

# US SEC examination priorities for 2021: what you need to know

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## Abstract

**Purpose** – To summarize the U.S. Securities and Exchange Commission Division of Examinations's recently published 2021 examination priorities.

**Design/methodology/approach** – Features short summaries of select aspects of the SEC Division of Examinations' recently published 2021 examination priorities.

**Findings** – The SEC's priorities for 2021 examinations include retail investor protection; information security; operational resiliency; financial technology and innovation, including digital assets; anti-money laundering; LIBOR transition, and selected areas for registered investment advisers.

**Practical implications** – Firms should consider the SEC examination priorities as they conduct their annual reviews of policies, procedures and business activities. Where firms observe deficiencies in their own practices, adjustments should be made before they find themselves the subject of an SEC investigation, examination or enforcement action.

**Originality/value** – Practical guidance for investment advisers, investment companies, municipal advisors, and broker-dealers from experienced broker-dealer, securities and investment management lawyer.

**Keywords** US Securities and Exchange Commission (SEC), Division of Examinations, Retail investor protection, Information security, Financial technology, Anti-money laundering

**Paper type** Technical paper

The US Securities and Exchange Commission (SEC) Division of Examinations ("The Division") has released its 2021 Examination Priorities. Focus themes for the 2021 exam priorities include:

- Retail investor protection with an emphasis on seniors and retirement savings;
- Information security and operational resiliency;
- Financial technology and innovation including digital assets;
- Anti-money laundering;
- The London Inter-Bank Offered Rate (LIBOR) transition; and
- Other selected areas for examinations of investment advisers, investment companies, broker-dealers and municipal advisors.

The Division indicated that its examinations and analysis will continue to remain grounded in four main pillars:

- Promoting compliance;
- Preventing fraud;
- Identifying and monitoring risk; and
- Informing SEC policy.

A more complete discussion of the exam priorities is included below. Firms should review their policies, procedures and business activities in light of the 2021 exam priorities. A copy of the examination priorities publication is available at [www.sec.gov/files/2021-exam-priorities.pdf](http://www.sec.gov/files/2021-exam-priorities.pdf). Firms should also review the Financial Industry Regulatory Authority, Inc.'s (FINRA) 2021 Report on Risk Monitoring and Examination Activities available at [www.chapman.com/media/publication/1075\\_Chapman\\_FINRA\\_Risk\\_Monitoring\\_Examination\\_020521.pdf](http://www.chapman.com/media/publication/1075_Chapman_FINRA_Risk_Monitoring_Examination_020521.pdf)

## Retail investor protection

Protecting retail investors remains a priority for the Division in 2021. It is expected to continue to be a focus for the foreseeable future. The Division has indicated that it will focus on the following areas, among others, in conducting its 2021 examinations:

- **Standards of Conduct:** With Regulation Best Interest and the Form CRS Relationship Summary requirements going into effect in 2020, the Division will prioritize examinations to assess compliance with Regulation Best Interest and Form CRS in 2021. While the Division conducted examinations in these areas in 2020, in 2021 the scope of these examinations will be expanded.
- **Fraud, Sales Practices and Conflicts:** Examiners will continue to focus on whether required disclosures are made to investors with an emphasis on fees, expenses and conflicts of interest with a particular focus on revenue-sharing arrangements, direct or indirect compensation to personnel for executing client transactions and disclosure of fees and revenue-sharing arrangements for registered investment advisers operating and utilizing turnkey asset management platforms. Examiners will also focus on whether firm actions match their disclosures.

The Division will focus exams on advice given to retail investors with a particular focus on:

- Recommendations and advice to seniors, teachers and military personnel;
  - Recommendations to individuals saving for retirement;
  - Recommendations regarding account type, conversions and rollovers;
  - Sales practices for product types including structured products, exchange-traded products, real estate investment trusts, private placements, annuities, digital assets, municipal and other fixed income securities and microcap securities;
  - Compliance obligations when providing retail customers access to complex strategies; and
  - Firm compliance with the amended definition of accredited investor when recommending and selling certain private offerings.

The Division will also be reviewing fees and expenses charged to accounts by registered investment advisers with a focus on advisory fee calculation errors, inaccurate calculations of tiered fees and failures to refund prepaid fees for terminated accounts.

- **Retail-Targeted Investments:** The Division will continue to prioritize examination of retail-targeted investments including:
  - *Mutual funds and ETFs*, with a focus on financial incentives to financial services firms and professionals that may influence the selection of particular mutual fund share classes along with conducting reviews for proper application of mutual fund fee discounts;

- *Municipal securities and other fixed income securities*, with a focus on best execution, fairness of pricing, markups/markdowns and commissions, and confirmation disclosure requirements; and
- *Microcap securities*, with a focus on transfer agent activities and broker-dealer sales practices.

### Information security and operational resiliency

- **Information Security:** The Division will continue to prioritize information security in its examination programs with a focus on:
  - Controls surrounding online and mobile access to investor account information;
  - Controls surrounding electronic storage of books and records and personally identifiable information maintained with third-party cloud service providers;
  - Firms' policies and procedures to protect investor records and information;
  - Safeguarding of customer accounts including verifying investors' identities to prevent unauthorized account access;
  - Overseeing vendors and service providers;
  - Addressing malicious email activities;
  - Responding to incidents including ransomware attacks; and
  - Managing operational risk as a result of dispersed employees in a work-from-home environment.
- **Business Continuity and Disaster Recovery:** The Division will also be reviewing registrants' business continuity and disaster recovery plans. Their reviews in 2021 will include a focus on accounting for risks associated with climate change including climate-related events.

### Financial technology and innovation

The Division's examination of firms in connection with financial technology and innovation will focus on:

- **Automated investment tools and platforms (e.g. "robo-advisers")** with an emphasis on whether firms are operating consistently with their representations to customers, whether firms are handling customer orders in accordance with customer instructions and compliance around trade recommendations made in mobile applications;
- **Use of technology for regulatory compliance implementation** with an emphasis on implementation and integration of the compliance program;
- **Use of alternative data** (i.e. data derived from non-traditional sources); and
- **Digital assets** with an emphasis on whether investments are in the best interests of investors, portfolio management and trading practices, safety of client funds and assets, pricing and valuation, effectiveness of compliance programs and controls and supervision of representatives' outside business activities.

### Anti-Money laundering programs

The Division will continue to examine whether SEC-regulated entities are establishing appropriate anti-money laundering programs including establishing appropriate customer

identification programs, meeting Suspicious Activity Reports (“SARs”) filing obligations, conducting due diligence on customers, complying with beneficial ownership requirements and conducting robust and timely independent testing of anti-money laundering programs.

### **LIBOR transition**

The Division will continue engage firms to assess their understanding of any exposure to LIBOR, preparation for the expected discontinuation of LIBOR and transition to an alternative reference rate.

### **Selected areas for examinations of registered investment advisers**

The Division typically assesses compliance programs of registered investment advisers in one or more core areas including:

- The appropriateness of account selection;
- Portfolio management practices;
- Custody and safekeeping of client assets;
- Best execution;
- Fees and expenses;
- Business continuity plans; and
- Valuation of client assets for consistency and appropriateness of methodology.

In addition, in 2021 the Division will focus on:

- Products and services that are referred to as sustainable, socially responsible, impact and ESG conscious;
- Whether firms’ client disclosures for investment strategies match processes and practices;
- Proxy voting policies and procedures and actual votes to assess whether they align with strategies;
- Firms dually registered as, or affiliated with, broker-dealers disclosing conflicts of interest that arise from certain compensation arrangement and outside business activities, best execution and prohibited transactions.

The Division will also focus on advisers to private funds, especially those with a high concentration of structured products, to assess compliance risks including a focus on liquidity and disclosures of investment risks and conflicts of interest.

### **Selected areas for examinations of investment companies**

In 2021, the Division will prioritize:

- Funds’ compliance programs and governance practices with an emphasis on valuation, disclosures to investors, filings with the SEC, personal trading activities, reports to funds’ boards, liquidity risk management programs, and contracts and agreements;
- Mutual funds or ETFs that have not previously been examined or have not been examined in a number of years; and
- Money market funds.

## Selected areas for examinations of Broker-Dealers

In addition to the focus on issues discussed above, in broker-dealer examinations the Division will focus on:

- Broker-dealer financial responsibility, to ensure that assets are safeguarded in accordance with the Customer Protection Rule and Net Capital Rule;
- Trading and broker-dealer risk management practices including:
  - Broker-dealer compliance with best-execution obligations in a zero-commission environment;
  - Compliance with amended Rule 606 order routing disclosures;
  - Payment for order flow arrangements and its possible effect on order routing and best execution obligations; and
  - Market-maker compliance with Regulation SHO.

## Selected areas for examinations of municipal advisors

With respect to its review of municipal advisors, the Division will focus on:

- Whether municipal advisors made appropriate adjustments to their practices, if necessary, in light of the COVID-19 pandemic and resulting impact to the finances and operations of many municipal issuers
- Whether municipal advisors have met their fiduciary duty obligations to municipal entity clients in disclosing and managing conflicts of interest and documentation of the scope of their client engagements; and
- Whether municipal advisors have satisfied their registration, professional qualification, continuing education and supervision requirements.

## Conclusion

Firms should consider the SEC examination priorities as they conduct their annual reviews of policies, procedures and business activities. Where firms observe deficiencies in their own practices, adjustments should be made before they find themselves the subject of an SEC investigation, examination or enforcement action.

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