

CLIENT ALERT

SEC Division of Examinations Releases Its 2023 Examination Priorities

February 9, 2023

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On February 7, 2023, the Division of Examinations (the “Division”) of the U.S. Securities and Exchange Commission (the “SEC”) released its 2023 examination priorities (the “Priorities”).¹ The Priorities include four topics that the Division identifies as “Notable New and Significant Focus Areas”: (i) compliance with recently adopted rules under the Investment Advisers Act of 1940 (“Advisers Act”) and the Investment Company Act of 1940 (“Investment Company Act”); (ii) registered investment advisers (“RIAs”) to private funds; (iii) standards of conduct, including Regulation Best Interest (“Regulation BI”), fiduciary duties and Form CRS; and (iv) environmental, social and governance (“ESG”) investing.

In addition, consistent with the Division’s 2022 examination priorities, the Priorities include specific examination areas relating to a number of other topics, discussed below, notably including information security and operational resiliency as well as crypto assets and emerging financial technology. With respect to information security and operational resiliency, the Division will continue to review broker-dealers’ and RIAs’ practices to prevent interruptions to mission-critical services and to protect investor information, records and assets by focusing on firms’ policies and procedures, governance practices and responses to cyber-related incidents. With respect to crypto assets, the Division will focus on “the offer, sale, or recommendation of, advice regarding and trading in crypto or crypto-related assets.” With respect to emerging financial technology, the Division will focus on broker-dealer mobile applications and RIAs providing automated digital investment advice (often referred to as “robo-advisers”) as well as on firms’ employment of digital engagement practices.

¹ 2023 *Examination Priorities*, Division of Examinations (Feb. 7, 2023), available [here](#).

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A. New or Significant Focus Areas

1. Compliance with Recently Adopted Rules under the Advisers Act and Investment Company Act

The Division intends to prioritize examining for compliance with certain recently adopted rules under the Advisers Act and the Investment Company Act, including: Advisers Act Rule 206(4)-1 (the “Marketing Rule”), Investment Company Act Rule 18f-4 (the “Derivatives Rule”) and Investment Company Act Rule 2a-5 (the “Fair Valuation Rule”).

Marketing Rule.² The Division intends to assess whether RIAs have adopted and implemented written policies and procedures that are reasonably designed to prevent violations of the Marketing Rule by RIAs and their supervised persons. The Division will also review whether RIAs have complied with the substantive requirements of the Marketing Rule, including the requirement that RIAs have a reasonable basis for believing they will be able to substantiate material statements of fact and requirements for performance advertising, testimonials, endorsements and third-party ratings.³

Derivatives Rule.⁴ If a fund relies on the Derivatives Rule, the Division will, among other things: (1) assess whether registered investment companies, including mutual funds (other than money market funds), exchange-traded funds (“ETFs”) and closed-end funds, as well as business development companies (“BDCs”), have adopted and implemented policies and procedures reasonably designed to manage the funds’ derivatives risks and to prevent violations of the Derivatives Rule pursuant to Investment Company Act Rule 38a-1; and (2) otherwise review for compliance with the rule, including the requirement to adopt and implement a derivatives risk management program, board oversight, and whether disclosures concerning the fund’s use of derivatives are incomplete, inaccurate or potentially misleading.

Fair Valuation Rule.⁵ To examine for compliance with the Fair Valuation Rule, the Division intends, among other things: (1) to assess funds’ and fund boards’ compliance with the new requirements for determining fair value, implementing board oversight duties, setting recordkeeping and reporting requirements, and permitting fund boards to designate valuation designees to perform fair value determinations subject to oversight by the board; and (2) to review whether adjustments have been made to valuation methodologies, compliance policies and procedures, governance practices, service provider oversight, and/or reporting and recordkeeping.

² The compliance date for the Marketing Rule was November 4, 2022. See *SEC Adopts Investment Adviser Marketing Rule to Update Its Advertising*, Willkie Client Alert (Jan. 27, 2021), available [here](#). See also *Solicitation Rules and Reminder: The Marketing Rule’s Upcoming November 4, 2022 Compliance Date*, Willkie Client Alert (Oct. 7, 2022), available [here](#).

³ See *Examinations Focused on the New Investment Adviser Marketing Rule*, Risk Alert of the Division (Sept. 19, 2022), available [here](#). See also *Marketing Compliance Frequently Asked Questions* (updated Jan. 11, 2023), available [here](#).

⁴ See *The SEC Adopts Derivatives Rule for Registered Investment Companies and BDCs*, Willkie Client Alert (Jan. 5, 2021), available [here](#).

⁵ See *SEC Adopts Fair Valuation Rule for Registered Funds and BDCs*, Willkie Client Alert (Feb. 4, 2021), available [here](#).

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2. RIAs to Private Funds

Private funds remain a top priority of the Division. Given that RIAs to private funds represent a significant portion of RIAs, the Division intends to focus on private fund RIAs': (1) conflicts of interest; (2) calculation and allocation of fees and expenses, including the calculation of post-commitment period management fees and the impact of valuation practices at private equity funds; (3) compliance with the new Marketing Rule, including performance advertising and compensated testimonials and endorsements, such as solicitations; (4) policies and practices regarding the use of alternative data and compliance with Advisers Act Section 204A; and (5) compliance with the Advisers Act Rule 206(4)-2, where applicable, including timely delivery of audited financials and selection of permissible auditors.⁶

The Division also intends to focus on RIAs to private funds "with specific risk characteristics," including those that advise (1) highly-leveraged funds; (2) private funds managed side-by-side with BDCs; (3) private equity funds that use affiliated companies or personnel as service providers; (4) private funds that hold crypto or commercial real estate holdings; (5) private funds that invest in or sponsor Special Purpose Acquisition Companies ("SPACs"); and (6) private funds involved in adviser-led restructurings, including continuation funds. Several of these items reflect new characteristics the Division plans to focus on, as compared to the Division's 2022 examination priorities.

3. Standards of Conduct: Regulation BI, Fiduciary Duty and Form CRS

Consistent with the 2021 and 2022 examination priorities, the Division will continue to address standards of conduct issues for broker-dealers and RIAs in 2023 examinations. Reviews will focus on how broker-dealers and RIAs are satisfying their obligations under Regulation BI⁷ and the Advisers Act fiduciary standard⁸ to act in the best interests of retail investors and not to place their own interests ahead of retail investors' interests.

Regulation BI and Fiduciary Duty. Examinations of broker-dealers and RIAs will continue to assess: (1) investment advice and recommendations with regard to products (e.g., derivatives, leveraged ETFs, other exchange-traded products, high cost and illiquid products and proprietary products), investment strategies, and account types; (2) disclosures made to investors and whether such disclosures include all material facts relating to the conflicts of interest associated with the advice and recommendations; (3) processes for making best interest evaluations, including those for reviewing reasonably available alternatives, evaluating costs and risks, and identifying and addressing conflicts of interest; and (4) factors considered in light of the investor's investment profile, including investment goals and account characteristics (e.g., whether an investor is a senior or is saving for retirement). In addition, in examinations of RIAs, the SEC staff will review whether

⁶ See *Observations from Examinations of Private Fund Advisers*, Risk Alert of the Division (Jan. 27, 2022), available [here](#).

⁷ See *Observations from Broker-Dealer Examinations Related to Regulation Best Interest*, Risk Alert of the Division (Jan. 30, 2023), available [here](#).

⁸ See *Standards of Conduct for Broker-Dealers and Investment Advisers Account Recommendations for Retail Investors*, SEC Staff Bulletin (Mar. 29, 2022), available [here](#) (Question and answer bulletin from the SEC Staff covering broker-dealer and investment adviser standards of conduct when making account recommendations to retail investors).

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conflicts of interest disclosures are sufficient such that a client can provide informed consent to the conflict, whether express or implied.

With respect to conflicts of interest involving retail investors, the Division intends to assess economic incentives that financial professionals have to recommend products, services or account types, such as revenue sharing, commissions, or other incentivizing revenue arrangements. The SEC staff will examine whether firm policies and procedures identify such conflicts of interest and whether such policies and procedures are tailored to the firm's particular business model and are periodically reviewed and updated. The Division will also review whether firms have customer or client agreements that purport to waive or limit firms' standard of conduct, such as through hedge clauses.

Form CRS. With respect to Form CRS compliance, examinations will assess whether firms have (1) delivered their relationship summaries to existing, new and prospective retail investors; (2) filed their relationship summary with the SEC; and (3) posted the current relationship summary on the firm's public website.

4. ESG Investing

Consistent with the Division's 2022 examination priorities, ESG investing continues to be a focus for examinations in 2023. The Division intends to assess ESG-related advisory services and fund offerings to determine whether funds are operating in the manner set out in their disclosures. In addition, the Division intends to assess whether ESG products are appropriately labeled and whether recommendations of such products for retail investors are made in the best interests of investors.

B. Information Security and Operational Resiliency

Consistent with the Division's 2022 examination priorities, information security and operational resiliency will remain a priority in 2023 examinations. In light of market events, geopolitical concerns and the proliferation of cybersecurity attacks, the Division explained that the risk environment related to cybersecurity is elevated. Accordingly, cybersecurity will continue to be an examination focus for registrants, particularly RIAs, broker-dealers, investment companies, municipal advisors, transfer agents, exchanges and clearing agencies.

The Division will also continue to review broker-dealers' and RIAs' practices to prevent interruptions to mission-critical services and to protect investor information, records and assets. In particular, the Division intends to focus on firms' policies and procedures, governance practices and responses to cyber-related incidents to determine whether they are reasonably designed to safeguard customer records and information and whether the location of such records has been properly disclosed to the SEC. In addition, the Division will evaluate whether broker-dealers and RIAs are complying with Regulations

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S-P and S-ID, as applicable.⁹ In addition, the Division will continue to evaluate firm practices designed to prevent account intrusions and safeguard customer records and information, including personally identifiable information.

The Division also plans to examine the use of third-party vendors. In particular, the SEC staff intends to focus on registrants' visibility into the security and integrity of third-party products and services and the unauthorized use of third-party providers.¹⁰ In a change from the 2022 examination priorities, the Priorities do not specifically refer to business continuity and disaster recovery plans of registrants.

The scope of these examinations will continue to assess systemically significant operational resiliency planning, including registrants' efforts to consider and/or address climate-related risks.

C. Crypto Assets and Emerging Financial Technology

The Division has continued to observe the proliferation of certain types of investments (e.g., crypto assets and their associated products and services) and emerging financial technology (e.g., broker-dealer mobile apps and RIAs choosing to provide automated digital investment advice to their clients).

In light of disruptions caused by recent financial distress among crypto asset market participants, the Division intends to conduct examinations focusing on the offer, sale, or recommendation of, advice and trading in crypto or crypto-related assets. Specifically, the staff intends to assess whether market participants involved with crypto or crypto-related assets: (1) met and followed their respective standards of care when making recommendations, referrals, or providing investment advice, to the extent required; and (2) routinely reviewed, updated, and enhanced their compliance, disclosure and risk management practices.

In addition, the Division will conduct examinations of broker-dealers and RIAs that are employing new practices, particularly technological and online solutions intended to meet the demands of compliance and marketing and to service investor accounts (e.g., online brokerage services, internet advisers and robo-advisers). In particular, broker-dealer and RIA examinations will focus on firms that employ digital engagement practices and the related tools and methods to assess whether: (1) recommendations were made or advice was provided (e.g., through the use of social media marketing and social trading platforms); (2) representations are fair and accurate; (3) operations and controls in place are consistent with disclosures made to investors; (4) any advice or recommendations are in the best interest of the investor and take into account the investor's financial situation and investment objectives; and (5) risks associated with such practices are considered, including the impact these practices may have on certain investors. In an update to the 2022 examination

⁹ See Observations From Broker-Dealer and Investment Adviser Compliance Examinations Related to Prevention of Identity Theft Under Regulation S-ID, Risk Alert of the Division (Dec. 5, 2022), available [here](#).

¹⁰ See *SEC Proposes New Rule to Require Investment Advisers to Conduct Additional Oversight of Service Providers*, Willkie Client Alert (Nov. 9, 2022), available [here](#). See also *Outsourcing by Investment Advisers*, Advisers Act Release No. 6,176 (Oct. 26, 2022), File No. S7-25-22, available [here](#).

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priorities, the Priorities release specifically defines “digital enhancement practices” to mean “behavioral prompts, differential marketing, game-like features (commonly referred to as gamification), and other design elements or features designed to engage with retail investors on digital platforms (e.g., websites, portals, and applications), as well as the analytical and technological tools and methods.”

D. Investment Advisers and Investment Companies

Focus Areas for Examinations of RIAs. The Division remains focused on whether RIA operations and compliance practices appropriately consider market factors, including market factors that may affect RIA regulatory filings. The Division noted that examinations tend to review compliance programs and related disclosures of core areas, such as custody and safekeeping of client assets, valuation, portfolio management, and brokerage and execution. In addition, examinations generally include a review of conflicts, compliance issues and oversight and approval processes related to RIA fees and expenses, including revenue earned on clients’ bank deposit sweep programs.

An additional focus in 2023 examinations will be RIA policies and procedures for retaining and monitoring electronic communications and selecting and using third-party service providers.¹¹

Focus Areas for Registered Investment Companies, Including Mutual Funds and ETFs. Noting the importance of registered investment companies to retail investors, the Division indicated that there will be a continued focus on registered investment company compliance programs and governance practices, disclosures to investors and accuracy of reporting to the SEC in 2023 examinations. In particular, the Division intends to focus on fiduciary obligations of RIAs to registered investment companies, particularly with respect to their receipt of compensation for services or other material payments made by registered investment companies. The Division will also continue to evaluate boards’ processes for assessing and approving advisory and other fund fees, particularly for funds with weaker performance relative to their peers. In addition, the Division intends to assess the effectiveness of funds’ derivatives risk management programs and liquidity risk management programs, as applicable.

The Priorities include a new list of fund characteristics that the Division will focus on, including turnkey funds (*i.e.*, funds that use a turnkey solutions provider for infrastructure purposes), mutual funds that have been converted to ETFs and loan-focused funds, for example. The Division intends to review such funds’ disclosures, marketing, conflicts and compliance with portfolio management disclosures, among other areas. In examining such materials, the Division will continue to focus on corporate governance, the advisory contract approval process, codes of ethics and compliance and oversight, including oversight of service providers.

¹¹ *Id.*

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E. Broker-Dealer and Exchange Examination Program

Broker-Dealers. Consistent with prior years, the Division plans to examine broker-dealer compliance and supervisory programs. This year, the Division intends to focus such examinations on compliance and supervisory programs for electronic communications related to firm business and the recordkeeping for such electronic communications. In addition, the Division will prioritize the examination of broker-dealers for compliance with the Customer Protection Rule and the Net Capital Rule, including the adequacy of internal processes, procedures and controls. Examiners also will assess credit, market and liquidity risk management controls designed to ensure that firms have sufficient liquidity to manage stress events.

The Division will continue to assess broker-dealer trading practices in both equities and fixed income securities, examining conflicts of interest in order routing and execution and compliance with Regulation SHO and Regulation ATS. The Division will also continue to focus on issues specific to municipal securities and other fixed income securities, such as fairness of pricing, compliance with confirmation disclosure requirements, and municipal securities dealer and municipal underwriter compliance with obligations related to municipal issuer disclosure. In addition, the Division will continue to focus on issues specific to over-the-counter securities and microcap securities, such as compliance with penny stock disclosure rules.

National Securities Exchanges. The Division intends to examine the national securities exchanges¹² to assess whether they are meeting their obligations under the federal securities laws. Examinations will focus on exchange operations to monitor, investigate, and enforce member and listed company compliance with self-regulatory organizations rules and the federal securities laws.

Security-Based Swap Dealers (“SBSDs”). Examinations of SBSBs will continue to assess whether SBSBs have implemented policies and procedures related to compliance with security-based swap (“SBS”) rules. In addition to the 2022 examination priorities, the Division intends to focus on whether SBSBs are meeting their obligations under Regulation SBSR, particularly the requirement to accurately report SBS transactions to swap data repositories.

Municipal Advisors. The Division will continue to examine whether municipal advisors have met their fiduciary duty to municipal entity clients as well as whether municipal advisors have complied with Municipal Securities Rulemaking Board (“MSRB”) Rule G-42 establishing core standards of conduct and duties. The Division will also continue to assess whether municipal advisors have disclosed conflicts of interest and have met their relationship documentation, registration, professional qualification and supervision requirements.¹³

Transfer Agents. The Division will continue to examine transfer agents’ core functions: the timely processing of items and transfers, recordkeeping and record retention, safeguarding of funds and securities, and filing obligations with the SEC.

¹² 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.

¹³ See *Recent Observations from Municipal Advisor Examinations*, Risk Alert of the Division (Aug. 22, 2022), available [here](#).

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Examination candidates will include transfer agents that service microcap and crypto assets and transfer agents that use emerging technology, among others.

F. Clearance and Settlement

The Division will conduct, as required by Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, 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 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 which have not been designated as systemically important. The Division will also examine both groups of clearing agencies for compliance with the SEC's Standards for Covered Clearing Agencies, which are rules that require covered clearing agencies to, among other things, have policies and procedures that address maintaining sufficient financial resources, protecting against credit risks, managing member defaults and managing operational and other risks.

The Division will also conduct risk-based examinations of SEC-registered clearing agencies to: (1) determine whether their respective risk management frameworks comply with the Securities Exchange Act of 1934 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. Areas of focus highlighted by the Division include liquidity risk management, counterparty credit stress testing, governance and escalation and the compliance function, among other areas.

G. Regulation Systems Compliance and Integrity ("SCI")

The Division also indicated that it will evaluate whether SCI entities¹⁴ have established, maintained, and enforced written policies and procedures. Areas of focus will include: (1) software development programs of SCI entities designed to review and keep current systems development and testing methodologies; (2) SCI systems operated by third parties; (3) network segmentation in the event of security breaches; and (4) security and operational risks posed by reliance on external application programming interfaces.

¹⁴ Regulation SCI applies to "SCI entities," which include self-regulatory organizations (including stock and options exchanges, registered clearing agencies, Financial Industry Regulatory Authority ("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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H. FINRA and MSRB

FINRA. The Division conducts risk-based oversight examinations of FINRA. It selects 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 new investor protection initiatives. The analysis is informed by collecting and analyzing extensive information and data, regular meetings with key functional areas within FINRA, and outreach to various stakeholders, including broker-dealers and investor groups. Based on the outcome of this risk-assessment process, the Division conducts inspections of FINRA's major regulatory programs. The Division also conducts oversight inspections of FINRA's examinations of certain broker-dealers and municipal advisors. From its observations during all of these inspections and examinations, the Division makes detailed recommendations to improve FINRA's programs, its risk assessment processes, and its future examinations.

MSRB. The Division, along with FINRA and the federal banking regulators, conducts examinations of registered firms to assess compliance with MSRB rules. The Division also applies a risk assessment process, similar to the one it uses to oversee FINRA, to identify areas to examine at MSRB. Examinations of MSRB evaluate the effectiveness of MSRB's policies, procedures, and controls.

I. Anti-Money Laundering ("AML")

The Bank Secrecy Act requires financial institutions, including broker-dealers and registered investment companies, to establish AML programs that are tailored to address the risks associated with a firm's location, size, and activities, including customers served, the type of products and services offered and the means by which 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 for compliance with their AML obligations to assess, among other things, whether firms have established appropriate customer identification programs and whether they 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 examinations is to evaluate whether broker-dealers and registered investment companies have adequate policies and procedures in place that are reasonably designed to identify suspicious activity and illegal money-laundering activities. In addition to the 2022 examination priorities, the Division also noted it will review firms' monitoring and compliance with Office of Foreign Assets Control- and U.S. Department of the Treasury-related sanctions.

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J. The London Interbank Offered Rate (“LIBOR”) Transition

The Division highlighted that RIAs, broker-dealers, investment companies, municipal advisors, transfer agents and clearing agencies could be significantly impacted by the discontinuation of LIBOR. The Division will continue to assess broker-dealer and RIA preparation for the transition away from LIBOR, which is currently scheduled for discontinuation in mid-2023.

K. Conclusion

The 2023 Priorities reflect a focus on recently adopted rules under the Advisers Act and the Investment Company Act, including the Marketing Rule, a continued focus on private funds and ESG products and disclosure, and a growing emphasis on crypto assets and emerging financial technologies. Market participants should evaluate their business activities and enhance their compliance policies and procedures in light of the Gensler administration’s increased regulatory scrutiny over the financial services industry.

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