

SEC and FINRA Focus on Retirement Accounts

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On June 22, 2015, the ***U.S. Securities and Exchange Commission's (SEC) Office of Compliance Inspections and Examinations (OCIE)*** announced a multi-year Retirement-Targeted Industry Reviews and Examinations Initiative (***ReTIRE Initiative***). OCIE, through the National Examination Program (NEP), will conduct examinations of SEC-registered investment advisers and broker-dealers under the ReTIRE Initiative that "will focus on certain higher-risk areas of registrants' sales, investment, and oversight processes, with particular emphasis on select areas where retail investors saving for retirement may be harmed." OCIE said that it will look closely at the compliance programs of registrants to determine whether the firms identify and address risks associated with conflicts of interest, supervision and compliance controls, marketing and disclosures, and the basis on which firms make recommendations to retirement clients. The ReTIRE Initiative follows OCIE's 2015 Examination Priorities, which include "examining matters of importance to retail investors and investors saving for retirement."

Last year, as part of a settlement agreement, the Financial Industry Regulatory Authority (FINRA) fined Merrill Lynch more than \$8 million and required the firm to make over \$24 million in restitution to more than 13,000 small business retirement accounts and over 3,100 403(b) retirement accounts. As part of the settlement, Merrill Lynch neither admitted nor denied the charges, but consented to the entry of FINRA's findings. FINRA found that Merrill Lynch failed to waive mutual fund sales charges for certain charitable and retirement accounts. Most of the mutual funds available on Merrill Lynch's retail platform offered sales charge waivers to retirement plan accounts and disclosed such waivers in their prospectuses. FINRA found, however, that since at least January 2006, Merrill Lynch did not waive the sales charges for eligible customers when it offered Class A shares. As a result, tens of thousands of small business retirement plan accounts and 403(b) retirement accounts for public school employees were unnecessarily subjected to higher ongoing fees and expenses. As a result of its investigation, FINRA found systemic failures in Merrill Lynch's written supervisory procedures and training and supervision of its financial advisers.

In connection with OCIE's ReTIRE Initiative, the Asset Management Unit of the SEC's Division of Enforcement will work closely with OCIE to investigate and prosecute violations relating to disclosure, compliance and supervisory procedures. What advisers and broker-dealers that operate in this area can expect are more detailed exams and requests relating to disclosures, conflicts of interest, supervision and compliance controls.

Through the use of data analytics, information from prior examinations and examiner-driven due

diligence, the staff will identify registrants to examine under the ReTIRE Initiative. As part of the examinations or the selection of registrants to examine, the staff may focus on the activities of investment advisory representatives and/or broker-dealer registered representatives that offer services to investors with retirement accounts. The “risk-based examinations” conducted under the ReTIRE Initiative will focus on the following areas:

- **Reasonable Basis for Recommendations:** Investment advisers and broker-dealers have certain obligations under federal securities laws and Self-Regulatory Organization (SRO) rules when providing investment advice or making recommendations to advisory clients. OCIE staff will assess how registrants (i) select the type of account; (ii) perform due diligence on investment options; (iii) make initial investment recommendations; and (iv) provide continued account management.
- **Conflicts of Interest:** Investment advisers and broker-dealers may have inherent conflicts of interest that arise from their business structure, compensation structure, personal relationships or relationships with service providers. Registrants are expected to identify and disclose any material conflicts of interest and design compliance programs to address the risks associated with such conflicts. OCIE staff will review registrants' (i) sales and account selection practices; (ii) fees charged; (iii) services provided; and (iv) expenses incurred, and determine whether compliance programs in place identify and address the risks associated with conflicts of interest and whether material conflicts of interest are properly disclosed.
- **Supervision and Compliance Controls:** Under applicable federal securities laws and SRO rules, investment advisers and broker-dealers are required to reasonably supervise individuals and entities acting on their behalf and implement effective compliance programs. OCIE staff will review registrants' controls, oversight, and supervisory policies and procedures and determine whether firms are complying with the requirements set forth therein. OCIE staff may also focus on (i) registrants with multiple and/or distant branch offices and (ii) representatives with outside business activities.
- **Marketing and Disclosure:** Investment advisers and broker-dealers are required to ensure that materials distributed to investors are not deceptive or misleading. OCIE staff will review brochures, sales and marketing materials, and disclosures to retail investors to confirm that: (i) the content and representations are true and accurate and do not omit material information; (ii) fee disclosures are accurate and complete; and (iii) credentials or other endorsements are valid and meet any stipulated standards.

What Registrants Can Do

Firms can be proactive by conducting internal reviews to identify possible risk areas and weaknesses and implementing remedial measures to address the above issues on which OCIE is focusing. Firms should also be mindful of privilege issues and, in order to best protect the attorney/client privilege, should consider having in-house or outside legal counsel lead or oversee the internal review process.

Early detection of possible issues or weakness controls can be beneficial to firms. For example, FINRA recently settled a case with Wells Fargo Advisors, LLC, Wells Fargo Advisors Financial Network, LLC, Raymond James & Associates, Inc., Raymond James Financial, Inc. and LPL Financial LLC wherein no fines were assessed against any of the firms as a result of their "extraordinary cooperation" with the investigation. The firms conducted internal reviews of their

mutual fund sales charges beginning in June 2014, on the heels of the Merrill Lynch enforcement action, and notified FINRA over the course of the following months when they discovered that certain eligible customers had not received fee waivers.

FINRA announced that it recognized the firms' remedial efforts, including the fact that the firms initiated the internal reviews on their own and prior to the detection or intervention by a regulator. FINRA also credited each of the firms with promptly establishing a plan for remediating customers and taking other corrective measures to improve their procedures.

With the OCIE ReTIRE Initiative in place and FINRA's activity, investment advisers and broker-dealers should consider stepping up their focus on retirement accounts. As OCIE noted, "[i]n sharing the focus areas for the ReTIRE Initiative, the NEP's intent is to encourage registrants to reflect upon their own practices, policies, and procedures in these areas and to promote improvements in their supervisory, oversight, and compliance programs, as deemed appropriate."

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