

# 2017 SEC EXAMINATIONS FOCUS AREAS - JANUARY 2017

## Legal Risk Management Tip January 2017

### 2017 SEC EXAMINATION FOCUS AREAS

Each year, the SEC's Office of Compliance Inspections and Examinations ("OCIE") publishes an examinations priorities letter so that its registrants will know of those areas that are of particular focus and are deemed potentially higher risk. On January 12, 2017, the SEC released its priorities,<sup>1</sup> which continue to focus on protection of retail investors, servicing retirement and elderly investors and assessment of market-wide risks.

The purpose of this month's legal tip is to highlight those priority areas that Jacko Law Group, PC ("JLG") believes will most directly impact our clients, with particular focus on three risk areas that we believe registrants should pay particular attention to. Please note that the below priorities are not all encompassing, and we strongly encourage you to review the examination priorities letter in its entirety.

#### **1. Protection of Retail Investors**

The investment world is ever-changing, and so too are the products and services which are offered. In 2015 and 2016, we saw some of the largest broker-dealer custodians launch new retail robo-adviser platforms. This automated platform allows investors to enter certain information online about their goals, financial circumstances and risk tolerance, which is then used to construct a portfolio that best meets that individual's needs. The robo-adviser platform is designed to target digital savvy, cost-conscious investors. Thus, the SEC will be examining registrants who offer this service, the automation they may be using to interface with consumers, how the service is marketed and disclosed and the compliance program's internal controls for supervising this activity.

Other areas that the SEC will be focusing on include wrap-fee programs, exchange-traded funds, never-before examined advisers, share class selection and multi-branch advisers. But of particular note, the staff will be paying attention to recidivist representatives and their employers. While this area was also a priority in 2016, this year there is a particular focus: the staff will be considering the supervisory controls and oversight of those firms who employ an individual "who has been subject to a regulatory action or barred from associate with a broker-dealer."<sup>2</sup>

As your firm is seeking new talent and expanding operations, it is possible that you may be interested in recruiting a particular individual who has a disciplinary record. It is imperative that, prior to hiring this individual, you (1) evaluate the systems and controls you have in place to ensure that you have an infrastructure to support heightened supervision, (2) are willing to accept the fact that your firm could be viewed as a "higher risk" firm for employing this individual and thus more likely to be examined and (3) are advancing rather than detracting from your professional team as the disciplinary history of that individual will need to be disclosed on his or her Form U4, Form ADV Part 2B and potentially on responses to due diligence questionnaires.

*Risk Management Tip:* Before making any new hire, involve Compliance and HR. Complete background checks, conduct internet searches and look on the individual's broker check for evidence of any prior disciplinary history. When possible, ask to speak to a former supervisor as a further reference check. Evaluate what type of heightened supervision you will need to put in place based on the type of disciplinary issue and assess what additional resources and infrastructure will be necessary to have an effective supervisory system.

## **2. Servicing Retirement and Elderly Investors**

In JLG's May 2016 Legal Tip,<sup>3</sup> we discussed the need for compliance programs to focus attention on how the firm is servicing their aging clients. This theme, which was a focus for the staff for the past two years, continues to be front and center. As the population continues to live longer, it is paramount that those who service the financial industry pay attention to two particular types of clients - retirees and senior investors.

For this reason, the SEC is continuing to proceed with the Retirement-Targeted Industry Reviews and Examinations ("ReTIRE") initiative<sup>4</sup> to assess the types of products (such as variable annuities and target date funds) and services (such as cross-transactions on fixed income securities) that are being offered. In addition, advisers to public pension plans will be examined with particular focus on how they are managing conflicts of interest, complying with pay-to-play requirements and supervising gifts and entertainment practices.

In addition, the SEC will be evaluating how registrants are interfacing with senior investors. Special focus will be placed on the types of investment portfolios offered for income generation and lifestyle needs, how firms are identifying financial exploitation of senior investors and internal controls that are specifically deployed by firms for supervising activities relating to this particular client segment.

*Risk Management Tip:* Take action now to advance your compliance program for servicing aging clients. Review and expand upon your policies and procedures to address what steps the firm is taking to protect aging clients. This includes implementing certain steps at account opening to gather emergency contact information, capturing who (and under what circumstances) has power of attorney for the client's account(s) and expanding upon language in your client

agreements to address the steps the firm will take if they suspect diminished capacity. Prior to implementation, conduct training with all client-interfacing team members.

### **3. Assessment of Market-wide Risks**

Protection against market-wide risks has long been a focus of the SEC; but some of this year's examination priorities are new to this category. For example, payment for order flow is a new

examination focus, which will assess how market-makers and others that service retail customers comply with best execution when routing customer orders for execution. In addition, OCIE is "enhancing its oversight of FINRA" by reviewing, among other things, the self-regulatory organization's approach to the examination of broker-dealers.

A number of examination focus areas are carried over from last year and includes the review of covered clearing agencies, examination of Systems Compliance and Integrity ("SCI") entities and how they are able to operate and maintain fair and orderly markets; review of cybersecurity compliance procedures and controls, including how they are implemented; inspection of National Securities Exchanges and their operational and regulatory programs; and assessment of Anti-Money Laundering ("AML") programs and how they are tailored to address particular risks.

*Risk Management Tip:* While most firms have adopted a cybersecurity policy, not all have customized and implemented a robust program, which includes an incident response plan. Take time to carefully inventory the latest cyber threats and address within your program how each will be assessed and mitigated. Develop an action plan of what will need to happen if and when a cyberattack does indeed occur. This includes notification procedures - to internal staff, critical service providers, customers and regulators, and integration between existing business continuity plans, Regulation S-P controls and cybersecurity protocols. Be sure to provide training on any enhancements to your cybersecurity plan as part of the implementation process.

### **Conclusion**

The SEC's examination priorities lists allow the financial industry to gain valuable insight into what regulators perceive to be some of the most significant risks today. Take this as an opportunity to customize your 2017 Annual Reviews for these areas, and evaluate your internal control structure to see if there are potential gaps that need to be addressed.

For more information on this topic, please contact us at (619) 298-2880 or at [info@jackolg.com](mailto:info@jackolg.com).

**Author: Michelle L. Jacko, Esq., Managing Partner, Jacko Law Group, PC. JLG works extensively with investment advisers, broker-dealers, investment companies, hedge funds, banks and corporate clients on securities and corporate counsel matters.**

*This article is for information purposes and does not contain or convey legal advice. The information herein should not be relied upon in regard to any particular facts or circumstances without first consulting with a lawyer.*

---

<sup>1</sup>See <https://www.sec.gov/about/offices/ocie/national-examination-program-priorities-2017.pdf>.

<sup>2</sup>*Id.* at page 2.

<sup>3</sup> See <http://www.jackolg.com/Regulatory-Considerations-for-Servicing-Aging-Clients-May-Legal.pdf>.

<sup>4</sup>For more information about the ReTIRE initiative, see <https://www.sec.gov/about/offices/ocie/retirement-targeted-industry-reviews-and-examinations-initiative.pdf>.