

## **SEC Division of Examinations Publishes 2024 Priorities: Spotlight on Investment Advisers and Broker-Dealers**

Article By:

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On October 16, the Securities and Exchange Commission's (SEC) Division of Examinations (Division) published its [examination priorities](#) for its fiscal year 2024 (Oct. 1, 2023 - Sep. 30, 2024). The Division noted that the publication of its examination priorities, together with an expected greater presence of examiners in the field and national and regional outreach events, demonstrate its commitment to providing more transparency into its processes and promoting compliance. Consistent with this theme, this fall, the Division also published a [Risk Alert](#) that provides useful information regarding how the Division employs its risk-based examination approach, including how it selects registrants to examine and how it makes scoping decisions for those examinations. Importantly, the Risk Alert also provides an attachment with the Division's typical initial document request list.

This post focuses on examination priorities identified for SEC-registered investment advisers, including advisers to private funds, as well as registered broker-dealers.

### **I. Investment Advisers**

The Division will continue to focus on advisers' adherence to its fiduciary standard (including the duty of care and duty of loyalty), including:

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- Investment advice provided to clients regarding complex products (e.g., derivatives), high-cost and/or illiquid products, and unconventional investment strategies (including those that are designed to address rising interest rates);
  - Processes for determining that investment advice is provided in the client's best interest, including with regard to initial and ongoing suitability determinations; seeking best execution; and identifying/addressing conflicts of interest (including investment allocation decisions and mitigating and/or eliminating conflicts when appropriate);
  - Economic incentives and conflicts of interest associated with dually registered advisers and broker-dealers, compensation and/or revenue sharing arrangements, investment advice regarding proprietary products, and the use of affiliated service providers; and
  - Compliance programs, “including whether [ ] policies and procedures reflect the various aspects of the advisers' business, compensation structure, services, client base, and operations, and address applicable current market risks.”

The Division noted, in part, particular examination focus on:

- Compliance with the new Marketing Rule, including, but not limited to, required written policies and procedures, Form ADV disclosures, and substantiation of processes and other required books and records. Marketing practice reviews will also assess whether disseminated advertisements include any untrue statements of a material fact or are otherwise materially misleading and, as applicable, comply with requirements regarding performance presentations (including hypothetical and predecessor performance), third-party ratings, and testimonials/endorsements;
- Valuation assessments regarding advisers' recommendations to clients to invest in illiquid or difficult-to-value assets (e.g., private placements);
- Safeguarding assessments regarding advisers' controls to protect clients' material non-public information (e.g., shared office space arrangements, use of expert networks); and
- Accuracy and completeness of regulatory filings, including the

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## Customer Relationship Summary (Form CRS).

### II. Investment Advisers to Private Funds

The Division also noted that it plans to continue to focus on advisers to private funds, prioritizing, for example:

- Portfolio management risks associated with exposure to recent market volatility and rising/higher interest rates (e.g., poor performance, significant withdrawals, use of leverage, and illiquid assets);
- Adherence to contractual requirements regarding advisory boards, including notification and consent provisions, as applicable;
- Accurate calculation and allocation of private fund fees and expenses (both fund-level and investment-level) and related disclosures;
- Due diligence practices to ensure consistency with policies/procedures/disclosures when evaluating prospective portfolio company investments;
- Compliance with custody rule requirements under the Advisers Act, including Form ADV disclosures and timely completion and distribution of private fund audited financial statements (where applicable); and
- Policies and procedures for reporting on Form PF.

### III. Broker-Dealers

The Division also identified a number of priorities with regard to examinations of SEC registered broker-dealers. Those areas include the following:

- **Regulation Best Interest:** In reviewing whether broker-dealer recommendations are in customers' best interest, the Division will focus on recommendations with regard to products, investment strategies, and account types (that involve complexity, high costs, or illiquidity); disclosures regarding conflicts of interest; conflict mitigation practices; processes for reviewing reasonably available alternatives; and factors considered in light of the investors' investment profile. The Division will also evaluate written policies and

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procedures governing Regulation Best Interest to ensure such procedures are reasonably designed to address the factors discussed above. Finally, the Division identified as another focal point issues that may arise with dually registered investment advisers / broker-dealers, including conflicts of interest, account allocation practices, and account-type selection (e.g., brokerage versus advisory and/or wrap fee accounts).

- **Form CRS:** The Division will review the content of Form CRS, such as how the broker-dealer describes the relationships and services offered, the fees and costs charged, its conflicts of interest and any disciplinary history. Examinations will also evaluate whether obligations have been met to file the Form CRS with the Commission and deliver the Form CRS to retail customers as required.
- **Broker-Dealer Financial Responsibility Rules:** Examinations will focus on broker-dealer compliance with the Net Capital Rule and the Customer Protection Rule and related internal processes, procedures, and controls. Focus areas will include, for example, accounting for certain types of liabilities (e.g., reward programs) and credit, interest rate, market and liquidity risk management controls.
- **Broker-Dealer Trading Practices:** The Division will review broker-dealers' equity and fixed-income trading practices, including compliance with Regulation SHO (e.g., rules regarding aggregation units and locate requirements); Regulation ATS (e.g., adequacy of operations disclosures in Forms ATS and ATS-N); and compliance with Exchange Act Rule 15c2-11 (governing the publication of quotations in securities traded over-the-counter). Regarding wholesale market makers, examinations may include quote generation, order routing and execution practices, market data ingestion, regulatory controls and risk management.

#### IV. Key Takeaways

More generally, the Division also highlighted certain risk areas impacting various market participants. The Division identified, for example:

- **Information Security and Operational Resiliency:** *E.g.*, reviewing registrants' policies and procedures, internal controls, oversight of

third-party vendors, governance practices, responses to cyber-related incidents and adequacy of staff training regarding the same.

- **Crypto Assets and Emerging Financial Technology:** *E.g.*, examining registrants' use of automated investment tools, artificial intelligence, and trading algorithms or platforms; and focusing examinations on the offer, sale, recommendation of, advice regarding, trading in, and other activities in crypto assets or related products.
- **Anti-Money Laundering (AML):** *E.g.*, examining whether broker-dealers and certain registered investment companies are tailoring their AML program to their business model and associated AML risks; conducting independent testing; establishing an adequate customer identification program; and meeting suspicious activity reporting filing obligations.

As in prior years, the Division continues to prioritize examinations of advisers who have never been examined (including recently registered advisers) and advisers who have not been examined for a number of years. Given the SEC's current aggressive posture towards enforcement, registrants would be advised to reevaluate existing compliance regimes and take into account such priorities when preparing for future regulatory examinations.

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