

SEC's Division of Examinations Publishes Its 2025 Exam Priorities

November 4, 2024

The Division of Examinations (the "Division") of the Securities and Exchange Commission ("SEC") published its examination priorities for fiscal year 2025 ("2025 Exam Priorities").¹ The 2025 Exam Priorities reflect practices, products, and services the Division believes present heightened risks to investors and the U.S. capital markets. We summarize below the 2025 Exam Priorities that pertain to investment advisers, investment companies, and broker-dealers.²

Investment Advisers

Adherence to Fiduciary Standards of Conduct

Investment advisers' adherence to their fiduciary duties of care and loyalty remains a priority. Accordingly, the 2025 Exam Priorities include a focus by the Division on whether investment advice satisfies fiduciary obligations owed to advisory clients with a particular focus on high-cost products, unconventional instruments, assets that are illiquid and difficult to value, and assets sensitive to higher interest rates or changing market conditions, including commercial real estate. For dual registrants and advisers with affiliated broker-dealers, the 2025 Exam Priorities include: (i) assessing investment advice and recommendations of certain products to determine suitability; (ii) reviewing disclosures to clients regarding the capacity in which recommendations are made; (iii) reviewing the appropriateness of account selection practices (e.g., brokerage vs advisory); and (iv) assessing the mitigation and disclosure of conflicts of interest. In addition, the Division will focus on the impact of advisers' financial conflicts of interest on their ability to provide impartial advice and best execution.

Effectiveness of Compliance Programs

The Division will continue to assess the core areas of investment advisers' compliance programs such as marketing, valuation, trading, portfolio management, disclosure and filings, and custody. In addition, examinations of compliance programs include an analysis of advisers' annual reviews of the effectiveness of their compliance program. The Division considers such reviews as critical elements for addressing and monitoring conflicts of interests.

Areas of focus specific to an adviser's policies and procedures are to determine if they are designed to prevent the adviser from placing its interests ahead of clients' interests and may include: (i) fiduciary obligations of advisers that outsource investment selection and management; (ii) alternative sources of revenue or benefits advisers receive, such as selling non-securities-based products to clients; and (iii) the appropriateness and accuracy of fee calculations³ and the disclosure of fee-related conflicts.

Advisers to Private Funds

With respect to advisers to private funds, the 2025 Exam Priorities include continued focus and prioritization of the Division's review of: (i) whether disclosures are consistent with actual practices and an adviser's adherence to its fiduciary obligations in times of market volatility and when a private fund is exposed to interest rate fluctuations; (ii) the accuracy of calculations and allocations of private fund fees and expenses, both at the fund and investment levels; (iii) disclosure of conflicts of interests and risks, and adequacy of policies and procedures; and (iv) compliance with recently adopted SEC rules, including amendments to Form PF (with a compliance date of March 2025), the adviser marketing rule,⁴ and whether advisers have established adequate policies and procedures that address actual practices.

Never Examined Advisers, Recently Registered Advisers, and Advisers Not Recently Examined

Consistent with its prior practice, the 2025 Exam Priorities continue to prioritize examinations of advisers that have never been examined or have not been recently examined, with a continued focus on newly registered advisers.

Investment Companies

The 2025 Exam Priorities reflect the Division's continued focus on examinations of registered investment companies ("RICs" or "funds"), including mutual funds and exchange-traded funds, because of their prevalence among retail investors. While examinations of RICs generally include reviews of compliance programs, disclosures, and governance, the 2025 Exam Priorities identified the following as examination focus areas: (i) fund fees and expenses, and any associated waivers and reimbursements; (ii) oversight of affiliated and unaffiliated services providers; (iii) portfolio management practices and disclosures, for consistency with investment strategies disclosures and with fund filings and marketing materials; and (iv) issues associated with market volatility. Developing areas of interest for the Division include RICs' exposure to commercial real estate and compliance with new and amended rules.

Newly registered funds and never-before-examined funds continue to be a priority for the Division.

Broker-Dealers

Regulation Best Interest

The 2025 Exam Priorities reiterate the Division's continued focus on broker-dealer compliance with Regulation Best Interest,⁵ including: (i) recommendations of products, investment strategies, and account types and whether such recommendations are in the best interest of the customer and do not place the broker's interest ahead of the customer's interests; (ii) disclosures of conflicts of interest; (iii) conflict identification, mitigation and elimination practices; (iv) processes for considering reasonably available alternatives; and (v) factors considered in light of the customer's investment profile. In particular, the Division will focus on recommended products that are complex, illiquid, or present higher risk to investors, such as highly leveraged or inverse products, crypto assets, structured products, alternative investments, products not registered with the SEC, products with complex fee structures or return calculations, products based on exotic benchmarks, or products that represent a growth area for retail investment. The 2025 Exam Priorities for broker-dealers also include a focus on recommendations: (i) using automated tools or digital interfaces; (ii) related to opening different types of accounts (e.g., option, margin, and self-directed IRA accounts); and (iii) made to certain types of investors (e.g., older investors and those saving for retirement or college).

For dual registrants, the 2025 Exam Priorities include reviews of firms' processes for identifying, mitigating and eliminating conflicts of interest, account allocation practices where an investor has more than one type of account, and account selection practices. Examinations may also focus on supervision of sales practices at branch office locations.

Form CRS

The Division will continue to review broker-dealers' compliance with the content, reporting, and delivery requirements of Form CRS.⁶

Financial Responsibility Rules

The 2025 Exam Priorities include a continued focus on broker-dealer compliance with the net capital rule,⁷ the customer protection rule,⁸ and related policies and procedures. Areas of review identified include accounting practices impacted by recent regulatory changes, the timeliness of financial notifications and other required filings, and operational resiliency programs, including the supervision of third-party service providers. Other areas of focus include credit, market, and liquidity risk management controls to ensure a firm's ability to overcome stress events.

Trading-Related Practices and Services

The Division will continue to prioritize its review of broker-dealer equity and fixed income trading practices. In particular, areas of review include consideration of the structure, marketing, fees, and potential conflicts associated with offerings to retail customers, including bank sweep programs, fully paid lending programs, and mobile apps/online trading platforms, and firm practices associated with trading in pre-IPO companies and the sale of private company shares in secondary markets. Examinations will also include reviews of broker-dealers' execution of retail orders, including: (i) whether retail orders are marked as "held" or "not held," and their consistency with retail instructions; and (ii) the pricing and valuation of illiquid or retail-focused instruments.

With respect to Regulation SHO,⁹ the Division will review broker-dealer reliance on the bona fide market making exception, including whether quoting activity is away from the inside bid/offer.

Other Areas of Focus Impacting Investment Advisers, Investment Companies, Broker-Dealers and Dual Registrants

Cybersecurity

With the increasing escalation of cybersecurity attacks, the Division will continue to examine firms' policies and procedures to assess whether they reasonably manage information-security and operational risks. The Division intends to pay particular attention to firms' governance practices, data loss prevention, access controls, account management, responses to cyber-related incidents, including ransomware attacks, and alternative trading systems' safeguards to protect confidential trading information. In addition, the Division will focus on cybersecurity risks and resiliency goals with respect to third-party products and services and assess how registrants identify and address such risks.

Privacy

The protection of personal identity and information remains a focus of examinations. The Division will continue to assess registrant compliance with Regulations S-ID¹⁰ and S-P,¹¹ as applicable, with a focus on policies and procedures, internal controls, oversight of third-party vendors, and governance practices. For firms providing electronic investment services, the Division will focus on firms' policies and procedures relating to the protection of customer records and information, including: (i) identification and detection to prevent and protect against identity theft during customer account takeovers and fraudulent transfers; (ii) practices to prevent account intrusions and safeguard personally identifiable information, especially for firms with multiple branch offices; and (iii) firm training on identity theft prevention. Examinations will also assess operational and technology risks that may impact a firm's ability to safeguard customer records and information.

T+1 Settlement

The Division will assess broker-dealers' compliance with Rule 15c6-1 under the Exchange Act, which reduced the standard settlement cycle for most securities to the day after trade date ("T+1"), and Rule 15c6-2 under the Exchange Act, which requires broker-dealers engaging in the allocation, confirmation, or affirmation process to have written agreements or written procedures reasonably designed to ensure completion of the process as soon as practicable and no later than the end of day on trade date ("T+0"). The Division will also assess investment advisers' compliance with amended books and records requirements associated with T+1, as well as advisers' operational changes or impacts related to the facilitation of institutional transactions subject to T+0.

Emerging Financial Technologies

The Division stated its intention to examine firms employing certain digital engagement practices, such as digital investment advisory services, recommendations and related tools and methods. Such examinations will assess whether: (i) representations are fair and accurate; (ii) operations and controls are consistent with disclosures; (iii) algorithms produce advice or recommendations consistent with investors' investment profiles or stated strategies;

and (iv) controls to confirm that advice and recommendations generated are consistent with regulatory obligations to investors, including older investors.

Firms touting their use of artificial intelligence (“AI”) will be reviewed for consistency with actual practices and whether such firms have implemented adequate policies and procedures to monitor and/or supervise their use of AI, including for tasks related to fraud prevention and detection, back-office operations, anti-money laundering, and trading functions. Examinations will also consider firm use of regulatory technology to automate internal processes and optimize efficiencies, as well as how firms protect against loss or misuse of client records occurring from the use of third-party AI models and tools.

Crypto Assets

In light of the proliferation of investments involving crypto assets, the Division will continue to assess registrants offering crypto asset-related services. The Division will focus on the offer, sale, recommendation, advice, trading, and other activities involving crypto assets offered and sold as securities or related products, such as spot bitcoin or ether exchange-traded products. Examinations will assess how registrants: (i) meet and follow their respective standards of conduct when recommending crypto asset-related products to retail investors; (ii) review and update their compliance practices, risk disclosures, and operational resiliency practices; and (iii) address the technological risks associated with the use of blockchain and distributed ledger technology, including the security of crypto assets.

Anti-Money Laundering

The Division stated its continued focus on anti-money laundering (“AML”) programs and whether broker-dealers and certain RICs are: (i) appropriately tailoring their AML program to their business model and associated AML risks; (ii) conducting independent testing; (iii) establishing an adequate customer identification program; and (iv) meeting obligations to file Suspicious Activity Reports (SARs). Examination of RICs will also review policies and procedures for oversight of applicable financial intermediaries.

Finally, the Division will review and assess whether broker-dealers and investment advisers are monitoring and complying with the Department of Treasury’s Office of Foreign Assets Control sanctions.

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As the new year is fast approaching, investment advisers, investment companies and broker-dealers should inventory and update current policies and procedures and practices to ensure their ability to address the 2025 Exam Priorities.

For More Information

We are available at any time to answer questions, discuss scenarios, and provide guidance. If you would like further information concerning the matters discussed in this article, please contact a member of the Investment Management Practice Group or visit us online at chapman.com.

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- 1 Division of Examinations, Securities and Exchange Commission, Fiscal Year 2025 Examination Priorities, available at: <https://www.sec.gov/files/2025-exam-priorities.pdf>.
 - 2 This alert focuses on the priorities described for investment advisers, investment companies and broker-dealers. The 2025 Exam Priorities also sets forth examination priorities for self-regulatory organizations, clearing agencies, other market participants, and risk areas impacting various market participants.
 - 3 Investment advisers’ fee calculations have been a continued focus of the Division and resulted in the November 10, 2021, Risk Alert “Division of Examinations Observations: Investment Advisers’ Fee Calculation” in which the Division begins: “It is important for clients to receive timely and accurate information regarding fees and expenses when hiring an investment adviser because every dollar an investor pays in fees and expenses is a dollar not invested for the investor’s benefit.”
 - 4 Rule 206(4)-1 under the Investment Adviser Act of 1940, as amended.
 - 5 Regulation Best Interest (Rule 15l-1 under the Securities Exchange Act of 1934, as amended (the “Exchange Act”)) established a “best interest” standard of conduct for broker-dealers and associated persons when making recommendations to retail customers of any securities transaction or investment strategy involving securities, including recommendations of types of accounts.

- 6 Form CRS is a relationship summary disclosure form for registered investment advisers and broker-dealers that offer services and products to retail investors.
- 7 Rule 15c3-1 under the Exchange Act.
- 8 Rule 15c3-3 under the Exchange Act.
- 9 Regulation SHO provides a framework for the regulation of short sales in securities.
- 10 Regulation S-ID (17 CFR 248.201 *et. seq.*) requires the development and implementation of an identity theft prevention program for firms that offer or maintain covered accounts. A "covered account" is (i) an account that a financial institution or creditor offers or maintains, primarily for personal, family, or household purposes, that involves or is designed to permit multiple payments or transactions; and (ii) any other account that the financial institution or creditor offers or maintains for which there is a reasonably foreseeable risk to customers or to the safety and soundness of the financial institution or creditor from identity theft, including financial, operational, compliance, reputation, or litigation risks.
- 11 Regulation S-P (17 CFR 248.1 through 248.100) governs the treatment of nonpublic personal information about consumers by certain financial institutions.

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