

2022 SEC Division of Examinations Priorities

April 6, 2022

On March 30, 2022, the U.S. Securities and Exchange Commission’s (“SEC”) Division of Examinations (“EXAMS” or “Division”) released its 2022 Examination Priorities (“2022 Priorities”).¹ The Division’s ambitious exam agenda spans virtually the entire spectrum of the securities markets, encompassing areas such as private funds, retail investors and working families, fintech, and crypto-assets. Although the Division casts several areas as “priorities,” the document actually provides a comprehensive overview of topics that the Division plans to examine in the upcoming year.

In addition, while many items covered in the 2022 Priorities are cast as perennial risks, the Division highlights, for the first time, “significant focus areas” that will receive heightened examination attention. Those focus areas include: (1) private funds; (2) Environmental, Social, and Governance (“ESG”) investing; (3) standards of conduct, including Regulation Best Interest (“Reg BI”); (4) information security and operational resiliency (i.e., cybersecurity); and (5) fintech and crypto-assets. Not surprisingly, many of these top examination priorities align with the topics covered by the SEC’s similarly ambitious and expansive rulemaking agenda. We have already seen equally aggressive EXAMS and Enforcement activity in these priority areas, and we expect that activity and focus only to increase throughout 2022.

General Themes

The Importance of Compliance

The 2022 Priorities reflect the Division’s focus on improving and promoting compliance and on the empowerment of compliance officers. At the outset, the 2022 Priorities emphasize that the Division’s December 2020 name change (from the Office of Compliance Inspections and Examinations to the Division of Examinations) was not intended to “deemphasize our long-standing focus on, and commitment to, promoting compliance and to empowering compliance officers,” stating that “[t]he importance of

¹ 2022 Examination Priorities, Division of Examinations, U.S. Securities and Exchange Commission (Mar. 30, 2022), available [here](#).

improving and promoting compliance remains at the forefront of the Division's work." To this end, the 2022 Priorities highlight the importance of "compliance engagement across business lines" within organizations, knowledgeable Chief Compliance Officers, and a commitment to compliance by firm principals. The 2022 Priorities also emphasize resiliency within compliance programs, especially in light of continued challenges resulting from the COVID-19 pandemic.

The Division notes that over the course of its examinations, it has observed common features shared by "resilient compliance programs:" (1) inclusivity, described as "participation and inputs across all business and operational lines;" (2) well-thought-out change management, with flexibility to "adjust to known variables in operations and business" and established processes for event and effectiveness monitoring; and (3) developed review and testing protocols, to ensure the "on-going adequacy and effectiveness of a compliance program" and affirm "that policies and procedures are operating as designed and to ensure the detection of outlier events or unusual patterns." The Division notes that this "focus on compliance, support of compliance, and compliance empowerment will continue" moving forward.

Likely Examination Candidates

The 2022 Priorities identify the following types of firms and business models on which the Division intends to focus its efforts:

- **Registered Investment Advisers ("RIAs") to Private Funds.** The Division will focus efforts on assessing the compliance of RIAs to private funds. The rationale underlying this focus is the "significance of examination findings over the past several years, and the size, complexity, and significant growth" of the market for such RIAs.
- **RIAs Never or Not Recently Examined.** RIAs that "have never been examined, including recently registered firms, and those that have not been examined for a number of years" remain a focus for EXAMS. Such examinations will typically "focus on firms' compliance programs."
- **Dual Registrants.** Another area of focus will be firms registered as both RIAs and broker-dealers. The Division will approach such examinations with a particular emphasis on "potential conflicts of interest present at these firms," including "account recommendations and allocation of investments across different accounts."
- **"Robo-advisers" and Use of Emerging Technologies.** The Division will look at firms providing "automated digital investment advice" as well as at firms using technology to offer "new products and services" or enable "new practices." The

specific practices highlighted include the sale of fractional shares, use of “Finfluencers” in marketing, and digital engagement practices (such as “gamification”). The Division will devote attention to whether firms have considered the “unique risks” of these activities when designing their regulatory compliance programs. This topic demonstrates the SEC’s continuing attention to the supposed “gamification” of finance, as also reflected in an August 2021 request for comment issued by the Commission regarding the use of such technology by firms.²

Increased Enforcement Referrals

Finally, reviewing the results from the previous year, EXAMS referred to the Division of Enforcement approximately 6.3% of the 3,040 examinations conducted during FY2021. This reflects an increase from the lower level of referrals from EXAMS to Enforcement during Chairman Clayton’s tenure—most recently, 4.4% in FY2020. Under the Biden Administration, we expect the referral percentage to continue to rise to levels resembling those seen in the later years of the Obama Administration, which averaged more than 11% from 2013 to 2016 (with a high of 13% during FY2013).

Heightened Focus on Private Funds

Notably, examinations of RIAs to private funds lead the Division’s priorities for the upcoming year, which marks a significant increase in attention to such registrants relative to the past several years. In explaining the rationale for prioritizing such examinations, the 2022 Priorities note that more than 5,000 RIAs, constituting more than 35% of all RIAs, manage approximately \$18 trillion in private fund assets, representing a 70% increase in the assets managed by advisers to private funds in the past five years. Chair Gensler cited this same “\$18 trillion” statistic in his statement in connection with the February 9, 2022 release of proposed rules for advisers to private funds.³ As part of such exams, the Division will evaluate issues related to an adviser’s fiduciary duty under the Investment Advisers Act of 1940, as amended (“Advisers Act”) and assess risks involving “compliance programs, fees and expenses, custody, fund audits, valuation, conflicts of interest, disclosure of investment risks, and controls around material nonpublic information.”

² See Press Release, SEC Requests Information and Comment on Broker-Dealer and Investment Adviser Digital Engagement Practices, Related Tools and Methods, and Regulatory Considerations and Potential Approaches; Information and Comments on Investment Adviser Use of Technology (Aug. 27, 2021), <https://www.sec.gov/news/press-release/2021-167>.

³ See Statement on Private Fund Advisers Proposal, U.S. Securities and Exchange Commission Chair Gary Gensler (Feb. 9, 2022), <https://www.sec.gov/news/statement/gensler-statement-private-fund-advisers-proposal-020922>.

Beyond this entity-level focus on RIAs to private funds, the Division intends to look at five specifically highlighted issues:

- “(1) the 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;
- (2) 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;
- (3) 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 that serve as important gate-keepers for private fund investors;
- (4) the adequacy of disclosure and compliance with any regulatory requirements for cross trades, principal transactions, or distressed sales; and
- (5) conflicts around liquidity, such as RIA-led fund restructurings, including stapled secondary transactions where new investors purchase the interests of existing investors while also agreeing to invest in a new fund.”

The 2022 Priorities further note that the Division will “also review private fund advisers’ portfolio strategies, risk management, and investment recommendations and allocations” with a specific eye to “conflicts and disclosures.” One of the conflicts specifically noted is private fund investments in Special Purpose Acquisition Companies (“SPACs”) where the “private fund adviser is also the SPAC sponsor.” The Priorities conclude the discussion of private funds by noting that EXAMS will focus on “private funds with indicia of systemic importance, such as outsized counterparty exposure or gross notional exposure when compared to similarly situated firms.”

Additional Significant Focus Areas

The Division also highlights the following areas as high priorities:

Environmental, Social, and Governance Investing

The 2022 Priorities’ focus on ESG investing reflects continuity with the 2021 Priorities and EXAMS’s continued scrutiny of this subject matter (as reflected in EXAMS’s April 9,

2021 Risk Alert on ESG investment practices in the advisory space).⁴ The Division notes in the 2022 Priorities that RIAs and registered funds are “increasingly offering and evaluating investments that employ ESG strategies or incorporate certain ESG criteria” in response to investor demand and that the increase in ESG investment and product offerings may create risks of materially false and misleading disclosures regarding portfolio management practices.

In particular, the Division notes that risk in the ESG space may be compounded as a result of “the lack of standardization in ESG investing terminology” along with the “variety of approaches to ESG investing” and “the failure to effectively address legal and compliance issues with new lines of business and products.” This commentary reflects agency-wide concerns about ESG-related compliance risks, as further demonstrated by the SEC’s recent issuance of proposed rules to standardize climate-related disclosures for investors.⁵ The Division plans to focus on ESG-related advisory services and investment products (including both registered and private fund offerings) and will examine whether RIAs and registered funds are “accurately disclosing their ESG investing approaches,” “voting client securities in accordance with proxy voting policies and procedures and whether the votes align with their ESG-related disclosures and mandates,” and accurately representing “the ESG factors considered or incorporated into portfolio selection.”

Standards of Conduct—Regulation Best Interest, Fiduciary Duty, and Form CRS

In another point of continuity with the previous year’s Priorities, the Division will focus on standards of conduct issues for broker-dealers (particularly under Reg BI) and involving the fiduciary standard applicable to RIAs. EXAMS plans to examine whether broker-dealers and RIAs are “satisfying their obligations . . . not to place their own interests ahead of retail investors’ interest” and will assess practices regarding consideration of investment alternatives, management of conflicts of interest, trading, disclosures, account selection, and account conversion and rollovers.

For broker-dealers specifically, EXAMS “will review firms’ recommendation and sales practices related to SPACs, structured products, leveraged and inverse exchange traded products (ETPs), REITs, private placements, annuities, municipal and other fixed income securities, and microcap securities.” These examinations will include an

⁴ See Risk Alert, U.S. Securities and Exchange Commission, The Division of Examinations’ Review of ESG Investing (Apr. 9, 2021), <https://www.sec.gov/files/esg-risk-alert.pdf>; see also Debevoise Update, SEC Division of Examinations Issue ESG Risk Alert (Apr. 16, 2021), <https://www.debevoise.com/insights/publications/2021/04/sec-division-of-examinations-issues-esg-risk-alert>.

⁵ See Press Release, U.S. Securities and Exchange Commission, SEC Proposes Rules to Enhance and Standardize Climate-Related Disclosures for Investors (Mar. 21, 2022), <https://www.sec.gov/news/press-release/2022-46>.

evaluation of compensation structures and potential conflicts involving such structures; sales by highly compensated financial professionals; and reviews of practices, policies, and procedures “concerning the evaluation of cost and reasonably available alternatives as they relate to recommendations of these products being in the investor’s best interest.”

For RIAs, the Division will focus on whether advisers have satisfied their duties of care and loyalty, “including best execution obligations, financial conflicts of interest and related impartiality of advice, and any attendant client disclosures.” EXAMS will pay close attention to revenue-sharing arrangements, recommendations regarding “more expensive classes of investment products when lower cost classes are available,” recommendations regarding wrap fee accounts without any assessment that “such accounts are in the best interests of clients,” and recommendations of proprietary products that result in “additional or higher fees.”

For dual registrants, EXAMS will place particular emphasis on reviewing “potential conflicts of interest present at these firms, including with regard to account recommendations and allocation of investments across different accounts.”

Information Security and Operational Resiliency

Consistent with the SEC’s prioritization of cybersecurity across market participants and the recent release of proposed cybersecurity rules for RIAs and funds,⁶ the Division “will review broker-dealers’ and RIAs’ practices to prevent interruptions to mission-critical services and to protect investor information, records, and assets.”

The Division’s cybersecurity priorities include many previously featured examination areas, including account takeovers, phishing, supervision of vendors and service providers, and ransomware. In addition, the exigencies of the pandemic and the work-from-home environment continue to be an area of concern, with specific reference to the operational risk occasioned by a “dispersed workforce.” The Division will also continue to review compliance with Regulations S-P and S-ID, as applicable.

The 2022 Priorities also integrate ESG and cybersecurity concepts with planned examinations of the impact of climate change on registrants’ business continuity and disaster recovery plans. This examination area will test registrants’ “resiliency as

⁶ See Press Release, U.S. Securities and Exchange Commission, SEC Proposes Cybersecurity Risk Management Rules and Amendments for Registered Investment Advisers and Funds (Feb. 9, 2022), <https://www.sec.gov/news/press-release/2022-20>; see also Press Release, U.S. Securities and Exchange Commission, SEC Proposes Rules on Cybersecurity Risk Management, Strategy, Governance, and Incident Disclosure by Public Companies (Mar. 9, 2022), <https://www.sec.gov/news/press-release/2022-39>.

organizations to anticipate, prepare for, respond to, and adapt to both sudden disruptions and incremental changes stemming from climate-related situations.”

Emerging Technologies and Crypto-Assets

This area encompasses two separate SEC priorities: the increased use of technology by broker-dealers and RIAs alongside offerings of crypto-assets. This focus comes as the Division has observed “a significant increase in the number of RIAs choosing to provide automated digital investment advice to their clients” along with “continued growth in the use of mobile apps by broker-dealers, and a proliferation of the offer, sale, and trading of crypto-assets.” In response, EXAMS will review whether such firms have considered the “unique risks” presented by such activities when designing regulatory compliance programs.

RIA and broker-dealer examinations will additionally look at the utilization of new products, services, and practices (such as “fractional shares, ‘Finfluencers,’ or digital engagement practices”). In conducting these reviews, EXAMS will assess whether registrants’ operations and controls are consistent with disclosures, the applicable standards of conduct, other regulatory obligations, and unique risks posed by particular practices, as well as whether advice and recommendations (including by algorithms) are consistent with investors’ investment strategies and the applicable standards of conduct.

The 2022 Priorities highlight a planned crypto-assets examination focus on custody arrangements for crypto-assets, as well as on whether crypto-asset market participants are meeting applicable standards of conduct when recommending such assets and with respect to investors’ initial and ongoing understanding of such products. In addition, EXAMS will review whether market participants “routinely review, update, and enhance their compliance practices” for matters such as custody practices, anti-money laundering reviews, and valuation procedures, along with risk disclosures and operational resiliency practices given unique risks posed by crypto-assets. Finally, the Division plans to review the compliance, liquidity and operational controls involving portfolio management and market risk for mutual funds and ETFs with crypto-asset exposure.

Registered Investment Advisers and Registered Investment Companies

RIA Compliance Programs

The Division will assess RIA compliance programs to determine whether RIAs are maintaining policies and procedures that are reasonably designed to prevent violations of the Advisers Act and its rules (including the antifraud provisions thereunder). These

reviews will also examine whether compliance programs ensure that “(1) investment advice is in each client’s best interest; (2) oversight of service providers is adequate; and (3) sufficient resources exist to perform compliance duties.” The Division will continue to scrutinize RIAs’ use of alternative data in their business and investment decision-making processes, including whether such registrants maintain sufficient compliance and controls frameworks to prevent the misuse of MNPI from such alternative data sources. The Division will also review whether registrants have implemented practices to mitigate heightened risks involving the employment of individuals with prior disciplinary histories, the transition from the broker-dealer business model to the advisory model, and branch-office risks. The Division will also continue to focus on RIA disclosures, particularly involving fees and expenses.

Registered Investment Companies

Although not emphasized to the same degree as in last year’s Priorities, the 2022 Priorities state that the Division plans to continue examinations of registered investment companies (including mutual funds and ETFs) “given their importance to retail investors.” Examinations will evaluate “disclosures to investors, accuracy of reporting to the SEC, compliance with the new rules and exemptive orders.” Furthermore, the Division will continue to test whether Liquidity Risk Management Programs (“LRMPs”) are reasonably designed to evaluate and manage liquidity risk.

Priority for Certain Types of Funds, Investments, and Practices

The Division will specifically emphasize money market funds and business development companies. For mutual funds that invest in private funds, EXAMS will focus on risk disclosure and valuation issues. Finally, EXAMS will prioritize examinations of RIAs that provide advisory fee waivers to assess the sustainability of services provided by such RIAs, and EXAMS will also focus on the “trading activities of portfolio managers that may be designed to inflate fund performance.”

Broker-Dealer Priorities

The 2022 Priorities contain multiple items concerning broker-dealer operations. As discussed previously, as part of an overall focus on “retail investors and working families,” the Division continues to highlight Reg BI examinations, representing a point of continuity from the previous year’s priorities. In addition to Reg BI, the Division also plans to examine multiple areas relating to categories of securities and broker-dealer operations.

Microcap, Municipal, Fixed Income, and Over-The-Counter Securities

EXAMS will evaluate broker-dealers' compliance with obligations involving the entire spectrum of transactions involving these securities. Examinations will test compliance with regulatory requirements, including Regulation SHO, penny stock disclosure rules, AML obligations, and municipal issuer disclosure requirements. Examinations will also test whether recommendations made for these products are consistent with the obligations established by Reg BI and with revised Exchange Act Rule 15c2-11.

Broker-Dealer Operations

EXAMS will test compliance with broker-dealer operations, including the Customer Protection Rule and Net Capital Rule. This will include not only an examination of policies and procedures, but also of broker-dealer funding and liquidity risk management practices "to assess whether firms have sufficient liquidity to manage stress events." Continued examination of practices in borrowing customer securities will be part of this examination focus. Reflecting Chair Gensler's keen interest in payment for order flow ("PFOF"), the Division will also review broker-dealer trading practices to scrutinize "potential conflicts of interest in order routing" such as those involving PFOF. The Division will also examine the operations of certain alternative trading systems for compliance with Regulation ATS and with the disclosure obligations of Form ATS-N.

Market Infrastructure

The Division plans to examine entities with important market infrastructure roles, like clearing agencies, national securities exchanges, newly-registered Security-Based Swap Dealers ("SBSDs"), municipal advisors, and transfer agents. These examinations will focus on compliance with the federal securities laws and the core areas of risk specific to the type of entity.

With respect to clearing agencies, EXAMS will (as required by Title VIII of Dodd-Frank) 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." The Division will also examine other registered clearing agencies, and all examinations will assess compliance with the SEC's Standards for Covered Clearing Agencies. These examinations will also investigate: (1) whether the clearing agency's risk management frameworks comply with the Exchange Act in addition to serving the needs of its members and the markets; (2) the adequacy and timeliness of past remediations by the clearing agency; and (3) "other risk areas identified in collaboration with the SEC's Division of Trading and Markets and other regulators." Areas of focus for these examinations may include, among other topics, margin, counterparty credit risk,

disclosure framework, governance, recovery and wind-down, default management, liquidity risk management, and project management.

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While the Division's 2022 Priorities outline an ambitious agenda that ranges across virtually the entire securities marketplace, they closely track Chair Gensler's well-established priorities involving private funds, fintech, and cybersecurity. Accordingly, registrants should take steps to plan for heightened examination activity in the year to come:

- RIAs to private funds should brace for increased examination scrutiny, which we expect to return to activity and referral levels (and, ultimately, enforcement actions) seen in the aftermath of Dodd-Frank and during the Obama Administration.
- All registrants should prepare for granular examinations in which firms' ESG and cybersecurity operational risk disclosures, practices, and policies and procedures will be scrutinized, given the SEC's laser focus on ESG and cybersecurity risks, including through its proposed rulemakings.
- Registrants with a retail investor base should expect examinations that focus squarely on investor disclosures and compliance with applicable standards of care.
- Finally, the Division has also clearly established that evergreen topics such as broker-dealer operational compliance will remain on the examination agenda.

We expect an extremely active year for EXAMS as it executes upon this broad roadmap for 2022.

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