

MEMO# 34101

April 8, 2022

The SEC's Division of Examinations Publishes Its Examinations Priorities for 2022

[34101]

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TO: ICI Members

Investment Company Directors

ICI Global Members

Chief Compliance Officer Committee

Internal Audit Committee

International Internal Audit Advisory Committee

SEC Rules Committee

Transfer Agent Advisory Committee SUBJECTS: Anti-Money Laundering

Compliance

Cybersecurity

Exchange-Traded Funds (ETFs)

Fixed Income Securities

Investment Advisers

Operations RE: The SEC's Division of Examinations Publishes Its Examinations Priorities for 2022

Overview of the Division of Examinations' 2022 Priorities

For the tenth year in a row, the SEC office responsible for conducting inspections of registrants, the Division of Examinations, has published its examination priorities for the coming year.[\[1\]](#) The Division's priorities for 2022 are grouped into the following thirteen areas:

- Private Funds;
- Environmental, Social, Governance (ESG) investing;
- Standards of Conduct: Regulation Best Interest, Fiduciary Duty, and Form CRS;
- Information Security and Operational Resiliency;
- Emerging Technologies and Crypto-Assets;
- Investment Adviser and Investment Company Examination Program;
- Broker-Dealer and Exchange Examination Program;
- Clearance and Settlement Examination Program;

- Regulation Systems Compliance and Integrity;
- FINRA;
- MSRB;
- The London Inter-Bank Offered Rate (LIBOR) Transition; and
- Anti-Money Laundering.

Before discussing each of these areas, the Priorities have a "Division of Examinations' Leadership Message." Among other things, this Message discusses: the evolution of the publication of the Division's examination priorities; the Division's statistics for fiscal year (FY) 2021; an emphasis on the importance of "compliance;" and a final note mentioning the pandemic and changes to the Division. The relevant portions of the Message from the Division's Leadership are briefly summarized next.

Division of Examination Leadership Message

Evolution of Priorities

The Division of Examinations' Leadership Message begins by marking a decade since the first publishing of examination priorities. Throughout this decade the priorities have provided transparency into areas that the Division believes to be of heightened risk. While not all priorities are perennial, many of the priorities evolve and develop in different ways, and it is noted that just because an area is not as prominently prioritized, it does not mean that examinations are no longer conducted.

Fiscal Year 2021 Statistics

In terms of the Division's Statistics, according to the Priorities:

- In FY22 there was a net addition of approximately 900 registered investment advisers (RIAs), increasing 20% over the last five years from approximately 12,250 to 14,800, and total assets under management has reached over \$113 trillion;
- The number of RIAs with over \$10 billion in assets has increased by 30% in the past five years. Approximately 60% of RIAs are affiliated with other financial industry firms, and more than 35% manage a private fund;
- In FY22, the Division completed 3,040 examinations, which was a 3% increase from FY20. More than 2,200 examinations of investment advisers were conducted and over 125 examinations of investment company complexes were conducted;
- The Division examined approximately 16% of RIAs in 2021;
- The Division issued more than 2,100 deficiency letters.

Note on "Compliance"

Under this heading, the Division reinforced that, just because the word "compliance" was removed from their official name, they still emphasize the importance of compliance. Promoting compliance is an important and valuable part of the Division's work, and the Division works with Chief Compliance Officers routinely. In performing examinations, the Division has found several commonalities of resilient compliance programs. These areas include inclusivity, change management, and reviews and testing.

Final Note

The final note first discusses the tenacity and resiliency of the Division and the financial service industry generally, during the Covid-19 pandemic, and wraps up by highlighting

changes to the Division. These highlights include the Division establishing the Office of Security-Based Swaps, examining registrants for compliance with several new regulations, and welcoming new leaders in the division.

The Division's 2022 Examination Priorities

As noted above, the Division's 2022 examination priorities are grouped into thirteen categories. The categories that would be relevant to the Institute's members are briefly summarized below.

Private Funds

Private funds are the first of the significant focus areas in the 2022 Priorities. Given the size, complexity, and significant growth of this market, the Division plans on continuing their focus on RIAs to private funds. Issues that will be examined fall under the Advisers Act, include an adviser's fiduciary duty, risk assessments, compliance programs, fees and expenses, custody, fund audits, valuation, conflicts of interest, disclosures of investment risks, and controls around material nonpublic information. Furthermore, the Priorities highlight a review of private fund RIAs' portfolio strategies, risk management, and investment recommendations and allocations, with a focus on conflicts and disclosures in these areas.

Environmental, Social, Governance (ESG) Investing

ESG investing is another one of the Division's significant focus areas in the 2022 Priorities. With RIAs and registered funds increasingly offering and evaluating investments through ESG strategies or criteria, truthful disclosure is vital to an informed investor. Risks in ESG investing may be compounded by: 1) the lack of standardized ESG investing terminology, 2) the variety of approaches to ESG investing, and 3) the failure to effectively address legal and compliance issues with new lines of business and products. The Division will continue to focus on ESG-related advisory services and investment products with a focus on whether these RIAs and registered funds are: accurately disclosing their ESG approaches through implemented policies and procedures; voting client securities in accordance with proxy voting policies that align with their ESG-related disclosures; and overstating or misrepresenting ESG factors considered into portfolio selection.

Standards of Conduct: Regulation Best Interest, Fiduciary Duty, and Form CRS

Standards of conduct is another significant focus area in the Priorities. Reviews on standards of conduct will focus on how broker-dealers and RIAs are satisfying their obligations under Reg BI and the Advisers Act fiduciary standard. Exams will include assessments of practices regarding consideration of alternatives, management of conflicts of interest, trading, disclosures, account selection, and account conversions and rollovers. Furthermore, examinations will focus on the effectiveness of compliance programs, testing, and training to support retail investors and working families. RIA examinations will look at both duties of care and loyalty, including best execution obligations, financial conflicts of interest and related impartiality of advice, and any attendant client disclosure. Focus areas include: 1) revenue sharing arrangements; 2) recommending or holding more expensive classes of investment products when lower cost classes are available; 3) recommending wrap fee accounts without assessing client's interest; and 4) recommending proprietary products resulting in higher fees. Dually registered RIAs and broker-dealers remain an area of interest for the division.

Information Security and Operational Resiliency

Information Security and Operational Resiliency is another significant focus area for the Division. Vigilant protection of data is critical to ensuring business continuity and the operation of the financial markets with the confidence of participants. The Division will continue to review whether firms have taken appropriate measures to: (1) safeguard customer accounts and prevent account intrusions, including verifying an investor's identity to prevent unauthorized account access; (2) oversee vendors and service providers; (3) address malicious email activities, such as phishing or account intrusions; (4) respond to incidents, including those related to ransomware attacks; (5) identify and detect red flags related to identity theft; and (6) manage operational risk as a result of a dispersed workforce in a work-from-home environment. In addition, the Division will again be reviewing registrants' business continuity and disaster plans, with specific focuses on the impact of climate risk and substantial disruptions to normal business operations.

Emerging Technologies and Crypto-Assets

Emerging Technology and Crypto-Assets is the final category of significant focus in the Priorities. The Division will conduct examinations of broker-dealers and RIAs that are using or developing financial technologies to review whether the unique risks these activities present were considered by the firms when they designed their regulatory compliance programs. The examinations will focus on firms offering new products and services or using new practices, in hopes of assessing whether the operations and controls in place are consistent with disclosures and the standard of conduct owed, whether advice and recommendations are consistent with strategies and standards of conduct, and whether the controls consider unique risks associated with such practices. In terms of market participants engaging with crypto-assets, the Division will review whether they have met their respective standards of conduct when recommending the products and whether they routinely review, update, and enhance their compliance practices. In addition, the Division will conduct examinations of mutual funds and ETFs offering exposure to crypto-assets to assess, among other things, compliance, liquidity, and operational controls around portfolio management and market risk.

Investment Adviser and Investment Company Examination Program

Investment Advisers

The Division highlighted a review of RIA compliance programs in one or more core areas including: marketing practices, custody and safety of client assets, valuation, portfolio management, brokerage and execution, conflicts of interest, and related disclosures. The Priorities go further to say that the Division will examine whether the compliance programs address that: 1) investment advice is in each client's best interest; 2) oversight of service providers is adequate; and 3) sufficient resources exist to perform compliance duties. Additionally, the Division will review whether the firm has implemented oversight practices to mitigate heightened risks. Furthermore, the Division will also continue to focus on RIA disclosures and other issues related to fees and expenses and to prioritize RIAs and registered funds that have never been examined.

Registered Investment Companies, Including Mutual Funds and ETFs

With their importance to retail investors, the Division will continue to prioritize examinations of registered investment companies. There are certain perennial areas that

the Division will review including, among other topics: disclosures to investors, accuracy of reporting to the SEC, and compliance with the new rules and exemptive orders. As part of its review of registered funds' Liquidity Risk Management Programs, the Division will consider the program's design as it comes to assessing and managing fund's liquidity risk and review the implementation of required liquidity classifications. This section concludes by stating that certain types of registered funds will be prioritized, highlighting money market funds and business development companies.

Regulation Systems Compliance and Integrity

With the Commission's adoption of Regulation SCI, the Division will continue to evaluate whether SCI entities have established, maintained, and enforced the required policies and procedures. The priorities highlight: whether the incident response policies and procedures are reasonably designed; the use of third-party network infrastructure to critical functions; policies and procedures surrounding hybridization of the workplace; and whether the policies can identify and mitigate supply chain risks.

The London Inter-Bank Offered Rate (LIBOR) Transition

Due to the significant impact that the cessation of LIBOR may have on financial markets and the material risk it may present to registered advisers, investment companies, and transfer agents, among others, the Division plans to review issues related to LIBOR. Its continued focus will be on registrants' exposure to LIBOR, their preparation for its discontinuation immediately after December 31, 2021, and their transition to an alternative reference rate.

Anti-Money Laundering

As in previous years, the Division will continue to prioritize examining broker-dealers and investment companies for their compliance with their AML obligations. The Division will assess whether registrants have established appropriate customer identification programs and are: satisfying their SAR filing obligations; conducting due diligence on customers; complying with beneficial ownership requirements; and conducting robust and timely independent tests of their AML programs. The goal of these reviews is to evaluate whether broker-dealers and investment companies have adequate policies and procedures in place that are reasonably designed to identify suspicious activity and illegal money-laundering activities.

Conclusion

This year's Priorities, like last year's, concludes by welcoming comments and suggestions regarding how the Division can better fulfill its mission to promote compliance, prevent fraud, identify and monitor risk, and inform SEC policies. It also encourages persons who suspect or observe activity that may violate the federal securities laws, or otherwise operate to harm investors, to notify the SEC staff. Additionally, this year's conclusion also includes a statement regarding the Division's allocation of resources to new and emerging risks, products and services, market events and investor concerns.

endnotes

[1] See 2022 Examination Priorities, Division of Examination, U.S. Securities and Exchange Commission (March 30, 2022) (the "Priorities"), which is available at: <https://www.sec.gov/files/2022-exam-priorities.pdf>.

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