



U.S. Securities and
Exchange Commission

2023

EXAMINATION PRIORITIES

Division of Examinations

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MESSAGE FROM THE LEADERSHIP TEAM

The last several years have been marked by a great deal of tumult and change. Our markets and investors have faced pandemic, geopolitical instability, inflation and widespread cyber threats. Throughout these challenges, the Division of Examinations (Division or EXAMS) has continued to monitor the U.S. capital markets and engage with market participants who make those markets the strongest and most innovative in the world. As the world and our markets have evolved and adapted, so too has the Division. We continue to move forward by adjusting to the new realities of the environment, guided by a new leadership team, dedicated EXAMS staff and the lodestar of our long-standing mission, our “four pillars”: (1) promote compliance; (2) prevent fraud; (3) monitor risk; and (4) inform policy.

Last year, as in prior years, the tremendously talented and experienced staff in EXAMS achieved remarkable success despite ever-increasing responsibilities and the headwinds that have emerged in recent years. Together, we successfully continued to advance a number of focused examinations—using our risk-based process to identify both firms and scope areas—to improve industry risk management practices and compliance with the federal securities laws.

While carrying out our planned targeted examinations, we also responded to emerging events that posed significant risks to investors and the markets. These events included continued market volatility, cyber-events, and market disruptions caused by recent bankruptcies and financial distress among crypto asset market participants. We also conducted hundreds of outreach events and engagements—many in-person—with investors, industry, and securities regulators, and published seven risk alerts to help inform regulated entities and investors of common compliance issues observed in our exams.

In addition to these and many other achievements, in fiscal year 2022, we examined approximately 15% of the registered investment adviser population. This was achieved despite continued growth in the registrant population to more than 15,000 investment advisers overseeing more than \$125 trillion in assets under management. Going forward, as the industry continues to grow and change, we believe increased examinations can only be achieved with significant investments in human capital and technology resources, as noted in our fiscal year 2021 priorities. With respect to broker-dealers, the Division completed over 360 examinations, and, together with FINRA, we examined nearly half of the approximately 3,500 registered broker-dealers in fiscal year 2022.

PROMOTE COMPLIANCE

An important component of carrying out our four-part mission is recognizing and supporting compliance functions at our regulated entities. We recognize that the compliance and risk management functions at many firms are important resources that can support their missions, and in turn, benefit the market and investors generally. EXAMS' mission and robust compliance programs go hand-in-hand. Guided by this principle, EXAMS will continue to support and empower regulated entities' compliance functions to comply with federal securities laws through communication and transparency concerning our examination priorities and findings. An important way we try to achieve this empowerment is by communicating with the compliance community about the deficiencies we observe during examinations in a synthesized and anonymized form through risk alerts, compliance outreach, and with our Annual Priorities. This allows us to share key observations from our examinations with regulated entities outside the context of an examination so that firms can proactively assess whether any changes need to be made to improve or enhance their respective compliance programs.

Risk Alerts

Our risk alerts are an important tool to communicate with firms and help promote compliance. In 2022, we published seven risk alerts. These include one that provides observations from examinations relating to digital assets and areas of focus for future examinations in that space, as well as others that discuss common compliance topics identified in investment adviser and municipal advisor examinations. We have also published risk alerts to announce our focused examinations and to separately announce the results of such examinations, including our multi-branch office examination initiative, as well as our observations from a series of mutual fund and ETF examinations that assessed industry practices and regulatory compliance in certain areas that may have an impact on retail investors.

Compliance Outreach Program

We promote compliance through a multi-level compliance outreach program, which is instrumental in messaging important observations from our examinations. We do so by striving to support and improve compliance functions and inform market participants through external engagements with investors and investor groups, industry, and our domestic and foreign regulatory partners. In 2022, EXAMS staff conducted or participated in hundreds of national and regional compliance outreach conferences and events to promote transparent communication and coordination among industry participants, investors, and regulators.

Our regional offices play a crucial role in the success of EXAMS' compliance program by collaborating with other regulators, as well as industry and professional associations within their respective regions, in conducting and participating in various outreach initiatives and events. For example, in October 2021, our Denver regional office led the Rocky Mountain Securities Conference where SEC leaders, the financial industry, and securities bar discussed issues impacting regulated entities, including investment advisers, investment companies, and broker-dealers. Additionally, during 2022, many of our other regional offices, including offices located in Boston, Chicago, New York, and San Francisco, held outreach events with industry, investor and affinity groups, such as teachers and members of the military, as well as targeted exams and enterprise risk management meetings. For example, EXAMS staff in our San Francisco regional office continued its multi-year teachers outreach initiative by hosting a virtual retirement investment summit that included other regulators, the industry, and investor groups.

Annual Priorities

The development of our annual examination priorities is an iterative process that involves significant input from stakeholders within and outside of the Commission. EXAMS staff, in collaboration with our colleagues in other Commission divisions and offices, work side-by-side to analyze and perform a risk-based assessment of a voluminous amount of information from a number of sources to develop our annual priorities. This includes information gathered through examinations, communications with other regulators, comments and tips received from investors and regulated entities, and industry publications. Additionally, this year, we reached out directly to representatives of state securities regulators and investor groups to gain additional feedback and viewpoints on critical investor protection issues to consider in developing this year's examination priorities. Going forward, we expect to continue to take innovative approaches to enhance how we identify potential risks and examination areas of focus important to investors and market participants.

PREVENT FRAUD

Preventing fraud is a critical goal of EXAMS. EXAMS continues to enhance our ability to uncover fraud and suspicious activity by refining risk-based targeting methodologies to assess and monitor risk, which allows us to better allocate limited resources more effectively and focus them on areas and entities that pose the greatest risk to investors and market stability. To be more effective in identifying and preventing fraud, EXAMS utilizes and continues to broaden our in-house expertise and capacity through the development of specialized working groups in key areas. Currently, EXAMS has specialized working groups in a diverse portfolio of areas, including technology, equity markets and trading practices, fixed income and new products, investment companies, marketing and sales practices, private funds, transfer agents, and valuation matters. These specialized groups have been and continue to be an invaluable resource to our examiners and our examinations, providing subject matter expertise in their respective areas.

In fiscal year 2022, firms returned more than \$50 million to investors in response to EXAMS' proactive work on examinations. EXAMS also made numerous referrals to Enforcement and we anticipate there may be additional referrals from our 2022 examinations. Notable examples of enforcement actions that have involved EXAMS referrals include: the SEC's first action alleging violations of Regulation Best Interest and the first action involving a broker-dealer for allegedly violating the municipal advisor registration rule; settled actions involving registered investment advisers and broker-dealers for deficiencies in programs to prevent customer identity theft under Regulation S-ID; and several settled actions involving advisers to private funds for custody rule violations under the Investment Advisers Act of 1940.

MONITOR RISK

The use of risk-based strategies and technology are critical underpinnings for EXAMS. Our risk-based approach, both in selecting regulated entities to examine and determining the scope of risk areas to examine, remains flexible in order to cover emerging and exigent risks to investors and the marketplace as they arise. Going forward, we will continue to evaluate changes in market conditions, industry practices, and investor preferences to assess risks to both investors and the markets.

EXAMS also leverages technology to collect and analyze large sets of data to help identify risk and better understand a regulated entity's business during examinations. During 2022, we leveraged this technology to better identify examination candidates and focus areas, such as our targeted examinations assessing how dual and affiliated investment advisers and broker-dealers, and their financial professionals, are meeting their obligations to act in the best interest of retail investors. As 2023 unfolds, we will continue to leverage data analysis to monitor and identify potentially problematic activities, as well as to determine how best to scope examinations of those activities and firms. We are also endeavoring to coordinate more closely with our foreign counterparts with the intended goal of enhancing oversight of our regulated entities from a global perspective.

INFORM POLICY

While informing policy is always a critical pillar, it has been even more important over the past few years. EXAMS provides an invaluable perspective on the industry, our regulated entities, and the impact of existing rules on regulated entities. Last year, EXAMS continued to share input with our colleagues in the policy divisions by participating on numerous working groups. EXAMS also provided useful information and observations from examinations to the policy divisions for a number of other purposes. For example, EXAMS staff highlighted instances in which, based on observations in examinations, regulated entities may have misinterpreted rules.

LOOKING AHEAD

Looking ahead in 2023, EXAMS will continue our unwavering commitment to effectively carry out examinations to protect investors and to support and empower the staff at regulated entities to better ensure strong compliance cultures are interwoven in the fabric of regulated entities. Our four pillars will continue to serve as historical and forward-looking guideposts informing how we continue to strengthen our examination program. We also expect to increase our on-site interactions with regulated entities while continuing to leverage remote examinations where it makes sense to do so. Simply put, we look forward to building on the many accomplishments from last year in 2023 and beyond while continuing to confront many of the same economic, geopolitical, and technological challenges that we successfully met in the past.

We hope the publication of our fiscal 2023 examination priorities proves valuable in our efforts to promote compliance and protect investors. Please also know that we are always interested in hearing more about new and emerging risk areas and products as well as how EXAMS can be more effective in our mission. Our contact information can be found at: <https://www.sec.gov/contact-information/sec-directory>. If you suspect or observe activity that may violate the federal securities laws or otherwise operates to harm investors, please notify SEC staff at <https://www.sec.gov/tcr>.



Richard R. Best
Director



Natasha Vij Greiner
Deputy Director and
National Investment
Adviser/Investment
Company Program
Director



Keith E. Cassidy
Deputy Director and
National Technology
Controls Program
Director



Allison M. Fakhoury
National Clearance
and Settlement
Examination Program
Director



Marshall M. Gandy
National Investment
Adviser/Investment
Company Program
Director



Kevin W. Goodman
National FINRA and
Securities Industry
Oversight Program
Director



John S. Polise
National Broker-
Dealer and Exchange
Program Director

Division of Examinations

2023

EXAMINATION PRIORITIES



The Division of Examinations prioritizes examinations of certain practices, products, and services that it believes present potentially heightened risks to investors or the integrity of the U.S. capital markets. This year's examinations will prioritize several significant focus areas that pose unique or emerging risks to investors or the markets, as well as examinations of core and perennial risk areas.

I. NOTABLE NEW AND SIGNIFICANT FOCUS AREAS

A. Compliance with Recently Adopted Rules Under the Investment Advisers Act of 1940 (Advisers Act) and Investment Company Act of 1940 (Investment Company Act)

The Commission recently adopted several significant new rulemakings as part of its efforts to drive efficiency in the capital markets and modernize SEC rules for the current economy and technologies. The Division is prioritizing examining for compliance with these recently adopted rules:

Advisers Act Rule 206(4)-1 (Marketing Rule). The new Marketing Rule is a significant change to a core examination review area for registered investment advisers (RIAs). As such, the Division will, among other things, assess whether RIAs have adopted and implemented written policies and procedures that are reasonably designed to prevent violations by the advisers and their supervised persons of the Marketing Rule. 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.

Investment Company Act Rule 18f-4 (Derivatives Rule).

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) review for compliance with Rule 18f-4, including the adoption and implementation of a derivatives risk management program, board oversight, and whether disclosures concerning the fund's use of derivatives are incomplete, inaccurate or potentially misleading.

DID YOU KNOW?

The compliance date for the SEC's new Marketing Rule was November 4, 2022.

Investment Company Act Fair Valuation Rule 2a-5. The Division will, among other things: (1) 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 the funds' board to designate valuation designees to perform fair value determinations subject to oversight by the board; and (2) review whether adjustments have been made to valuation methodologies, compliance policies and procedures, governance practices, service provider oversight, and/or reporting and recordkeeping.

B. RIAs to Private Funds

RIAs to private funds represent a significant portion of the RIA population. Currently, more than 5,500 RIAs, totaling over 35% of all RIAs, manage approximately 50,000 private funds with gross assets exceeding \$21 trillion. Private fund assets continue to grow. In the past five years, there has been an 80% increase in the gross assets of private funds, with retirement plans steadily contributing to this growth. These assets are deployed through a variety of investment strategies used by hedge funds, private equity funds, and real estate-related funds, among others.

DID YOU KNOW?

Currently, more than 5,500 RIAs, totaling over 35% of all RIAs, manage approximately 50,000 private funds with gross assets exceeding \$21 trillion.

Given these facts, the Division will continue to focus on RIAs to private funds. In particular, the Division will 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 (Custody Rule), where applicable, including timely delivery of audited financials and selection of permissible auditors.

In addition, the Division will focus on RIAs to private funds with specific risk characteristics, such as: (1) highly-leveraged private funds; (2) private funds managed side-by-side with BDCs; (3) private equity funds that use affiliated companies and advisory personnel to provide services to their fund clients and underlying portfolio companies; (4) private funds that hold certain hard-to-value investments, such as crypto assets and real estate-connected investments, with an emphasis on commercial real estate; (5) private funds that invest in or sponsor Special Purpose Acquisition Companies (SPACs); and (6) private funds involved in adviser-led restructurings, including stapled secondary transactions and continuation funds.

C. Standards of Conduct: Regulation Best Interest, Fiduciary Duty, and Form CRS

1. Regulation Best Interest and Fiduciary Duty

Regulation Best Interest for broker-dealers and the fiduciary standard for investment advisers are drawn from key fiduciary principles that include an obligation to act in a retail investor's best interest and not to place the firm's or its financial professionals' interests ahead of the investor's interest.¹

The Division will continue to prioritize examinations of broker-dealers and RIAs for compliance with their applicable standard of conduct. In this regard, broker-dealers and dually registered RIAs are an area of continued interest for the Division, as are affiliated firms with financial professionals who service both brokerage customers and advisory clients. These and other examinations will continue to focus on: (1) investment advice and recommendations with regard to 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. Also, in the case of RIAs, examiners will review whether the conflicts of interest disclosures are sufficient such that a client can provide informed consent to the conflict, whether express or implied.

¹ An investment adviser's fiduciary duty is established by and enforced through Advisers Act Section 206. See [Commission Interpretation Regarding Standard of Conduct for Investment Advisers](#), Advisers Act Rel. No. 5248 (June 5, 2019) (An investment adviser's fiduciary duty is broad and applies to all advisory clients and the entire adviser-client relationship).

DID YOU KNOW?

All broker-dealers and investment advisers have at least some conflicts of interest with retail investors. The nature and extent of those conflicts of interest will depend on various factors, including a firm's business model.

Examinations may focus on advice or recommendations regarding: (1) complex products, such as derivatives and leveraged exchange-traded funds (ETFs), exchange-traded notes (ETNs), and other exchange-traded products (ETPs); (2) high cost and illiquid products, such as variable annuities and non-traded REITs; (3) proprietary products; (4) unconventional strategies that purport to address rising interest rates; and (5) microcap securities. Examinations may also focus on recommendations or advice to certain

types of investors, such as senior investors and those saving for retirement, and specific account recommendations, such as retirement account rollovers and 529 plans.

All broker-dealers and investment advisers have at least some conflicts of interest with retail investors. The nature and extent of those conflicts of interest will depend on various factors, including a firm's business model. The Division will seek to identify and understand the economic incentives that a firm and its financial professionals have to recommend products, services, or account types, such as the source and structure of compensation, revenue, or other benefits. Part of this inquiry will look at whether the firm has established written policies and procedures to identify such conflicts of interest and periodically reviewed and updated their policies and procedures, as appropriate. The Division will also review whether compliance policies and procedures are tailored to the firm's particular business model, compensation structure, and product menu and customer base and are sufficient to support compliance with the standards.

Such economic incentives may include revenue sharing, commissions (including markdowns and markups), or other incentivizing revenue arrangements (*e.g.*, conflicts often exist if firms use the services of, or invest in the products offered by, an affiliate, particularly when these arrangements result in additional or higher fees to investors). Examinations will review how firms are managing conflicts of interest, including mitigating or eliminating the conflicts of interest, when appropriate.

Lastly, examinations will review whether firms have customer or client agreements that purport to inappropriately waive or limit their standard of conduct, such as through the use of hedge clauses.

2. Form CRS

Compliance with Form CRS will continue to be prioritized and incorporated into the Division's core examinations of broker-dealers and RIAs. SEC rules require that firms deliver their relationship summaries to new and prospective retail investors, as well as to existing retail investors, file their relationship summary with the Commission and post the current relationship summary on the firm's public website, if the firm has one.

D. Environmental, Social, and Governance (ESG) Investing

RIAs and registered funds are competing for the rising investor demand for ESG-related investments and strategies that incorporate certain ESG criteria, and, thus are increasingly offering and evaluating investments that employ such strategies and investments. Therefore, the Division will continue its focus on ESG-related advisory services and fund offerings, including whether the funds are operating in the manner set forth in their disclosures. In addition, the Division will assess whether ESG products are appropriately labeled and whether recommendations of such products for retail investors are made in investors' best interest.

II. 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. The current risk environment related to cybersecurity is considered elevated given the larger market events, geopolitical concerns, and the proliferation of cybersecurity attacks, particularly ransomware attacks. Given these risks and concerns, cybersecurity remains a perennial focus area for registrants, including RIAs, broker-dealers, investment companies, municipal advisors, transfer agents, exchanges and clearing agencies.

DID YOU KNOW?

The current risk environment related to cybersecurity is considered elevated given larger market events, geopolitical concerns and the proliferation of cybersecurity attacks, particularly ransomware attacks.

The Division will focus on firms' policies and procedures, governance practices, and response to cyber-related incidents, including those related to ransomware attacks, and broker-dealers' and RIAs' compliance with Regulations S-P and S-ID, where applicable. The focus on policies and procedures will include a review as to whether they are reasonably designed to safeguard customer records and information—both information residing in registrants' systems and stored through a third-party provider—as well as whether the location of such records has been properly disclosed to the Commission, where required.

Examinations of broker-dealers and RIAs will continue to look at firms' practices to prevent account intrusions and safeguard customer records and information, including personally identifiable information, while recognizing that personnel may continue to

access information in a remote environment. 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's focus will also include reviewing whether there has been an unauthorized use of third-party providers, particularly for transition assistance when departing RIA personnel attempt to migrate client information to another firm.

Lastly, the Division will continue to assess systemically significant registrants' operational resiliency planning, such as their efforts to consider and/or address climate-related risks.

DID YOU KNOW?

The Division will focus on firms' policies and procedures, governance practices, and response to cyber-related incidents, including those related to ransomware attacks, and broker-dealers' and RIAs' compliance with Regulations S-P and S-ID, where applicable.

III. CRYPTO ASSETS AND EMERGING FINANCIAL TECHNOLOGY

The Division continues 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). To address these observations, the Division will conduct examinations of broker-dealers and RIAs offering new products and services or employing new practices. These new practices include technological and on-line solutions to meet the demands of compliance and marketing and to service investor accounts (*e.g.*, on-line brokerage services, internet advisers, and automated investment tools and trading platforms, including RIAs referred to as “robo-advisers”).

Given the disruptions caused by recent financial distress among crypto asset market participants, the Division will continue to monitor and, when appropriate, conduct examinations of potentially impacted or affected registrants. Examinations of registrants will focus on the offer, sale, or recommendation of, advice regarding and trading in crypto or crypto-related assets. Specifically, the staff will assess whether such 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 focus on new or never before examined registrants offering crypto or crypto-related assets.

DID YOU KNOW?

Given the disruptions caused by recent financial distress among crypto asset market participants, the Division will continue to monitor and, when appropriate, conduct examinations of potentially impacted or affected registrants.

Broker-dealer and RIA examinations will also focus on firms that employ digital engagement practices² 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 taking 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, such as seniors.

² For purposes of these examinations, the term “digital engagement practices” includes tools with 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.

IV. INVESTMENT ADVISERS AND INVESTMENT COMPANIES

A. Focus Areas for Examinations of RIAs

The Division remains focused on whether the various aspects of RIAs' operations and compliance practices have appropriately adopted and considered current market factors, such as those that might impact valuation and the accuracy of RIA regulatory filings. During a typical examination, the Division reviews the compliance programs and related disclosures of RIAs in one or more core areas, such as custody and safekeeping of client assets, valuation, portfolio management, and brokerage and execution. Often examinations also include a review for conflicts, compliance issues and the oversight and approval process related to RIA fees and expenses, including: (1) the calculation of fees; (2) alternative ways that RIAs may try to maximize revenue, including revenue earned on clients' bank deposit sweep programs; and (3) excessive fees.

In addition to reviewing these core focus areas, examinations will review RIA policies and procedures for retaining and monitoring electronic communications and selecting and using third-party service providers.

As in previous years, the Division prioritizes RIAs that have never been examined, including recently registered firms, and those that have not been examined for a number of years. Typically, these examinations focus on firms' compliance programs.

B. Focus Areas for Registered Investment Companies, Including Mutual Funds and ETFs

The Division prioritizes examinations of registered investment companies, including mutual funds and ETFs, given their importance to retail investors. The perennial focus areas for such examinations include, among other topics, an assessment of registered investment companies' compliance programs and governance practices, disclosures to investors, and accuracy of reporting to the SEC.

The Division will focus on the fiduciary obligations of RIAs to registered investment companies, particularly with respect to their receipt of compensation for services, or other material payments made by such registered investment companies and other sources. As part of its review of registered investment companies' compliance programs and governance practices, the Division will 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 will assess the effectiveness of funds' derivatives risk management programs and liquidity risk management programs, as applicable.

The Division will also focus on funds with specific characteristics, such as: (1) turnkey funds, to review their operations and assess effectiveness of their compliance programs;³ (2) mutual funds that converted to ETFs, to assess governance and disclosures associated with the conversion to an ETF; (3) non-transparent ETFs, to assess compliance with the conditions and other material terms of their exemptive relief; (4) loan-focused funds, such as leveraged loan funds and funds focused on collateralized loan obligations, for liquidity concerns and to review whether the funds have been significantly impacted by, and have adapted to, elevated interest rates; and (5) medium and small fund complexes that have experienced excessive staff attrition, to focus on whether such attrition has affected the funds' controls and operations. The Division will also monitor the proliferation of volatility-linked and single-stock ETFs, and may review such funds' disclosures, marketing, conflicts, and compliance with portfolio management disclosures, among other things.

As with RIA examinations, the Division will prioritize 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. These examinations often focus on corporate governance, the advisory contract approval process, fund code of ethics, practices that deviate from disclosures, and the implementation and effectiveness of the fund's compliance program, including the oversight of service providers through which the fund conducts its activities.

V. BROKER-DEALER AND EXCHANGE EXAMINATION PROGRAM

A. Broker-Dealers

The Division has long emphasized the importance of robust broker-dealer compliance and supervisory programs as a proactive measure to ensure compliance with the federal securities laws. This year, the Division intends to focus examinations on broker-dealer compliance and supervisory programs generally, including those for electronic communications related to firm business, as well as the recordkeeping for those electronic communications.

DID YOU KNOW?

The Division intends to focus examinations on broker-dealer compliance and supervisory programs generally, including those for electronic communications related to firm business, as well as the recordkeeping for those electronic communications.

³ In this context, the term "turnkey funds" references funds that utilize a turnkey solutions provider for infrastructure purposes (*i.e.*, to organize, operate, and service the funds, such as governance and compliance services).

Broker-dealers that hold customer cash and securities have a responsibility to ensure that those assets are safeguarded in accordance with the Customer Protection Rule and the Net Capital Rule. The Division will continue to prioritize the examination of broker-dealers for compliance with these rules, including the adequacy of internal processes, procedures, and controls. Examiners will also assess broker-dealer credit, market, and liquidity risk management controls to ensure that firms have sufficient liquidity to manage stress events.

The Division will continue to examine broker-dealer trading practices in both equities and fixed income securities. Examinations will assess conflicts of interest in order routing and execution that may negatively affect retail investors. Examinations will also focus on compliance with Regulation SHO, including the rules regarding aggregation units and locate requirements. The Division will also examine the operations of alternative trading systems for compliance with Regulation ATS, and in particular focus on consistency with their disclosures provided in Form ATS-N.

The Division will 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. The Division will also continue to focus on issues specific to over-the-counter securities and microcap securities, such as compliance with Securities Exchange Act of 1934 (Exchange Act) Rule 15c2-11, which requires broker-dealers to refrain from publishing quotations for an issuer's security when current issuer information is not publicly available (among other requirements) unless an exception is available, and compliance with the penny stock disclosure rules (*i.e.*, Exchange Act Rules 15g-2 through 15g-6). Examiners will also seek to identify whether firms may be involved in the illegal distribution of unregistered securities.

B. National Securities Exchanges

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. The Division will examine the national securities exchanges 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.

C. Security-Based Swap Dealers (SBSDs)

SBSDs act as market makers or dealers in security-based swaps by regularly entering into security-based swaps with counterparties as an ordinary course of business for their own account. Examinations will continue to focus on whether SBSBs have implemented policies and procedures related to compliance with SBS rules generally. In addition, examinations will focus on whether SBSBs are meeting their obligations under Regulation SBSR to accurately report SBS transactions to swap data repositories, among other requirements.

D. Municipal Advisors

Municipal advisors provide advice to, or on behalf of, a municipal entity or obligated person with respect to municipal financial products or the issuance of municipal securities or municipal financial products. 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 MSRB Rule G-42, which establishes the core standards of conduct and duties applicable to municipal advisors when engaging in municipal advisory activities. The Division will also continue to examine whether municipal advisors have disclosed conflicts of interest and have met their relationship documentation, registration, professional qualification, and supervision requirements.

E. Transfer Agents

Transfer agents serve as agents for securities issuers and are responsible for maintaining security holder records, recording changes of ownership, canceling and issuing certificates, distributing dividends and other payments to security holders, and facilitating communications between issuers and security holders. The Division will continue to examine transfer agent processing of items and transfers, recordkeeping and record retention, safeguarding of funds and securities, and filings with the Commission. Examinations will also focus on transfer agents that service certain types of issuers, including microcap and crypto assets, and transfer agents that use emerging technology to perform their transfer agent functions.

VI. CLEARANCE AND SETTLEMENT

Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act) requires the SEC to examine, at least once annually, each clearing agency designated as systemically important and for which the SEC serves as the supervisory agency. Pursuant to Section 807 of the Dodd-Frank Act, 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 will examine all registered clearing agencies for compliance with the SEC's Standards for Covered Clearing Agencies, which are rules that require covered clearing agencies to have policies and procedures that address, among other things, maintaining sufficient financial resources, protecting against credit risks, managing member defaults, and managing operational and other risks.

Examinations of registered clearing agencies include both risk-based exams and corrective action reviews, and are undertaken to assess: (1) 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) the adequacy and timeliness of their remediation of prior deficiencies, including, for example, the role of senior leadership in the remediation process; and (3) other risk areas identified in collaboration with the SEC's Division of Trading and Markets and other regulators. In addition, the Division will also examine other entities providing clearing services, which may include swap data repositories, as well as entities providing clearing services exempt from registration.

Areas of focus in fiscal year 2023 may include liquidity risk management, counterparty credit stress testing, governance and escalation, and the compliance function, among other things. Finally, the Division consults with the Federal Reserve Board each year on the scope and methodology of the SEC's Dodd-Frank examinations, as required by that Act, and routinely consults with the SEC's Division of Trading and Markets concerning risks it observes in its supervisory role over the above clearing agencies. These risks are incorporated into the risk-based planning of the examinations discussed above.

VII. REGULATION SYSTEMS COMPLIANCE AND INTEGRITY (SCI)

The Commission adopted Regulation SCI to strengthen the technology infrastructure of the U.S. securities markets. Regulation SCI entities include national securities exchanges, registered and certain exempt clearing agencies, FINRA, MSRB, plan processors, and alternative trading systems that meet certain volume thresholds. Among other things, these critical market infrastructure entities must establish, maintain, and enforce written policies and procedures reasonably designed to ensure that their systems' capacity, integrity, resiliency, availability, and security is adequate to maintain their operational capability and promote the maintenance of fair and orderly markets. The Division will continue to evaluate whether SCI entities have established, maintained, and enforced written policies and procedures as required. Areas of focus will include:

Software Development Life Cycle. The Division will evaluate whether the policies and procedures of SCI entities are reasonably designed, with a particular focus on the programs of SCI entities to review and keep current systems development and testing methodologies.

Third-Party Dependencies. The Division will assess whether policies and procedures are reasonably designed to ensure that SCI systems operated by third-parties on behalf of SCI entities have adequate levels of capacity, integrity, resiliency, availability, and security.

Network Segmentation. The Division will assess whether a system if breached, would be reasonably likely to pose a security threat to SCI systems.

Application Programming Interface. Reliance on external applications, such as those residing in the cloud might introduce security and operational risks to SCI systems. The Division will assess whether policies and procedures are reasonably designed to ensure SCI systems have adequate levels of security to maintain the SCI entity's operational capability.

VIII. FINRA AND MSRB

A. FINRA

FINRA oversees approximately 3,400 brokerage firms, 150,000 branch offices, and more than 620,000 registered representatives through examinations, enforcement, and surveillance. In addition, FINRA, among other things, provides a forum for securities arbitration and mediation, conducts market regulation, including by contract for a

majority of national securities exchanges, reviews broker-dealer advertisements, administers the testing and licensing of registered persons, and operates industry utilities, such as Trade Reporting Facilities.

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 investor protection initiatives

such as Regulation BI and Form CRS. 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 examinations of FINRA's examinations of certain broker-dealers and municipal advisors that are FINRA members. 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.

DID YOU KNOW?

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B. MSRB

MSRB regulates the activities of broker-dealers that buy, sell, and underwrite municipal securities, and municipal advisors. MSRB establishes rules for municipal broker-dealers (including registered municipal securities dealers) and municipal advisors, supports market transparency by making municipal securities trade data and disclosure documents available, and conducts education and outreach regarding the municipal securities market. 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.

IX. ANTI-MONEY LAUNDERING (AML)

The Bank Secrecy Act requires 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 customers they serve, 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.

The importance of conducting examinations of AML programs of broker-dealers and certain registered investment companies has been elevated due to the current geopolitical environment and the increased imposition of international sanctions, as has the review of firms' monitoring and compliance with OFAC and Treasury-related sanctions. The Division will continue to prioritize examinations of broker-dealers and certain registered investment companies for compliance with their AML obligations in order to assess, among other things, whether firms have established appropriate customer identification programs and whether they are satisfying their SAR filing obligations, conducting ongoing 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.

X. THE LONDON INTERBANK OFFERED RATE (LIBOR) TRANSITION

The discontinuation of LIBOR could have a significant impact on the financial markets and may present a material risk for certain market participants, including the RIAs, broker-dealers, investment companies, municipal advisors, transfer agents and clearing agencies overseen by the Division. The Division will continue to assess broker-dealer and RIA preparation for the transition away from LIBOR. LIBOR is currently scheduled for discontinuation in mid-2023.

DID YOU KNOW?

LIBOR is currently scheduled for discontinuation in mid-2023.

XI. CONCLUSION

These priorities reflect the Division's assessment of certain risks, issues, and policy matters arising from market and regulatory developments, information gathered from examinations, and other sources, including tips, complaints, and referrals, and coordination with other Divisions and Offices at the SEC as well as other regulators. While the Division will allocate significant resources to the examination issues described herein, it will also conduct examinations focused on and devote resources to new or emerging risks, products and services, market events, and investor concerns.

The Division welcomes comments and suggestions regarding how it can better fulfill its mission to promote compliance, prevent fraud, identify and monitor risk, and inform SEC policy. Our contact information is available at <https://www.sec.gov/exams>. If you suspect or observe activity that may violate the federal securities laws or otherwise operates to harm investors, please notify SEC staff at <https://www.sec.gov/tcr>.

U.S. Securities and
Exchange Commission
100 F Street NE
Washington, DC 20549
[SEC.gov](https://www.sec.gov)