SEC Examination Priorities for 2016:

By: Mark Griffin, Will Routt and Matt White

Each year, the United States Securities and Exchange Commission (SEC) issues guidance concerning their regulatory priorities for the coming year. This year, the SEC Office of Compliance Inspections and Examination's National Exam Program (NEP) issued its Examination Priorities for 2016 on January 11, 2016. The SEC's Priorities centered around the same three thematic areas as last year:

- Examining matters of importance to retail investors, including investors saving for retirement;
- Assessing issues related to market-wide risks; and
- Using the SEC's evolving ability to analyze data to identify and examine registrants that may be engaged in illegal activity.

In order to provide additional insight into the evolution the SEC's examination priorities, we have also prepared a detailed comparison of the SEC's priorities between 2013 and 2016. The comparison of the SEC's priorities is available HERE.

Below are summaries of each of the SEC's key themes for 2016, which are much the same as last year. Also set forth below are some of the new areas upon which the SEC will focus in the coming year:

Retail Investor Protection:

Protecting retail investors and investors saving for retirement remains a priority for the SEC in 2016. Specifically, the SEC has indicated that it will focus on the following areas, among others, in conducting its 2016 examinations:

Retirement Accounts – The SEC 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) – The SEC 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 – The SEC will continue to focus on supervision of registered representatives and investment adviser representatives in branch offices.

Fee Selection and Reverse Churning – The SEC 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 – The SEC 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 – The SEC 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:

The SEC will examine for structural risks and trends that may involve multiple firms or entire industries. One of the key areas of the SEC's focus will be on cybersecurity. The SEC will continue the initiative it launched in September 2015 to examine broker-dealers' and investment advisers' cybersecurity compliance and controls. The SEC will also evaluate whether firms have established, maintained, and enforced written policies and procedures reasonably designed to ensure the capacity, integrity, resiliency, availability, and security of their Regulation Systems Compliance and Integrity (SCI) systems. This will include, among other things, assessing the resiliency of their primary and back-up data centers, evaluating whether computing infrastructure components are geographically diverse, and assessing whether security operations are tailored to the risks each entity faces. The SEC will also examine advisers to mutual funds, ETFs and private funds that have exposure to potentially illiquid fixed income securities, as well as broker-dealers who have become new or expanding liquidity providers in the marketplace. The SEC will focus on whether these firms have controls over market risk management, valuation, liquidity management, trading activity and regulatory capital. Finally, the SEC will continue to examine certain clearing agencies as required by the Dodd-Frank Wall Street Reform and Consumer Protection Act, using a risk-based approach in collaboration with the Division of Trading and Markets and other regulators, as applicable.

Use of Data Analytics:

In all of the SEC's examination initiatives, the SEC utilizes data and intelligence from their own examinations, as well as from regulatory filings, to identify registrants that appear to have elevated risk profiles. The SEC will particularly leverage its use of data analytics to identify recidivist representatives and the firms that employ them. The SEC will also focus on anti-money laundering (AML) programs of firms that have not filed the number of suspicious activity reports (SARs) that would be consistent with their business models, and firms that have filed incomplete or late SARs. The SEC will aim 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. The SEC will also evaluate the operations of broker-dealers and transfer agents that may be engaged in or aiding and abetting pump-and-dump schemes or other market manipulation. Additionally, the SEC will use data analytics to examine firms and their representatives that appear to be engaged in excessive or otherwise inappropriate trading activities, and those who promote new, complex and high risk products, in order to identify potential suitability issues and potential breaches of fiduciary obligations.

New Areas of Focus in 2016:

Municipal Advisors – The SEC will focus its examinations on newly-registered municipal advisers to assess their compliance with recently adopted SEC and Municipal Securities Rulemaking Board rules.

EB-5 Private Placements – The SEC will review private placement offerings through the Immigrant Investor Program (EB-5 Program) to evaluate whether legal requirements are being met in the areas of due diligence, disclosure, and suitability. The SEC will similarly focus on private placements offerings through Regulation D of the Securities Act of 1933.

Never-Before-Examined Investment Advisers and Investment Companies – The SEC will conduct risk-based examinations of selected registered investment advisers and investment company complexes that have not yet been examined.

Private Fund Advisors – The SEC will focus on the adequacy of fee and expense disclosures and practices in all private adviser exams. The SEC will also evaluate among other things, the controls and disclosure associated with side-by-side management of performance-based and purely asset-based fee accounts.

Transfer Agents – In addition to examining transfer agents' timely turnaround of items and transfers, recordkeeping and record retention, and safeguarding of funds and securities, the SEC will also examine transfer agents providing paying agent services for their issuers, focusing on the safeguarding of security-holder funds.

If you have any questions regarding these issues or any other securities-related issues, or need assistance in evaluating your company's policies and procedures, please contact any of the attorneys in Baker Donelson's Broker-Dealer/Registered Investment Adviser Group.