

# Clients & Friends Memo

## Under Advisement: SEC Scrutinizes Wealth Management Industry

March 21, 2018

Recent events have made it clear that there is an increased regulatory focus on the conduct of investment professionals in the wealth-management industry. The Securities and Exchange Commission (“SEC”) in particular has emphasized that certain activities by investment advisers directly impacting retail investors, such as inadequate fee disclosure, dubious sales practices and inappropriate steering to unsuitable strategies and products, is a top enforcement priority under the leadership of SEC Chairman Jay Clayton. In the last year and a half, the Enforcement Division has resolved a number of actions against leading financial institutions over allegations of inadequately disclosed fees and improper investment recommendations. The Division has demonstrated through these actions that it is particularly focused on:

- steering clients to higher-cost products, such as mutual-fund share classes charging higher fees and commissions;<sup>1</sup>
- abuses in wrap-fee accounts;<sup>2</sup>
- investment-adviser recommendations to buy and hold highly volatile products like inverse exchange-traded funds;<sup>3</sup>
- suitability issues involving the sale of structured products to retail investors;<sup>4</sup> and
- abusive sales practices like churning and excessive trading.<sup>5</sup>

The SEC has also made a series of announcements aimed at addressing misconduct by investment professionals in their dealings with retail investors. In September 2017, the Division announced the

<sup>1</sup> See e.g., [SEC Charges Ameriprise With Overcharging Retirement Account Customers for Mutual Fund Shares](#); [SunTrust Charged With Improperly Recommending Higher-Fee Mutual Funds](#).

<sup>2</sup> See e.g., [Two Firms Charged With Compliance Failures in Wrap Fee Programs](#).

<sup>3</sup> See e.g., [Morgan Stanley Settles Charges Related to ETF Investments](#).

<sup>4</sup> See e.g., [SEC Charges UBS With Supervisory Failures in Sale of Complex Products to Retail Investors](#).

<sup>5</sup> See e.g., [SEC Detects Brokers Defrauding Customers](#).

formation of a Retail Strategy Task Force to develop targeted initiatives and collaborate with others in the SEC, including the Office of Compliance Inspections and Examinations (“OCIE”), to identify and address misconduct impacting retail investors. OCIE, in turn, has said that examinations this year will focus on firms that have practices or business models that may create increased risks that investors will pay fees, expenses, or other charges that are inadequately disclosed. This includes firms that provide financial incentives to advisory personnel who favor particular in-house products or investments with higher fees without proper disclosure. To date, we have not seen any enforcement actions directly attributable to the work of the Task Force.

On February 12, 2018, the Division launched the Share Class Selection Disclosure (“SCSD”) Initiative, a four-month self-reporting initiative with favorable settlement terms aimed at investment advisers who, without appropriate justification, put their clients into higher-fee mutual-fund share classes when lower- or no-fee classes were available. Although the Division will recommend settlements that do not impose civil monetary penalties for eligible advisers that participate in the SCSD Initiative, the Division has made no assurances that individuals associated with eligible advisers will receive preferential settlement terms. Moreover, the Division may recommend stronger sanctions against advisers that engaged in misconduct but failed to self-report.

Earlier this month, Wells Fargo & Company disclosed that it is conducting a review of certain activities within its Wealth and Investment Management division in response to federal inquiries. The areas that Wells Fargo is reviewing, and the likely focus of the federal inquiries, include whether there have been inappropriate referrals or recommendations, including with respect to rollovers for 401(k) plan participants, certain alternative investments, or referrals of brokerage customers to the investment and fiduciary-services business. Given the SEC’s focus on this area of activity, it is likely that its inquiries will encompass the wealth-management businesses of other financial institutions.

The SEC’s focus on the sales practices of financial institutions has not been limited to retail investors. In February 2018, it commenced an action against Deutsche Bank Securities, Inc., for allegedly misleading statements made by its traders and salespeople while negotiating the sale of commercial mortgage-backed securities. Similar to the well-known issues involving former Jefferies, Inc. trader Jessie Litvak, the allegations concern misstatements by traders to potential counterparties regarding the prices at which Deutsche Bank had originally purchased them. This is the SEC’s third enforcement action of this type, in addition to related criminal prosecutions.

The Chief of the Enforcement Division’s Complex Financial Unit recently reiterated that misrepresentations in the sale of complex products will continue to be a focus for the Division. He also stated that a new area for concern for the SEC is cross-trading activity in a number of asset classes that improperly provides an advantage to one client over another, and that the Enforcement Division was using data analytics to identify activity that warranted further scrutiny.

Despite some predictions to the contrary, this activity shows that the SEC continues to focus on financial institutions under its current leadership, particularly in the wealth-management area. Given the heightened focus on adviser conduct impacting retail consumers – particularly on conflicts of interest relating to higher-cost investments and sales practices in general – wealth-management firms should carefully review their policies and practices to ensure they adequately instruct advisory personnel to disclose any conflicts of interest and incentivize them to recommend the best deal for their clients, and revisit any training program for advisory personnel. Firms within the SEC's heightened focus should consider developing action plans or taking further pre-emptive actions, such as performing an independent risk assessment and conducting robust mandatory training programs if they believe they may have potential issues, to better prepare for a possible enforcement inquiry from the SEC or other applicable regulator.

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