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SEC Announces 2022 Examination Priorities

On March 30, 2022, the Securities and Exchange Commission (SEC) Division of Examinations (Division) announced its examination priorities (the Exam Priorities), identifying areas of focus for examinations in 2022. The announcement focuses on five different categories:

1. Private Funds;
2. Environmental, Social, and Governance (ESG);
3. Retail Investors and Working Families;
4. Information Security and Operational Resiliency; and
5. Emerging Technologies and Crypto-Assets.

This GT Alert discusses the Exam Priorities related to each of these categories.

Private Funds

The Division will focus on examining registered investment advisers (RIAs) who manage private funds. Specifically, they will focus on Advisers Act issues including an adviser's fiduciary duty and will assess risks focusing on compliance programs, conflicts of interest, disclosures of investment risks, and controls around material nonpublic information. The Division will also concentrate on fees and expenses, specifically reviewing the calculation and allocation of such fees and expenses, including the calculation of post-commitment period management fees and the impact of valuation practices at private equity funds. The Division will look into the potential preferential treatment of certain investors by RIAs to private funds that have experienced issues with liquidity, including imposing gates or suspensions on fund withdrawals and will review compliance with the Advisers Act Custody Rule, including the "audit exception" to the surprise examination requirement and related reporting and updating of Form ADV regarding the audit and auditors.

The Division will also review the adequacy of disclosure and compliance with regulatory requirements for cross trades and principal transactions, as well as look into conflicts around liquidity issues, such as gating or suspending fund withdrawals, RIA-led fund restructurings and "stapled secondary" transactions (where new investors purchase the interests of existing fund investors while also agreeing to invest in new funds). Additionally, the Division will review portfolio strategies, risk management, and investment recommendations and allocations, with a focus on conflicts and disclosures around these areas. Lastly, the Division will review the practices, controls, and investor reporting around risk management and trading for private funds with indicia or signs of systemic importance.

ESG

The Division will focus on ESG-related advisory services and investment products, including mutual funds, exchange-traded funds, and private fund offerings. Generally, the Division will focus on accurate disclosure of ESG investing approaches for RIAs and registered funds. The Division will also examine if such RIAs and registered funds have adopted and implemented policies, procedures, and practices designed to prevent violations of the federal securities laws in connection with their ESG-related disclosures, including review of their portfolio management processes and practices. The Division will also review the voting of client securities in accordance with proxy voting policies and procedures, including whether the votes align with stated ESG-related disclosures and mandates. Lastly, the Division will review whether there are misrepresentations of the ESG factors considered or incorporated into portfolio selection.

Retail Investors and Working Families

The Division will continue to address standards of conduct issues for broker-dealers and RIAs to ensure retail investors and working families are receiving recommendations and advice in their best interests. This examination priority will focus on how registrants are satisfying their obligations under Regulation Best Interest and the Advisers Act fiduciary standard to act in the best interests of retail investors instead of the Firm's own interests. To track compliance, the Division will assess practices regarding consideration of investment alternatives, management of conflicts of interest, trading, disclosures to enable investors to provide informed consent, account selection, and account conversions and rollovers.

The Division will also focus on revenue-sharing arrangements; recommendations or the holding of more expensive classes of investment products when lower cost classes are available; recommendations of wrap fee accounts without assessing whether such accounts are in the best interests of clients, including the impact of the move to zero commissions on certain types of securities transactions by a number of broker-dealers; and recommendations of proprietary products resulting in additional or higher fees.

Information Security and Operational Resiliency

The Division will review broker-dealer, RIA, and other registrant practices regarding prevention of interruptions to mission-critical services and will also review data protection measures for investor information, records, and assets. Specifically, the Division will look at whether firms have taken appropriate measures to safeguard customer accounts and prevent account intrusions; oversee vendors and service providers; address malicious email activities, such as phishing or account intrusions; respond to incidents, including ransomware attacks; identify and detect red flags related to identity theft; and manage operational risk as a result of remote work. In addition, the Division will be reviewing registrants' business continuity and disaster recovery plans, with particular focus on the impact of climate risk and substantial disruptions to normal business operations.

Emerging Technologies and Crypto-Assets

The Division will conduct examinations of broker-dealers and RIAs that are using emerging financial technologies to review whether firms have considered the unique risks thereof when designing their regulatory compliance programs. Such examinations will focus on firms that are or claim to be offering new products, services, or are employing new practices by focusing on whether the operations and controls related to them are consistent with firms' disclosures, the standard of conduct such firms owe to investors, and other regulatory obligations as well as such controls taking into account the unique risks associated with them. The Division will also assess whether firms' advice and recommendations regarding these products, services, and practices (including the use of algorithms) are consistent with investors' investment strategies and the standard of conduct owed to them. Additionally, the Division's examinations of firms engaged with crypto assets will continue to include review of the custody arrangements for said crypto and will also assess the offer, sale, recommendation, advise, and trading of crypto assets.

In addition to these exam priorities, on May 3, 2022, the SEC announced a near-doubling of its unit within the Division of Enforcement, now known as the Crypto Assets and Cyber Unit, to oversee see areas: crypto asset offerings, crypto assets exchanges, crypto asset lending and staking products, decentralized finance (DeFi) platforms, and non-fungible tokens (NFTs), and stablecoins. *See* GT blog post, SEC Steps Up Enforcement Activities in Crypto Markets.

Conclusion

Firms registered with the SEC should be aware that the Division's exam priorities list is not exhaustive, and exams may cover many issues not stated in this list. However, the Division exam priorities align with recent SEC announcements and activity, particularly regarding private funds, ESG, and crypto. Registered firms should take note of these priorities when reviewing compliance programs to ensure that their compliance programs address the Division's focus if such priorities relate to their programs and practices.

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