SEC 2021 Examination Priorities

The SEC Division of Examinations published its 2021 Examination Priorities on March 3 and provided highlights from its 2020 fiscal year. SEC exam staff focused in 2020 on the impact of the COVID pandemic on investment adviser operations, investment activities and the financial markets in general. Exam staff worked remotely for most of 2020 and continue to work remotely and have heavily utilized technology and data to oversee registrant operations as part of their mission to (1) improve compliance; (2) prevent fraud; (3) monitor risk; and (4) inform policy. The recently established Event and Emerging Risks Examination Team (EERT) was designed to proactively engage with the industry and address emerging threats and market events when critical matters arise (such as in the recent Gamestop/Reddit market developments).

Examinations are selected and scoped based on multiple risk factors, including:

- Products and services offered, including those identified as higher risk
- Compensation and funding arrangements
- Whether a firm has custody of client assets
- Disclosures and representations made to customers
- Prior examination observations and regulatory history
- Whether and how recently a firm has been examined
- Material changes in firm leadership or other personnel (e.g., the CCO)

Private fund focus areas for 2021 will include the following:

- Compliance risks
- Disclosures of conflicts of interest
- Disclosures of investments risks, including portfolio impact from economic conditions (e.g., real estate) and use of structured products
- Preferential treatment of certain investors
- Liquidity considerations including imposing gates or suspending fund withdrawals
- Portfolio valuations and the impact on management fees
- Disclosures and compliance related to cross trades, principal investments or distressed sales
- Conflicts around liquidity, such as adviser led fund restructurings and stapled secondary transactions
- Strategies that focus on sustainable, socially responsible investing and ESG and related practices and disclosures

In addition, compliance program core areas also continue to be a focus, including:

- Portfolio management practices
- Custody and safekeeping of client assets
- Best execution
- Fees and expenses
- Business continuity plans
- Valuation of assets

Finally, following are general focus areas for adviser and other exams:

- Fiduciary Duty – Assessment of whether advisers have fulfilled their duty of care and loyalty through:
    - Providing advice that is in the best interest of clients based on their objectives

  - Eliminating or making full and fair disclosure of conflicts of interest so clients can provide informed consent
- Fraud, Sales Practices and Conflicts – Continued focus on retail investors and appropriateness of recommendations and practices related to:
  - Various higher risk products, including private placements, structured products, REITs, municipal and fixed income securities, microcap securities and others
  - Compliance with recent changes to the definition of accredited investor:
- Fees and Expenses – Continued focus on conflicts of interest related to fees and expenses including:
  - Revenue sharing arrangements with issuers, service providers and others
  - Direct and indirect compensation to personnel
  - Management fee calculations, tiered fees, breakpoints and refunds for terminated accounts
- Information Security and Operational Resiliency – Reviews regarding measures firms have taken and controls related to:
  - Safeguarding customer accounts and preventing account intrusions and unauthorized access
  - Overseeing vendors and service providers
  - Addressing malicious email activities including phishing
  - Responding to incidents, including ransomware attacks
  - Managing operational risks from remote work arrangements
  - Online and mobile application access to accounts/information
  - Electronic storage of books and records and personal information with third-party cloud storage
  - Policies and procedures to protect investor records and information
- Financial Technology & Innovation – Continued focus on the impact of technology on activities and compliance, including
  - Automated investment, asset allocation and trading tools and platforms
  - Use of technology to facilitate compliance with regulatory requirements (RegTech)
  - Use of alternative data in investment decisions and business
  - Digital assets and distributed ledger technology, including:
    - Whether investments are in the best interest of investors
    - Portfolio management and trading practices
    - Safety of client funds and assets
    - Pricing and valuation
    - Effectiveness of compliance programs and controls
    - Supervision of outside business activities
- Anti-Money Laundering – Focus particularly for broker-dealers and investment companies to confirm whether firms:
  - Have appropriate customer identification programs
  - Are satisfying obligations to file suspicious activities reports
  - Are conducting due diligence on customers
  - Are complying with beneficial ownership requirements
  - Are conducting robust and timely independent tests of their AML programs

Attached is a link to the **full document** for review. Let us know if you have questions.