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[SEC Examination Priorities for 2017]

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The United States Securities and Exchange Commission (SEC) annually issues guidance concerning its regulatory priorities for the coming year. This year, the SEC Office of Compliance Inspections and Examinations (OCIE) issued its [Examination Priorities for 2017] on January 12. While many of the SEC's Priorities were similar to those identified last year, there were several new topics of interest, including:

- **Robo-advising**: Examining investment advice delivered through electronic mechanisms, often referred to as "robo-advising" and firm's oversight of such advice;
- **FINRA**: Enhancing OCIE's oversight of FINRA by continuing to conduct inspections of FINRA's operations and regulatory programs, and assessing the quality of FINRA's evaluations of individual broker-dealers;
- **Share Class Selection**: Reviewing conflicts of interest and other factors that may affect registrants' recommendations to invest, or remain invested, in particular share classes of mutual funds;
- **Money Market Funds**: Examining MMF's for compliance with the rule amendments that became effective in October 2016; and
- **Multi-Branch Advisers**: Focusing on registered investment advisers that provide services from multiple locations.

In order to provide additional insight into the evolution of the SEC's examination priorities, we have also prepared a detailed comparison of the SEC's priorities between 2013 and 2017. The comparison can be found [HERE]. Below are summaries of several of the SEC's key themes for 2017.

Retail Investor Protection:

In 2017, the SEC intends to expand its retail investor protection focus to include both "robo-advising" and wrap fee programs. Specifically, the SEC has indicated that it will focus on the following areas, among others, in conducting its 2017 examinations:

Electronic Investment Advice – The SEC will focus on automated computer programs that perform money management tasks that previously required a human adviser. "Robo-advisers" utilize algorithms to manage assets or predict trading that is driven by sets of questions that customers answer related to portfolio aggression. The SEC appears concerned that these services may operate under assumptions provided by customers that may be incorrect or faulty. Accordingly, the SEC's examinations will focus on registrants' compliance programs, marketing, formulation of investment recommendations and disclosures relating to conflicts of interest. The SEC will also review firms' compliance practices for overseeing the algorithms that generate recommendations.

Wrap Fee Programs – The SEC will also focus on wrap fee programs, which charge investors a single bundled fee for advisory and brokerage services. The SEC is particularly focused on whether these fees uphold the industry's fiduciary and contractual obligations to clients.

Exchange-Traded Funds (ETFs) – The SEC will continue its examination of 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.

Never-Before Examined Investment Advisers and Recidivist Representatives – The SEC is expanding its initiative in this area to include risk-based examinations of newly-registered advisors, advisers who have never been examined by the OCIE and individuals with a track record of misconduct. For the latter category, the SEC will also assess the compliance oversight and controls of firms employing such individuals.

Branch Advisers – The SEC will continue its initiative in this area announced in December 2016 and examine registered investment advisers that provide advisory services from multiple locations.

Share Class Selection – The SEC has stated that by failing to place clients in lower cost share classes, an adviser may be failing "to seek best execution for their clients on these transactions." The SEC 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, variable annuities and unit investment trusts. Specifically, the SEC is examining the possible breaches of fiduciary duty if an investor causes a client to purchase a more expensive share class of a fund when a less expensive class of that fund is available.

Senior Investors and Retirement Investments:

Senior Investors remain a hot topic with the SEC and other regulators. Specifically, the SEC indicated that it will continue its multi-year ReTIRE initiative, focusing on registrants' recommendations and sales of variable insurance products as well as the sales and management of target date funds to retirement accounts. The SEC intends to further analyze pension plans of states, municipalities, and other government entities' assets, and review pay-to-play and undisclosed gifts and entertainment practices. Finally, the SEC will analyze how firms manage their interactions with senior investors to prohibit the possible exploitations of seniors.

Assessing Market-Wide Risks:

The SEC will continue its examination 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 cybersecurity. The SEC will 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. The SEC will also continue its focus on money laundering and terrorist financing through its Anti-Money Laundering (AML) initiative. The SEC will ensure that firms adapt their programs to current risks and that they are monitoring for suspicious activity at the firm. The SEC will also continue to assess broker-dealers' compliance with suspicious activity report (SAR) requirements.

Other Continued Initiatives from 2016:

Municipal Advisors – The SEC will continue its focus on newly-registered municipal advisers to assess their compliance with recently adopted SEC and Municipal Securities Rulemaking Board (MSRB) rules. This initiative will continue through industry outreach and education and will include cooperation with the MSRB.

Private Fund Advisors – The SEC will also continue its focus on the adequacy of fee and expense disclosures and practices in all private adviser exams. The SEC will evaluate conflicts of interest and the disclosure of conflicts as well as actions that benefit an advisor at the expense of customers.

Additional New Areas of Focus for 2017:

Money Market Funds – The SEC intends to examine money market funds for compliance with rule amendments that it adopted to make structural and operational reforms to address redemption risks in money market funds. Specifically, the SEC will review compliance policies and procedures relating to stress testing and funds' periodic reporting of information to the SEC.

Payment for Order Flow – The SEC intends to examine select firms, such as market-makers and those that serve primarily retail customers to ensure that their influence on the routing of client orders adheres to their fiduciary duties.

Transfer Agents – The SEC will also examine transfer agents' timely turnaround of items and transfers, recordkeeping, and safeguarding of clients' confidential information. Specifically, the SEC will focus on detecting issuers that may be engaging in unregistered offerings.

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.