange-traded funds), more than 400 transfer agents and over 650 municipal advisors. In addition, OCIE has oversight responsibility for 20 national securities exchanges, the Financial Industry Regulatory Authority (FINRA), the Municipal Securities Rulemaking Board (MSRB), the Securities Investor Protection Corporation (SIPC), eight clearing agencies, and the Public Company Accounting Oversight Board (PCAOB). The Dodd-Frank Wall Street Reform and Consumer Protection Act increased OCIE’s responsibilities to include security-based swap dealers, security-based swap data repositories, major security-based swap participants, and securities-based swap execution facilities. Additionally, the Jumpstart Our Business Act expanded OCIE’s responsibilities to include oversight of crowdfunding portals.

and services for retail investors in response to their financial needs. We are pursuing a variety of examination initiatives to assess potential risks to retail investors that arise in the increasingly complex investment landscape.

- **Electronic Investment Advice.** Investors are increasingly able to obtain investment advice through automated or digital platforms. We will examine registered investment advisers and broker-dealers that offer such services, including “robo-advisers” that primarily interact with clients online and firms that utilize automation as a component of their services while also offering clients access to financial professionals. Examinations will likely focus on registrants’ compliance programs, marketing, formulation of investment recommendations, data protection, and disclosures relating to conflicts of interest. We will also review firms’ compliance practices for overseeing algorithms that generate recommendations.
- **Wrap Fee Programs.** We will expand our focus on registered investment advisers and broker-dealers associated with wrap fee programs, which charge investors a single bundled fee for advisory and brokerage services. We will likely review whether investment advisers are acting in a manner consistent with their fiduciary duty and whether they are meeting their contractual obligations to clients. Areas of interest may include wrap account suitability, effectiveness of disclosures, conflicts of interest, and brokerage practices, including best execution and trading away.
- **Exchange-Traded Funds (“ETFs”).** We will continue to examine ETFs, reviewing for compliance with applicable exemptive relief granted under the Securities Exchange Act of 1934 and the Investment Company Act of 1940 and with other regulatory requirements, as well as review ETFs’ unit creation and redemption processes. We will also focus on sales practices and disclosures involving ETFs and the suitability of broker-dealers’ recommendations to purchase ETFs with niche strategies.
- **Never-Before Examined Investment Advisers.** We are expanding our Never-Before Examined Adviser initiative<sup>3</sup> 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 by OCIE.
- **Recidivist Representatives and their Employers.** We will continue to use our analytic capabilities to identify individuals with a track record of misconduct and examine the investment advisers that employ them.<sup>4</sup> For example, we will assess the compliance oversight and 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.** We will continue to focus on registered investment advisers that provide advisory services from multiple locations.<sup>5</sup> The use of a branch office model can pose unique risks

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<sup>3</sup> See OCIE’s Letter to Never-Before Examined Investment Advisers, February 20, 2014, <http://www.sec.gov/about/offices/ocie/nbe-final-letter-022014.pdf>.

<sup>4</sup> See OCIE Risk Alert, “Examinations of Supervision Practices at Registered Investment Advisers,” Sept. 12, 2016, <https://www.sec.gov/ocie/announcement/ocie-2016-risk-alert-supervision-registered-investment-advisers.pdf>.

<sup>5</sup> See OCIE Risk Alert, “Multi-Branch Adviser Initiative,” Dec. 12, 2016, <https://www.sec.gov/ocie/announcement/risk-alert-multi-branch-adviser-initiative.pdf>.

and challenges to advisers, particularly in the design and implementation of a compliance program and the oversight of advisory services provided at branch offices.

- **Share Class Selection**. We will continue reviewing conflicts of interest and other factors that may affect registrants' recommendations to invest, or remain invested, in particular share classes of mutual funds.<sup>6</sup> For example, we will identify and assess conflicts that certain investment advisory personnel may have, such as those who also are registered representatives of a broker-dealer, which may influence recommendations in favor of share classes that have higher loads or distribution fees. We will also assess the formulation of investment recommendations and the management of client portfolios.

### III. FOCUSING ON SENIOR INVESTORS AND RETIREMENT INVESTMENTS

As the U.S. population ages and investors become more dependent than ever on their own investments for retirement income, we are devoting increased attention to issues affecting senior investors and those investing for retirement.

- **ReTIRE**. We will continue our multi-year ReTIRE initiative, focusing on investment advisers and broker-dealers along with the services they offer to investors with retirement accounts.<sup>7</sup> This year, these examinations will likely focus on, among other things, registrants' recommendations and sales of variable insurance products as well as the sales and management of target date funds. We will also assess controls surrounding cross-transactions, particularly with respect to fixed income securities.
- **Public Pension Advisers**. Pension plans of states, municipalities, and other government entities hold a large amount of U.S. investors' retirement assets. We will examine investment advisers to these entities to assess how they are managing conflicts of interest and fulfilling their fiduciary duty. We will also review other risks specific to these advisers, including pay-to-play and undisclosed gifts and entertainment practices.
- **Senior Investors**. Today's Americans are more reliant on returns from their investment portfolios to fund their retirement compared to previous generations. We will evaluate how firms manage their interactions with senior investors, including their ability to identify financial exploitation of seniors. Examinations will likely focus on registrants' supervisory programs and controls relating to products and services directed at senior investors.

### IV. ASSESSING MARKET-WIDE RISKS

As part of the SEC's mission to maintain fair, orderly, and efficient markets, we will examine for structural risks and trends that may involve multiple firms or entire industries. In 2017, we will focus on the following initiatives:

- **Money Market Funds**. In 2014, the SEC adopted amendments to rules governing money market funds to make structural and operational reforms to address redemption risks in money market funds,

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<sup>6</sup> See OCIE Risk Alert, "OCIE's 2016 Share Class Initiative," July 13, 2016, <https://www.sec.gov/ocie/announcement/ocie-risk-alert-2016-share-class-initiative.pdf>.

<sup>7</sup> See OCIE Risk Alert, "Retirement-Targeted Industry Reviews and Examinations Initiative," June 22, 2015, <http://www.sec.gov/about/offices/ocie/retirement-targeted-industry-reviews-and-examinations-initiative.pdf>.

while preserving the benefits of the funds for remaining investors.<sup>8</sup> We will examine money market funds for compliance with these rule amendments, which became effective in October 2016. Examinations will likely include assessments of the boards' oversight of the funds' compliance with these new amendments as well as review of compliance policies and procedures relating to stress testing and funds' periodic reporting of information to the Commission.

- **Payment for Order Flow**. We will examine select broker-dealers, such as market-makers and those that serve primarily retail customers, to assess how they are complying with their duty of best execution when routing customer orders for execution.
- **Clearing Agencies**. We will continue to conduct annual examinations of clearing agencies designated systemically important and for which the Commission is the supervisory agency pursuant to the requirements of the Dodd-Frank Wall Street Reform and Consumer Protection Act. Areas for review will be determined through a risk-based approach in collaboration with the Division of Trading and Markets and other regulators, as applicable. Once compliance is required, the staff will examine for compliance with the Commission's Standards for Covered Clearing Agencies.<sup>9</sup>
- **FINRA**. We will enhance our oversight of FINRA, consistent with our aim to protect investors and the integrity of our markets. In addition to continuing to conduct inspections of FINRA's operations and regulatory programs, we will focus resources on assessing the quality of FINRA's examinations of individual broker-dealers.
- **Regulation Systems Compliance and Integrity ("SCI")**. We will continue to examine SCI entities to evaluate whether they have established, maintained, and enforced written policies and procedures reasonably designed to ensure their systems have levels of capacity, integrity, resiliency, availability, and security adequate to maintain operational capacity and promote maintenance of fair and orderly markets, and that they operate in a manner compliant with the Exchange Act.<sup>10</sup> OCIE will also review, among other things, controls relating to how systems record the time of transactions or events, how they synchronize with other systems, as well as collection, analysis, and dissemination of market data. Examinations will also assess entities' enterprise risk management, including whether these programs cover appropriate business units, subsidiaries, and related interconnected infrastructure.
- **Cybersecurity**. In 2017, we will continue our initiative to examine for cybersecurity compliance procedures and controls, including testing the implementation of those procedures and controls.
- **National Securities Exchanges**. We will continue to conduct risk-based inspections of the national securities exchanges. These inspections will focus on selected operational and regulatory programs.
- **Anti-Money Laundering ("AML")**. Money laundering and terrorist financing continue to be risk areas that are considered in our examination program. We will continue to examine broker-dealers to assess whether AML programs are tailored to the specific risks that a firm faces, including whether

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<sup>8</sup> See Money Market Fund Reform; Amendments to Form PF, Release No. 33-9616 (July 23, 2014), <https://www.sec.gov/rules/final/2014/33-9616.pdf>.

<sup>9</sup> See Standards for Covered Clearing Agencies, Release No. 34-78961 (adopted Sept. 28, 2016), <https://www.sec.gov/rules/final/2016/34-78961.pdf> (compliance date April 11, 2017).

<sup>10</sup> See Regulation Systems Compliance and Integrity, Release No. 34-37639, (November 19, 2014), <http://www.sec.gov/rules/final/2014/34-73639.pdf>.

broker-dealers consider and adapt their programs, as appropriate, to current money laundering and terrorist financing risks. We will also review how broker-dealers are monitoring for suspicious activity at the firm, in light of the risks presented, and the effectiveness of independent testing. We will also continue to assess broker-dealers' compliance with suspicious activity report ("SAR") requirements and the timeliness and completeness of SARs filed.

## V. OTHER INITIATIVES

In addition to examinations related to the themes described above, we expect to allocate examination resources to other priorities, including:

- **Municipal Advisors.** We will continue to conduct examinations of municipal advisors to evaluate their compliance with SEC and Municipal Securities Rulemaking Board rules. This initiative will continue to include industry outreach and education.<sup>11</sup>
- **Transfer Agents.** In addition to our examinations of transfer agents' timely turnaround of items and transfers, recordkeeping and record retention, and safeguarding of funds and securities, we will examine transfer agents that service microcap issuers, focusing on detecting issuers that may be engaging in unregistered, non-exempt offerings of securities.
- **Private Fund Advisers.** We will continue to examine private fund advisers, focusing on conflicts of interest and disclosure of conflicts as well as actions that appear to benefit the adviser at the expense of investors.

## VI. CONCLUSION

This description of OCIE priorities is not exhaustive. While we expect to allocate significant resources throughout 2017 to the examination issues described herein, our staff will also conduct examinations focused on risks, issues, and policy matters that arise from market developments, new information learned from examinations or other sources, including tips, complaints, and referrals, and coordination with other regulators, as well as regulatory developments.

OCIE welcomes comments and suggestions regarding how we can better fulfill our mission to promote compliance, prevent fraud, monitor risk, and inform SEC policy. If you suspect or observe activity that may violate the federal securities laws or otherwise operates to harm investors, please notify SEC Staff at [http://www.sec.gov/complaint/info\\_tipscomplaint.shtml](http://www.sec.gov/complaint/info_tipscomplaint.shtml).

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<sup>11</sup> See OCIE's Industry Letter for the Municipal Advisor Examination Initiative, August 19, 2014, <https://www.sec.gov/about/offices/ocie/muni-advisor-letter-081914.pdf>.