

MEMO# 35504

November 8, 2023

The SEC's Division of Examinations Publishes Its Examinations Priorities for 2024

[35504]

November 07, 2023

TO:

ICI Members

Investment Company Directors

ICI Global Members

Chief Compliance Officer Committee

Internal Audit Committee

SEC Rules Committee

Transfer Agent Advisory Committee

SUBJECTS: Anti-Money Laundering

Compliance

Cybersecurity

ESG

Exchange-Traded Funds (ETFs)

Fixed Income Securities

Investment Advisers

Operations RE: The SEC's Division of Examinations Publishes Its Examinations Priorities for 2024

For the twelfth 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.[\[1\]](#) While the Division has commonly published its examination priorities near the beginning of the calendar year, this is the first time it published its examination priorities to align with its fiscal year, "with the hope that it will better inform investors and registrants of the key risks, trends, and examination topics that [they] plan to focus on in the upcoming year." Highlights of the 2024 Priorities most relevant to ICI's members are briefly described below.

Message from the Leadership Team

Before describing those areas that the Division will focus on in conducting examinations

during 2024, the Priorities begin with a "Message from the Leadership Team." This Message begins by noting the "four pillars" that govern its mission,[\[2\]](#) the risk-based approach it uses to identify firms to examine and the scope of those exams, and its response to market changes and regulatory shifts. It also notes that "several initiatives and focus areas from last year remain as fiscal year 2024 priorities," providing continuity and adaptation to accommodate the dynamic economic and regulatory environment.[\[3\]](#)

The Message acknowledges that the industry is preparing to meet new regulatory requirements, and these changes in the regulatory landscape will impact many registrants and other market participants. To support the industry, the Division intends to have a "focused engagement with the industry and investors through [their] national and regional outreach events and a greater presence of [their] examiners in the field ... to provide more transparency and to continue to move forward together with investors and the industry to promote compliance."[\[4\]](#)

Investment Advisers

The Priorities note that investment advisers are fiduciaries that owe a duty of care and a duty of loyalty to its clients. To ensure adviser's adherence to this fiduciary standard, EXAMS will focus on the following:[\[5\]](#)

- The investment advice provided to clients regarding (1) complex products, such as derivatives and leveraged exchange-traded funds (ETFs); (2) high-cost and illiquid products, such as variable annuities and non-traded real estate investment trusts (REITs); and (3) unconventional strategies, including those that purport to address rising interest rates.
- The processes for determining that investment advice is provided in clients' best interest, including those processes for (1) making initial and ongoing suitability determinations, (2) seeking best execution, (3) evaluating costs and risks, and (4) identifying and addressing conflicts of interest.
- The economic incentives that an adviser and financial professionals may have to recommend products, services, or account types, such as the source and structure of compensation, revenue, or other benefits.
- The disclosures made to investors and whether they include all material facts relating to conflicts of interest associated with the investment advice sufficient to allow a client to provide informed consent to the conflict.

Additionally, the Division will continue to focus on the advisers' compliance programs, which should align with various aspects of their business and address current market risks. The examination of compliance policies and procedures covers a range of areas outlined in the Compliance Rule under the Investment Advisers Act of 1940, including portfolio management, disclosures, safeguarding client assets, record-keeping, privacy protection, trading practices, marketing, fee assessment, and business continuity plans.

Particular examinations will include:[\[6\]](#)

- Marketing practice assessments for whether advisers, including advisers to private funds, have: (1) adopted and implemented reasonably designed written policies and procedures to prevent violations of the Advisers Act and the rules thereunder, including reforms to the Marketing Rule; (2) appropriately disclosed their marketing related information on Form ADV; and (3) maintained substantiation of their processes and other required books and records.
- Compensation arrangement assessments focusing on: (1) fiduciary obligations of

advisers to their clients, including registered investment companies, particularly concerning the advisers' receipt of compensation for services or other material payments made by clients and others; (2) alternative ways that advisers try to maximize revenue, such as revenue earned on clients' bank deposit sweep programs; and (3) fee breakpoint calculation processes, particularly when fee billing systems are not automated.

- "Valuation assessments regarding advisers' recommendations to clients to invest in illiquid or difficult to value assets, such as commercial real-estate or private placements."
- "Safeguarding assessments for advisers' controls to protect clients' material non-public information, particularly when multiple advisers share office locations, have significant turnover of investment adviser representatives, or use expert networks."
- "Disclosure assessments to review the accuracy and completeness of regulatory filings, including Form CRS, with a particular focus on inadequate or misleading disclosures and registration eligibility."

As with previous years, the Division continues to prioritize examinations of advisers that have never been examined, including recently registered advisers, and those that have not been examined for several years.

Examinations of Investment Advisers to Private Funds

According to the Priorities, the Division will continue to focus on advisers to private funds and emphasize specific areas such as assessing portfolio management risks in the face of market volatility and higher interest rates, ensuring adherence to contractual requirements for advisory committees, accurate calculation and allocation of fund fees and expenses, due diligence practices, conflicts in managing private funds alongside registered investment companies, compliance with custody requirements, and reporting on Form PF in response to certain events.

Registered Investment Companies

According to the Priorities, the Division maintains its focus on conducting examinations of registered investment companies, such as mutual funds and ETFs, "due to their significance for retail investors, particularly those saving for retirement." The 2024 examination focus areas may include:[\[7\]](#)

- "Fees and expenses and reviewing whether registered investment companies have adopted effective written compliance policies and procedures concerning the oversight of advisory fees and implemented any associated fee waivers and reimbursements. A particular focus will be on: (1) charging different advisory fees to different share classes of the same fund; (2) identical strategies offered by the same sponsor through different distribution channels but that charge differing fee structures; (3) high advisory fees relative to peers; and (4) high registered investment company fees and expenses, particularly those of registered investment companies with weaker performance relative to their peers."
- Derivatives risk management assessments to review whether registered investment companies and business development companies have established and followed appropriate written policies and procedures to prevent violations of the Commission's fund derivatives rule (Investment Company Act Rule 18f-4). This review includes examining the adoption and implementation of a derivatives risk management program, board oversight, and the accuracy of disclosures related to the use of derivatives.

Additionally, the Division will assess compliance with the conditions of exemptive order and examine concerns related to recent market disruptions and volatility, including reviewing whether registered investment companies in liquidation are following liquidation procedures.

As with adviser examinations, the Division continues to prioritize examinations of registered investment companies that have never been examined, including recently registered investment companies and those that have not been examined in several years.

Transfer Agents

Under the heading of Transfer Agents, the Priorities note that the Division will continue to examine transfer agents' processing of items and transfers, recordkeeping and record retention, safeguarding of funds and securities, and filings with the Commission. These exams will be focused on those transfer agents that service certain types of issuers, such as those issuing microcap and crypto assets and transfer agents that use emerging technology to perform their transfer agent functions.

Information Security and Operational Resiliency

Under the heading of Information Security and Operational Resiliency, the Priorities discuss how the Division will continue to review registrants' practices to prevent interruption of mission-critical services in order to protect investor information, records, and assets. Their focus on this topic will include firms' policies and procedures, governance practices, and response to cyber-related incidents. The policies and procedures will be reviewed to ensure they are reasonably designed to safeguard customer records and information - whether such records and information reside on the registrant's systems and or are stored with a third-party. The Division will also be reviewing cybersecurity issues associated with the use of third-party vendors, including the registrant's visibility into the security and integrity of third-party products and services.

Crypto Assets and Emerging Financial Technology

According to the Priorities, the Division will continue to monitor registrants' involvement with crypto assets. These exams will focus on the offer, sale, or recommendation of, advice regarding and trading in crypto or crypto-related assets.

Additionally, with respect to crypto assets that are funds or securities, the Division will consider whether advisers are complying with the custody requirements under the Advisers Act (Rule 206(4)-2).

Anti-Money Laundering

The Division will continue to focus on AML programs to review whether broker-dealers and certain registered investment companies are: (1) appropriately tailoring their AML program to their business model and associated AML risks; (2) conducting independent testing; (3) establishing an adequate customer identification program, including for beneficial owners of legal entity customers; and (4) meeting their SAR filing obligations. Examinations of certain registered investment companies will also review policies and procedures for oversight of applicable financial intermediaries.

Further, the Division will review whether broker-dealers and advisers are monitoring OFAC sanctions and ensuring compliance with such sanctions.

Miscellaneous Priorities

Other topics discussed in the Priorities as areas of focus for EXAMS in 2024 but not summarized in this memo include: Broker-Dealers (p. 13-14); National Securities Exchanges (p. 15); FINRA and the MSRB (p. 15-16). Clearing Agencies (p. 16); Municipal Advisors (p. 17); Security-Based Swap Dealers (p. 18); and Regulation Systems Compliance and Integrity (Reg. SCI) (p. 20).

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Notes

[1] See 2024 Examination Priorities, Division of Examination, U.S. Securities and Exchange Commission (Oct. 16, 2023) ("Priorities"), which is available at: <https://www.sec.gov/files/2024-exam-priorities.pdf>.

[2] These four pillars are: promoting compliance, preventing fraud, monitoring risk, and informing policy.

[3] Priorities at p.1.

[4] Id.

[5] Priorities at p.7-8.

[6] Priorities at p.9.

[7] Priorities at p.11-12.

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