Press Release

SEC Division of Examinations Announces 2021 Examination Priorities

Enhanced Focus on Climate-Related Risks

FOR IMMEDIATE RELEASE
2021-39

Washington D.C., March 3, 2021 —The Securities and Exchange Commission's Division of Examinations today announced its 2021 examination priorities, including a greater focus on climate-related risks. The Division will also focus on conflicts of interest for brokers (Regulation Best Interest) and investment advisers (fiduciary duty), and attendant risks relating to FinTech in its initiatives and examinations. The Division publishes its examination priorities annually to provide insights into its risk-based approach, including the areas it believes present potential risks to investors and the integrity of the U.S. capital markets.

"This year, the Division is enhancing its focus on climate and ESG-related risks by examining proxy voting policies and practices to ensure voting aligns with investors' best interests and expectations, as well as firms' business continuity plans in light of intensifying physical risks associated with climate change," said Acting Chair Allison Herren Lee. "Through these and other efforts, we are integrating climate and ESG considerations into the agency's broader regulatory framework."

"Our priorities reflect the complicated, diverse, and evolving nature of the risks to investors and the markets, including climate and ESG," said Division Director Pete Driscoll. "In this unprecedented time, the Division is committed to continuing to adapt examination processes and find innovative ways to enhance the effectiveness of examinations and our risk-based approach. However, the bedrock of our examination program remains unchanged. The work we do, from examinations to publishing risk alerts and conducting outreach, serves our mission to promote compliance and protect investors," Driscoll continued.

The following is an overview of the Division's 2021 examination priorities:

Retail Investors, Including Seniors and Those Saving for Retirement, Through Reg. BI and Fiduciary Duty Compliance – The Division will focus on compliance with Regulation Best Interest, Form CRS, and whether registered investment advisers have fulfilled their fiduciary duties of care and loyalty. The Division will examine whether firms are appropriately mitigating conflicts of interest and, where necessary, providing disclosure of conflicts that is sufficient to enable informed consent by retail investors. With respect to those investments heavily used by retail investors or those that may present elevated risks, the Division will continue to prioritize these products, including mutual funds, exchange-traded funds (ETFs), municipal securities and other fixed income securities, variable annuities, private placements, and microcap securities.

Information Security and Operational Resiliency – The Division will continue to review business continuity and disaster recovery plans of firms, but will shift its focus to whether such plans, particularly those of systemically important registrants, are accounting for the growing physical and other relevant risks associated with climate change. As climate-related events become more frequent and more intense, the division will review whether firms are considering effective practices to help improve responses to large-scale events. The Division will also review whether registrants have taken appropriate measures to: safeguard customer accounts and prevent account intrusions, including verifying an investor's identity to prevent unauthorized account access; oversee vendors and service providers; address malicious email activities, such as phishing or account intrusions; respond to incidents, including those related to ransomware attacks; and manage operational risk as a result of dispersed employees in a work-from-home environment.

Financial Technology (Fintech) and Innovation, Including Digital Assets – Among other areas, examinations will focus on evaluating whether registrants are operating consistently with their representations, whether firms are handling customer orders in accordance with their instructions, and review compliance around trade recommendations made in mobile applications. Examinations of market participants engaged with digital assets will continue to assess the following: 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 review for compliance with applicable anti-money laundering (AML) requirements, including evaluating 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.

The London Inter-Bank Offered Rate (LIBOR) Transition – The Division will continue to engage with registrants through examinations to assess their understanding of any exposure to LIBOR, their preparations for the expected discontinuation of LIBOR and the transition to an alternative reference rate, in connection with registrants' own financial matters and those of their clients and customers.

Focus Areas Relating to Investment Advisers and Investment Companies –

- **Compliance Programs –** The Division will continue to review the compliance programs of registered investment advisers (RIAs), including whether those programs and their policies and procedures are reasonably designed, implemented, and maintained. RIAs are also increasingly offering investment strategies that focus on ESG factors. The Division will continue to focus on products in these areas that are widely available to investors including open-end funds and ETFs, as well as those offered to accredited investors such as qualified opportunity funds. The Division will review the consistency and adequacy of the disclosures RIAs and fund complexes provide to clients regarding these strategies, determine whether the firms' processes and practices match their disclosures, review fund advertising for false or misleading statements, and review proxy voting policies and procedures and votes to assess whether they align with the strategies.

- **Registered Funds, Including Mutual Funds and ETFs –** Examinations of registered funds will focus on disclosures to investors, valuation, filings with the Commission, personal trading activities, contracts and agreements, and will include a review of fund governance practices and compliance programs. The Division will prioritize examinations of mutual funds or ETFs that have not previously been examined or have not been examined in a number of years, and will generally focus on fund compliance programs and financial condition, particularly where funds have instituted advisory fee waivers. In addition, the Division will focus on compliance with exemptive relief, including for the newly created non-transparent, actively managed ETFs. The Division will also review funds' and advisers' disclosures and practices related to securities lending.

- **RIAs to Private Funds –** The Division will continue to focus on advisers to private funds, and will assess compliance risks, including a focus on liquidity and disclosures of investment risks and conflicts of interest. The Division will also focus on advisers to private funds that have a higher concentration of structured products, such as collateralized loan obligations and mortgage backed securities, to assess whether the private funds are at a higher risk for holding non-performing loans and having loans with higher default risk than that disclosed to investors.

Focus Areas Involving Broker-Dealers and Municipal Advisors – Examination of broker-dealers will continue to focus on compliance with the Customer Protection Rule and the Net Capital Rule, including the adequacy of internal processes, procedures, controls, and compliance with requirements for borrowing securities from customers. Broker-dealer examinations will also focus on compliance with best execution in a zero commission environment, recently amended Rule 606 order routing disclosure rules, and market-maker compliance with Reg SHO. The Division will examine, in light of the COVID-19 pandemic and its potential impact on municipal advisors and their clients, how municipal advisors may have adjusted their practices. The Division will also examine whether municipal advisors have met their fiduciary duty obligations to municipal entity clients, including the disclosing of and managing conflicts of interest and documentation of the scope of their client engagements.

Market Infrastructure -

- **Clearing Agencies –** The division will focus clearing agency examinations on compliance, legal, recovery and wind down, margin, back-testing, settlement and operations, liquidity risk management, effect of the LIBOR transition and cybersecurity and resiliency, among other things. The Division will also examine governance, legal, compliance and risk management frameworks of registered clearing agencies by reviewing the efforts to escalate deficiencies identified by the Division and internal auditors and whether they have taken timely and appropriate action to correct and mitigate the risks associated with those deficiencies.

- **National Securities Exchanges –** Examinations will focus particularly on exchange operations to monitor, investigate, and enforce member and listed company compliance with, as applicable, exchange rules and the federal securities laws.

- **Regulation Systems Compliance and Integrity –** The Division will continue to evaluate whether SCI entities have established, maintained, and enforced written SCI policies and procedures as required. Areas of focus will include IT governance, IT asset management, cyber threat management/incident response, business continuity planning, and third party vendor management, including utilization of cloud services.

- **Transfer Agents –** The Division will continue to examine core functions of transfer agents including the timely turnaround of items and transfers, recordkeeping and record retention, and safeguarding of funds and securities.

- **FINRA and MSRB –** The Division will continue its oversight of FINRA by focusing examinations on FINRA's operations and regulatory programs and the quality of FINRA's examinations of broker-dealers and municipal advisors. It will also examine MSRB to evaluate the effectiveness of its policies, procedures, and controls.

The published priorities for FY 2021 are not exhaustive and will not be the only areas the Division focuses on in its examinations, risk alerts, and outreach. While the priorities primarily drive the Division's examinations, the scope of any examination is determined through a risk-based approach that includes analysis of a given entity's history, operations, services, products offered, and other risk factors.

The collaborative effort to formulate the annual examination priorities starts with feedback from examination staff who are uniquely positioned to identify the practices, products, services, and other factors that may pose risk to investors or the financial markets. Division staff also takes into account input and advice from the Chair and other Commissioners, staff from other SEC divisions and offices, and other federal financial regulators.

###