Client Alert

Americas FS Regulatory Center of Excellence

2017 securities regulatory and examination priorities

The Securities and Exchange Commission (SEC) and the Financial Industry Regulatory Authority (FINRA) recently released their annual letters outlining regulatory and examination priorities for 2017. These priorities provide firms with a roadmap for proactively reviewing and strengthening the compliance program areas that are likely to be subject to heightened regulatory scrutiny this year. As in past recent years, the SEC and FINRA share a number of the priorities, which broadly include "matters of importance to retail investors" such as high risk and recidivist brokers, protecting senior investors and retirement investment accounts (including suitability and conduct/culture issues), as well as maintaining the integrity of the markets and assessing market-wide risks, such as the risks associated with cybersecurity and anti-money laundering compliance. In addition, each of the supervisors highlighted the use of enhanced technologies and data analytics to target risk-based reviews of firms, individuals, and/or industry practices presenting elevated risk profiles. Separately, the SEC's Office of Compliance Inspections and Examinations (OCIE) indicated that it will also focus on investment advisers, money market funds, and electronic investment advice along with enhanced oversight of FINRA. For its part, FINRA will also focus on sales practices, financial risks, and operational risks in its examination of broker-dealers.

High-risk brokers

Both the SEC and FINRA noted the need to focus on high-risk and recidivist brokers and how they are hired. The SEC stated that it 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."

Similarly, FINRA stated that it will strengthen its monitoring of high-risk brokers in three areas: (1) compliance with rules regarding suitability, know-your-customer, outside business activities, private securities transactions, and commissions and fees; (2) due diligence for hiring or retaining statutorily disqualified and recidivist brokers and supervisory plans reasonably tailored to the broker based on their prior misconduct and regulatory disclosures; and (3) evaluations of branch office inspection programs and supervisory systems for branch and non-branch office locations.

Protecting retail investors

The SEC's focus on protecting retail investors includes so-called "robo advising" electronic investment advisors; wrap fee programs; exchange traded funds (ETF), including sales practices and the suitability of recommendations; and multi-branch advisors.

Similarly, FINRA's 2017 supervision priorities will involve controls around product suitability determinations and product concentrations. FINRA will also focus on supervision and training for the objectives, risks, and pricing factors for

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new products or features that could change market conditions and affect product performance.

Protecting senior investors

The SEC has made the protection of senior investors a priority, noting that aging investors become more dependent on their investments for retirement income. OCIE will focus examinations through its Retirement-Targeted Industry Reviews and Examinations (ReTIRE) initiative on sales and product recommendations in insurance, sales and management of target date funds, and cross-transactions for fixed income securities as well as supervision and controls around products and services for seniors and the "financial exploitation of seniors."

Likewise, FINRA will examine sales practices targeted at seniors, including product suitability and concentrations, supervision of problematic sales practices, and microcap fraud schemes.

Cybersecurity

Cybersecurity is a growing risk for financial services regulators, and both the SEC and FINRA have prioritized supervision in this area. The SEC will test broker-dealers and investment advisers on implementation of cybersecurity compliance procedures and controls.

FINRA's cybersecurity and cyber-risk program assessments will vary based on several factors, including a firm's business model, size, and risk profile. Possible reviews include data loss prevention, data and data flow, and controls to monitor and protect data. FINRA may also review cybersecurity supervision of third parties.

Anti-money laundering

The SEC will continue its focus on compliance with Regulation SCI and anti-money laundering rules. It will evaluate the compliance of money market funds with the SEC's amended rules, which became effective in October 2016.

FINRA's assessments of anti-money laundering programs will focus on data integrity issues and surveillance patterns that fail to capture problematic behavior in automated trading and money movement surveillance systems.

Additional FINRA priorities

In addition to the priorities previously discussed, FINRA supervision priorities also include several additional areas around sales practices, market integrity, and financial risks.

- **Sales practices:** Additional focus areas for sales practices are excessive and short-term trading of long-term products, the outside business activities and private securities transactions of registered representatives, and record retention for social media and electronic communications.
- **Financial risks:** Priorities for financial risks will include liquidity risk, financial risk management, and credit risk policies under FINRA Rule 4210. *Regulatory Notice 15-33* offers some guidance for firms as they evaluate these risk practices.
- **Operational risks:** In addition to cybersecurity, supervision priorities for operational risks will include internal controls testing, customer protection, Regulation SHO, and municipal advisor registration.
- **Market integrity:** Market integrity priorities will include market manipulation, best execution, the Audit Trail Reporting Early Remediation Initiative and expansion, Tick Size Pilot, the Market Access Rule, trading examinations, and the fixed income securities surveillance program.

Conclusion

Many of the priorities for 2017, such as retirement investors and sales practices are consistent with those from 2016. Newer priorities, such as the increase in the use of "robo-advisers," are a reflection of market developments such as passage of the Department of Labor's Fiduciary Rule, which is directed toward retirement investments and will impact both investment advisers and broker-dealers. The SEC and FINRA are also both placing an increased emphasis on technology and data analytics.

Given that these are exam focus areas and not regulatory changes, these priorities could change during the coming year in response to new priorities established by the Trump Administration. Notably, SEC Chair Mary Jo White has resigned as of January 20, 2017, and Donald Trump has appointed Jay Clayton to be her replacement.

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