EXAMINATION PRIORITIES FOR 2016

I. Introduction

This document identifies selected 2016 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 and products that OCIE perceives to present potentially heightened risk to investors and/or the integrity of the U.S. capital markets.[1]

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.[2] We selected our 2016 examination priorities in consultation with the Commissioners, senior staff from the SEC's regional offices, the SEC's policy-making and enforcement divisions, the SEC's Investor Advocate, and our fellow regulators.

This year, our priorities are organized around the same three thematic areas as last year:

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

This document does not address OCIE's examination priorities for the national securities exchanges, which we are addressing separately.

II. Protecting Retail Investors and Investors Saving for Retirement

Protecting retail investors and retirement savers remains a priority in 2016, and it will likely continue to be a focus for the foreseeable future. Retail investors of all ages face a complex and evolving set of choices when determining how to invest their money. Additionally, as investors are more dependent than ever on their own investments for retirement,[3] the financial services industry is offering a broad array of information, advice,

1 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.

2 The regulated entities that OCIE examines include investment advisers, investment companies, broker-dealers, municipal advisors, transfer agents, exchanges, clearing agencies, and other self-regulatory organizations.

3 For decades, employers have shifted from offering defined benefit pensions to defined contribution plans, such as 401(k) accounts, that place funding and investment risk directly on participants. Today, it is estimated that approximately $16.5 trillion is invested in defined contribution plans (including individual retirement accounts and annuity reserves), while approximately $8.2 trillion is invested in defined benefit plans. *See* Nari Rhee, "Retirement Savings Crisis: Is it Worse than We Think" (June

products, and services to retail investors to help them plan for, and live in, their retirement years. We are planning and/or conducting various examination initiatives to assess risks to retail investors that could arise from these trends.

- **ReTIRE**. In June 2015, we launched a multi-year examination initiative, focusing on SEC-registered investment advisers and broker-dealers and the services they offer to investors with retirement accounts.[4] We will continue this initiative, which includes 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")**. We will examine ETFs 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 the ETFs' unit creation and redemption process. We 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**. We will continue to review regulated entities' supervision of registered representatives and investment adviser representatives in branch offices of SEC-registered investment advisers and broker-dealers, including using data analytics to identify registered representatives in branches that appear to be engaged in potentially inappropriate trading.

- **Fee Selection and Reverse Churning**. We will continue to examine investment advisers and dually-registered investment adviser/broker-dealers that offer retail investors a variety of fee arrangements (e.g., asset-based fees, hourly fees, wrap fees, commissions). We will focus on recommendations of account types and whether the recommendations are in the best interest of the retail investor at the inception of the arrangement and thereafter, including fees charged, services provided, and disclosures made about such arrangements.

- **Variable Annuities**. Variable annuities have become a part of the retirement and investment plans of many Americans.[5] We will assess the suitability of sales of variable annuities to investors (e.g., exchange recommendations and product classes), as well as the adequacy of disclosure and the supervision of such sales.

- **Public Pension Advisers**. We will examine advisers to municipalities and other government entities, focusing on pay-to-play and certain other key risk areas related to advisers to public pensions, including identification of undisclosed gifts and entertainment.

2013), a publication of the NATIONAL INSTITUTE ON RETIREMENT SECURITY; *see also* "Retirement Assets Total $24.8 Trillion in Second Quarter 2015" (Sept. 2015), a publication of the INVESTMENT COMPANY INSTITUTE.

4 *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.

5 *See* SEC Investor Publications, "Variable Annuities: What You Should Know," April 18, 2011, http://www.sec.gov/investor/pubs/varannty.htm.

III. Assessing Market-Wide Risks

The SEC's mission includes not only protecting investors and facilitating capital formation, but also maintaining fair, orderly, and efficient markets. We will examine for structural risks and trends that may involve multiple firms or entire industries. In 2016, we will focus on the following initiatives:

- **Cybersecurity**. In September 2015, we launched our second initiative to examine broker-dealers' and investment advisers' cybersecurity compliance and controls.[6] In 2016, we will advance these efforts, which include testing and assessments of firms' implementation of procedures and controls.

- **Regulation Systems Compliance and Integrity ("SCI")**. We will examine SCI entities to evaluate whether they have established, maintained, and enforced written policies and procedures reasonably designed to ensure the capacity, integrity, resiliency, availability, and security of their SCI systems.[7] 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.

- **Liquidity Controls**. Amidst the changes in fixed income markets over the past several years, we will examine advisers to mutual funds, ETFs, and private funds that have exposure to potentially illiquid fixed income securities. We will also examine registered broker-dealers that have become new or expanding liquidity providers in the marketplace. These examinations will include a review of various controls in these firms' expanded business areas, such as controls over market risk management, valuation, liquidity management, trading activity, and regulatory capital.

- **Clearing Agencies**. We will continue to conduct annual examinations of clearing agencies designated systemically important, 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.

IV. Using Data Analytics to Identify Signals of Potential Illegal Activity

Since our examination program is risk-based, we are always striving to detect risks across those industries and within those firms that we oversee. In *all* of our examination initiatives, including those highlighted in this section, we utilize data and intelligence from our own examinations, as well as from regulatory filings, to identify registrants that appear to have elevated risk profiles. A few of our initiatives that leverage our capabilities in the area of data analytics include:

- **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 firms that employ them. For example, we will assess the compliance oversight and controls of investment advisers that have employed such individuals after they have been disciplined or barred from a broker-dealer.

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6 *See* OCIE Risk Alert, "OCIE's 2015 Cybersecurity Examinations Initiative," Sept. 15, 2015, https://www.sec.gov/ocie/announcement/ocie-2015-cybersecurity-examination-initiative.pdf.

7 For the definitions of "SCI entities" and "SCI systems" see Regulation Systems Compliance and Integrity, Release No. 34-37639, http://www.sec.gov/rules/final/2014/34-73639.pdf.

- **Anti-Money Laundering ("AML")**. We will continue to examine clearing and introducing broker-dealers' AML programs, using our analytic capabilities to 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. We will also continue to assess broker-dealers' AML programs, with a particular emphasis on (1) 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 (2) the extent to which firms consider and adapt, as appropriate, their programs to current money laundering and terrorist financing risks.

- **Microcap Fraud**. We will continue to examine the operations of broker-dealers and transfer agents for activities that indicate they may be engaged in, or aiding and abetting, pump-and-dump schemes or market manipulation. We will also assess whether broker-dealers are complying with their obligations under the federal securities laws when publishing quotes for or trading securities in the over-the-counter markets.

- **Excessive Trading**. We will continue to analyze data, including data obtained from clearing brokers, to identify and examine firms and their registered representatives that appear to be engaged in excessive or otherwise potentially inappropriate trading.

- **Product Promotion**. We will focus on detecting the promotion of new, complex, and high risk products and related sales practice issues to identify potential suitability issues and potential breaches of fiduciary obligations.

Through collaborative efforts with the Division of Economic and Risk Analysis, we will continuously enhance our analytic approach and capabilities in these areas through the use of new technologies and risk-based initiatives.

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 newly-registered municipal advisors to assess their compliance with recently adopted SEC and Municipal Securities Rulemaking Board rules. This initiative will continue to include industry outreach and education.[8]

- **Private Placements.** We will review private placements, including offerings involving Regulation D of the Securities Act of 1933 or the Immigrant Investor Program ("EB-5 Program")[9] to evaluate whether legal requirements are being met in the areas of due diligence, disclosure, and suitability.

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8 *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*.

9 The EB-5 Program is a federal visa initiative, administered by United States Citizenship and Immigration Services. It provides a path to legal U.S. residency for foreign investors who make a qualifying investment in a commercial enterprise in the United States that creates or preserves at least ten permanent full-time jobs for qualified U.S. workers. *See* EB-5 Immigrant Investor Program description at http://www.uscis.gov/eb-5.

- **Never-Before-Examined Investment Advisers and Investment Companies**. We will continue conducting focused, risk-based examinations of selected registered investment advisers and investment company complexes that we have not yet examined.[10]

- **Private Fund Advisers**. We will examine private fund advisers, maintaining a focus on fees and expenses and evaluating, 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 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 providing paying agent services for their issuers, focusing on the safeguarding of security-holder funds.

VI. Conclusion

This description of OCIE priorities is not exhaustive. While we expect to allocate significant resources throughout 2016 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.

OCIE welcomes comments and suggestions about 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 us at http://www.sec.gov/complaint/info_tipscomplaint.shtml.

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[10] *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. *See also* OCIE Risk Alert, "OCIE's Never-Before-Examined Registered Investment Company Initiative," April 20, 2015, http://www.sec.gov/about/offices/ocie/ocie-never-before-examined-registered-investment-company-initiative.pdf.