

CLIENT ALERT

SEC Division of Examinations Releases Its 2024 Examination Priorities

October 23, 2023

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On October 16, 2023, the Division of Examinations (the “Division”) of the U.S. Securities and Exchange Commission (the “SEC”) released its 2024 examination priorities (the “Priorities”).¹ The Priorities include specific examination areas relating to a number of topics for investment advisers, investment companies, broker-dealers and other market participants. While the Priorities do not single out significant focus areas as the Division has done in the recent past, the Priorities reflect an enhanced focus on registered investment companies and their importance to retail investors, particularly those saving for retirement. In a notable change from last year’s examination priorities release, the Priorities do not highlight environmental, social and governance (“ESG”) investing as an examination focus for 2024, though Division officials have cautioned that the Priorities are not exhaustive.

Consistent with the Division’s 2023 examination priorities, the Priorities include specific examination areas relating to a number of other topics such as compliance with Rule 206(4)-1 (the “Marketing Rule”) under the Investment Advisers Act of 1940 (the “Advisers Act”), examination of investment advisers to private funds, information security and operational resiliency, crypto assets and emerging financial technology.

¹ *2024 Examination Priorities*, Division of Examinations (Oct. 16, 2023), available [here](#). For additional information on the examination process, see *Investment Advisers: Assessing Risks, Scoping Examinations, and Requesting Documents*, Risk Alert of the Division (Sept. 6, 2023), available [here](#).

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A. Investment Advisers

Examining advisers' adherence to their duty of care and duty of loyalty obligations remains a priority for the Division. The Division intends to focus on: (1) investment advice regarding certain products, investment strategies, and account types; (2) the process for determining that investment advice is provided in clients' best interest; (3) economic incentives to recommend products or services; and (4) investor disclosures.

In addition, the Division continues to focus on advisers' compliance programs and whether their policies and procedures reflect the advisers' business, compensation structure, services, client base, operations, and applicable current market risks. In particular, the Division will focus on:

- (1) Marketing practice assessments for whether advisers, including advisers to private funds, have: (a) adopted and implemented reasonably designed written policies and procedures to prevent violations of the Marketing Rule; (b) appropriately disclosed marketing related information on Form ADV; and (c) maintained substantiation of their processes and other required books and records. Marketing practice reviews will also assess whether disseminated advertisements include any untrue statements of a material fact, are materially misleading, or are otherwise deceptive and, as applicable, comply with the requirements for performance (including hypothetical and predecessor performance), third-party ratings, and testimonials and endorsements;
- (2) Compensation arrangement assessments focusing on: (a) fiduciary obligations to clients, including registered investment companies, particularly with respect to an adviser's receipt of compensation for services or other material payments made by clients and others; (b) alternative ways that advisers try to maximize revenue, such as revenue earned on clients' bank deposit sweep programs; and (c) fee breakpoint calculation processes, particularly when fee billing systems are not automated;
- (3) Valuation assessments in connection with recommendations that clients invest in illiquid or difficult to value assets, such as commercial real estate or private placements;
- (4) Safeguarding assessments for 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; and
- (5) 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.

The Division also will continue to focus on advisers' policies and procedures for: (1) selecting and using third-party and affiliated service providers; (2) overseeing branch offices when advisers operate from numerous or geographically dispersed offices; and (3) obtaining informed consent from clients when advisers implement material changes to their advisory

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agreements. Such reviews will assess, among other things, whether the advisers' policies and procedures are reasonably designed and implemented and whether the procedures prevent the advisers from placing their interests ahead of clients' interests.

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

Particular Considerations Regarding Investment Advisers to Private Funds

Private funds remain a high priority of the Division, and the Division intends to focus on reviews of:²

- (1) Portfolio management risks from exposure to market volatility and higher interest rates. This may include private funds experiencing poor performance, significant withdrawals and valuation issues and private funds with more leverage and illiquid assets;
- (2) Adherence to contractual requirements regarding limited partnership advisory committees or similar structures (e.g., advisory boards), including adhering to any contractual notification and consent processes;
- (3) Accuracy of calculation and allocation of private fund fees and expenses (both fund-level and investment-level), including valuation of illiquid assets, calculation of post- commitment period management fees, adequacy of disclosures, and potential offsetting of such fees and expenses;
- (4) Due diligence practices for consistency with policies, procedures, and disclosures, particularly with respect to private equity and venture capital fund assessments of prospective portfolio companies;
- (5) Conflicts, controls, and disclosures regarding private funds managed side-by-side with registered investment companies and use of affiliated service providers;
- (6) Compliance with Advisers Act requirements regarding custody, including accurate Form ADV reporting, timely completion of private fund audits by a qualified auditor and the distribution of private fund audited financial statements; and
- (7) Policies and procedures for reporting on Form PF, including upon the occurrence of certain reporting events.

² See Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews, Advisers Act Release No. 6383 (Sept. 14, 2023), available [here](#). See also SEC Adopts Major Rule Changes for Private Fund Advisers, Willkie Client Alert (Sept. 28, 2023), available [here](#).

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B. Investment Companies

While the Division intends to continue its prioritization of examinations of registered investment companies generally, the Priorities reflect an increased focus on the importance of registered investment companies to retail investors, particularly those saving for retirement.

The Division indicates that there will be a continued focus on assessing registered investment companies' compliance programs and fund governance practices, disclosures to investors, and accuracy of reporting to the SEC. As with prior years, the Division also will review boards' processes for assessing and approving advisory and other fund fees, particularly for funds with weaker performance relative to their peers.

The Division also will review registered investment company valuation practices, particularly for those addressing fair valuation practices (e.g., implementing board oversight duties, setting recordkeeping and reporting requirements, and overseeing valuation designees), and, as applicable, will assess the effectiveness of registered investment companies' derivatives risk management and liquidity risk management programs.

The Priorities include the following additional examination topics for investment companies, which reflect several notable changes from the 2023 priorities:

- (1) 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: (a) charging different advisory fees to different share classes of the same fund; (b) identical strategies offered by the same sponsor through different distribution channels with differing fee structures; (c) high advisory fees relative to peers; and (d) high registered investment company fees and expenses, particularly those of registered investment companies with weaker performance relative to their peers. Examinations will also review the boards' approval of the advisory contract and registered investment company fees;³ and
- (2) Derivatives risk management assessments to review whether registered investment companies as well as business development companies have adopted and implemented written policies and procedures reasonably designed to prevent violations of the SEC's fund derivatives Rule 18f-4 under the Investment Company Act of 1940. Review of compliance with the derivatives rule may include review of the adoption and implementation of a derivatives risk management program, board oversight, and whether disclosures concerning the registered investment companies' or business development companies' use of derivatives are incomplete, inaccurate or potentially misleading.

³ See SEC Staff Bulletin, Differential Advisory Fee Waivers (Feb. 2, 2023), available [here](#).

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Examinations may also cover the associated registered investment companies' or business development companies' procedures for, and oversight of, derivatives valuations.

In other new language compared to the 2023 priorities, the Division will review compliance with the terms of exemptive order conditions and the issues associated with recent market dislocations and volatility, such as whether registered investment companies in liquidation are following liquidation procedures.

As with adviser examinations, the Division will continue prioritizing examinations of registered investment companies that have never been examined, including recently registered investment companies and those that have not been examined in a number of years.

C. Broker-Dealers

1. Regulation Best Interest ("Regulation BI")

Consistent with prior years, the Division will continue to address standards of conduct issues for broker-dealers. Reviews will focus on how broker-dealers are satisfying their obligations under Regulation BI.

In reviewing whether broker-dealer recommendations are in customers' best interest, areas of particular interest will include: (1) recommendations of products, investment strategies, and account types; (2) investor disclosures regarding conflicts of interest; (3) conflict mitigation practices; (4) processes for reviewing reasonably available alternatives; and (5) factors considered in light of the investor's investment profile, including investment goals and account characteristics.

The Division will focus on recommended products that are: (1) complex, such as derivatives and leveraged ETFs; (2) high cost, such as variable annuities; (3) illiquid, such as nontraded REITs and private placements; (4) proprietary; and (5) microcap securities. Examinations may also focus on recommendations to certain types of investors, such as older investors and those saving for retirement or college. The Division intends to evaluate whether the broker-dealer has established, maintained, and enforced written policies and procedures reasonably designed to achieve compliance with the areas described above as well as with Regulation BI as a whole. This analysis will include considering whether the written policies and procedures are reasonably designed based on the costs, risks, and rewards of the securities and investment strategies that the broker-dealer recommends to customers.

The Division also will continue to focus on issues affecting dual registrants, including conflicts of interest, account allocation practices (e.g., allocation of investments where an investor has more than one type of account) and account selection practices (e.g., brokerage versus advisory and wrap fee accounts). Examinations will assess broker-dealers' supervision of branch office locations.

2. Form CRS

Consistent with prior years, the Division will prioritize compliance with Form CRS, including reviews of the content of a broker-dealer's relationship summary, such as how the broker-dealer describes: (1) the relationships and services that it offers to retail customers; (2) its fees and costs; and (3) its conflicts of interest, and whether the broker-dealer discloses any disciplinary history. The Division will also evaluate whether broker-dealers have met their obligations to file their relationship summary with the SEC and deliver it to retail customers.

3. Broker-Dealer Financial Responsibility Rules

As with the 2023 examination priorities, the Division plans to focus on broker-dealer compliance with the Net Capital Rule and the Customer Protection Rule and related internal processes, procedures and controls. The areas of review will include fully paid lending programs and broker-dealer accounting for certain types of liabilities, such as reward programs, point programs, gift cards and non-brokerage services, and also will assess broker-dealer credit, interest rate, market, and liquidity risk management controls to assess whether broker-dealers have sufficient liquidity to manage stress events.

4. Broker-Dealer Trading Practices

The Division will continue to assess broker-dealer equity and fixed income trading practices, including compliance with: (1) Regulation SHO, including the rules regarding aggregation units and locate requirements; (2) Regulation ATS, and whether the operations of alternative trading systems are consistent with the disclosures provided in Forms ATS and ATS-N; and (3) Rule 15c2-11 under the Securities Exchange Act of 1934 (the "Exchange Act").

Examinations of wholesale market makers may include quote generation, order routing and execution practices, market data ingestion, regulatory controls, and risk management.

A. Self-Regulatory Organizations

1. National Security Exchanges

As with examinations in prior years, the Division's examinations will focus on whether national securities exchanges⁴ are meeting their obligations to enforce compliance with self-regulatory organization rules and the federal securities laws, including exchange order handling and exchange surveillance, investigation, and enforcement programs to detect and discipline member firm violations. In addition, examinations will focus on exchange oversight of regulatory service agreements.

⁴ National securities exchanges provide marketplaces for facilitating securities transactions and, under the federal securities laws, serve as self-regulatory organizations responsible for enforcing compliance by their members with the federal securities laws and rules and the exchanges' own rules.

2. Financial Industry Regulatory Authority (“FINRA”)

The Division will conduct risk-based oversight examinations of FINRA. This will involve selecting areas within FINRA to examine through a risk assessment process designed to identify those aspects of FINRA’s operations important to the protection of investors and market integrity, including FINRA’s implementation of investor protection initiatives such as Regulation BI and Form CRS.

3. Municipal Securities Rulemaking Board (“MSRB”)

The Division, along with FINRA and the federal banking regulators, will conduct examinations to assess compliance with MSRB rules, and applicable federal securities laws. The Division also will apply a risk assessment process, similar to the one it uses to oversee FINRA, to identify areas to examine at the MSRB. Examinations of MSRB evaluate the effectiveness of MSRB’s policies, procedures, and controls.

B. Clearing Agencies

As required by Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, the Division will conduct at least one risk-based examination of each clearing agency designated as systemically important and for which the SEC serves as the supervisory agency. These examinations will focus on clearing agencies’ core risks, processes, and controls and will cover the specific areas required by statute, including the nature of clearing agencies’ operations and assessment of financial and operational risk. Additionally, the Division will conduct risk-based examinations of other registered clearing agencies that have not been designated as systemically important.

The Division also will conduct risk-based examinations of SEC-registered clearing agencies to: (1) determine whether the clearing agencies’ respective risk management frameworks comply with the Exchange Act, and serve the needs of their members and the markets they serve; (2) assess the adequacy and timeliness of their remediation of prior deficiencies, including, for example, the role of senior leadership in the remediation process; and (3) examine other risk areas identified in collaboration with the SEC’s Division of Trading and Markets and other regulators. In addition, the Division will examine security-based swap data repositories, as well as entities operating pursuant to an SEC order exempting them from the clearing agency registration requirement under Section 17A(b)(1) of the Exchange Act.

Areas of new or heightened examination focus in fiscal year 2024 also may include, among other things, risk management of liquidity, models and model validation, margin systems, third-party service providers, operations and the internal audit function.

C. Other Market Participants

1. Municipal Advisors

As with examinations in prior years, the Division will continue to review whether municipal advisors have met their fiduciary duty obligation to clients, particularly when providing advice regarding the pricing, method of sale, and structure of municipal securities. Examiners will review whether municipal advisors are complying with their obligations to document municipal advisory relationships and disclose conflicts of interest and requirements related to registration, professional qualification, continuing education, recordkeeping, and supervision.

Examinations of solicitor municipal advisors during the second half of fiscal year 2024 will focus on compliance with new MSRB Rule G-46, which becomes effective on March 1, 2024. The Rule is designed to establish the core standards of conduct for solicitor municipal advisors, which include, among other things, disclosure of conflicts of interest and documentation of client relationships.

2. Security-Based Swap Dealers

The Division will continue to focus on whether security-based swap dealers have implemented policies and procedures related to compliance with security-based swap rules generally and are meeting their obligations under Regulation SBSR to accurately report security-based swap transactions to security-based swap data repositories. The Division also will focus on whether security-based swap dealers are complying with applicable capital, margin, and segregation requirements and relevant conditions in SEC orders governing substituted compliance.

3. Transfer Agents

The Division will focus on transfer agent processing of items and transfers, recordkeeping and record retention, safeguarding of funds and securities, and filings with the SEC. Examinations also will focus on transfer agents that service certain types of issuers, including those issuing microcap and crypto asset securities, and transfer agents that use emerging technologies to perform their transfer agent functions.

D. Risk Areas Impacting Various Market Participants

1. Information Security and Operational Resiliency

The Division will continue to review broker-dealers' and advisers' practices to prevent interruptions to mission-critical services and to protect investor information, records, and assets. Operational disruption risks remain elevated due to the proliferation of cybersecurity attacks, firms' dispersed operations, intense weather-related events, and geopolitical concerns. Given these risks and concerns, cybersecurity should remain a perennial focus area for all registrants.

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The Division will focus on registrants' policies and procedures, internal controls, oversight of third-party vendors, governance practices, and responses to cyber-related incidents, including those related to ransomware attacks. Part of this review will consider whether registrants adequately train staff regarding their identity theft prevention program and their policies and procedures designed to protect customer records and information.

With respect to third-party products and services in particular, the Division will continue to assess how registrants identify and address risks to essential business operations. The Division also will look at the concentration risk associated with the use of third-party providers, including how registrants are managing this risk and the potential impact to the U.S. securities markets.

Examinations of broker-dealers and advisers will continue to look at firms' practices to prevent account intrusions and safeguard customer records and information, including personally identifiable information, especially as it pertains to their multiple other offices.

The SEC adopted rule changes to shorten the standard settlement cycle for most broker-dealer transactions from two business days after the trade date to one business day after the trade date. In connection with this rule change, the Division will assess registrant preparations associated with this shortening of the settlement cycle, which has a compliance date of May 28, 2024.

Examinations of broker-dealers and advisers will continue to look at firms' practices to promote cyber resiliency. Reviews will include firm practices, policies, and procedures to prevent account intrusions and safeguard customer records and information, including personally identifiable information. Additional focus will be on the cybersecurity issues associated with the use of third-party vendors, including registrant visibility into the security and integrity of third-party products and services. The Division will also review whether there has been an unauthorized use of third-party providers.

2. Crypto Assets and Emerging Financial Technology

The Division continues to observe crypto assets and their associated products and services and emerging financial technology. Consistent with 2023 examinations, the Division will focus on broker-dealers and advisers offering new products and services or employing new practices, particularly technological and online solutions that service online accounts. The Division remains focused on certain services, including broker-dealer mobile applications, automated investment tools, artificial intelligence, and trading algorithms or platforms, and the risks associated with the use of emerging technologies and alternative sources of data.

Examinations will focus on the offer, sale, recommendation of, advice regarding, trading in, and other activities in crypto assets or related products. Specifically, the Division will assess whether registrants involved with crypto assets: (1) meet and follow applicable standards of conduct when recommending or advising customers and clients, with a focus on an initial and ongoing understanding of the products, particularly when the investors are retail-based (including older investors) and

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investments involve retirement assets; and (2) routinely review, update, and enhance their compliance practices (including crypto asset wallet reviews, custody practices, Bank Secrecy Act (the “BSA”) compliance reviews, and valuation procedures), risk disclosures, and operational resiliency practices (i.e., data integrity and business continuity plans), if required. With respect to crypto assets that are funds or securities, the Division will consider whether registered advisers are complying with the custody requirements under the Advisers Act Custody Rule: Rule 206(4)-2. The Division will also assess whether any technological risks associated with the use of blockchain and distributed ledger technology have been addressed, including whether compliance policies and procedures are reasonably designed, accurate disclosures are made and the risks pertaining to the security of crypto asset securities are addressed, if required by applicable law.

3. Regulation Systems Compliance and Integrity (“SCI”)

The Division will continue to evaluate whether SCI entities⁵ have established, maintained, and enforced written policies and procedures. One area of focus will include whether the policies and procedures of SCI entities are reasonably designed to ensure the security of the SCI systems, including the physical security of the systems housed in data centers.

4. Anti-Money Laundering (“AML”)

The BSA requires certain financial institutions, including broker-dealers and certain registered investment companies, to establish AML programs that are tailored to address the risks associated with the firm’s location, size, and activities, including the customers they serve, the types of products and services offered, and how those products and services are offered. These programs must, among other things, include policies and procedures reasonably designed to identify and verify the identity of customers and beneficial owners of legal entity customers, perform customer due diligence (as required by the Customer Due Diligence rule), monitor for suspicious activity, and, where appropriate, file Suspicious Activity Reports (SARs) with the Financial Crimes Enforcement Network. SARs are used to detect and combat terrorist financing, public corruption, market manipulation, and a variety of other fraudulent behaviors.

Given the importance of these requirements, the Division will continue to prioritize examinations of broker-dealers and registered investment companies to ensure they 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.

⁵ Regulation SCI applies to “SCI entities,” which include self-regulatory organizations (including stock and options exchanges, registered clearing agencies, FINRA and the MSRB), alternative trading systems that trade National Market System (“NMS”) stocks and non-NMS stocks exceeding specified volume thresholds, disseminators of consolidated market data and certain exempt clearing agencies.

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The Division will also review whether broker-dealers and advisers are monitoring and complying with Office of Foreign Assets Control sanctions.

E. Conclusion

The Priorities reflect a focus on registered investment companies and their importance to retail investors, particularly those saving for retirement, as well as a continued focus on the examination of investment advisers to private funds, information security and operational resiliency, and emerging financial technology such as crypto assets and artificial intelligence. Market participants should evaluate their business activities and enhance their compliance policies and procedures in light of the agency's increased regulatory scrutiny over the financial services industry.

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