



U.S. SECURITIES AND
EXCHANGE COMMISSION

2021

EXAMINATION PRIORITIES

Division of Examinations

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MESSAGE FROM THE LEADERSHIP TEAM

This year marks the 25th anniversary of the creation of the U.S. Securities and Exchange Commission (SEC) Office of Compliance Inspections and Examinations (OCIE). During that time, we have grown in size and share of the SEC's workforce to become the second largest office or division at the SEC—with more than 1,000 employees across all 11 regional offices and the Washington, DC, headquarters. Over the past 25 years, our examination responsibilities have substantially increased with the organic growth in the securities markets and industry and with the introduction of many new types of registered firms, all highlighting the growing breadth and complexity of our mission.

To better reflect the important contributions of the examination program and our overall role at the SEC, we are honored and proud that on December 17, 2020, the Commission unanimously supported the decision to rename OCIE the "Division of Examinations."¹ This significant step recognizes the important role we have, both within the SEC, as well as externally, to promote a strong culture of compliance within the financial services industry.

DID YOU KNOW?

On December 17, 2020, the Commission unanimously supported the decision to rename OCIE the "Division of Examinations."

The Division of Examinations (the Division or EXAMS) is pleased to announce our examination priorities for fiscal year (FY) 2021, marking the 9th year of their publication. We hope you find our discussion of key risks, trends, and examination priorities valuable in overall efforts to promote and improve compliance and ultimately protect investors.

¹ <https://www.sec.gov/news/public-statement/joint-statement-division-examinations>.

Global Pandemic: Observations and Impacts

The past year has been unprecedented in the markets, our careers, and our lives. The pandemic has impacted everyone in different, and in some cases profound ways—including health and medical concerns, care for family members, financial stresses, virtual schooling, and social distancing. The year 2020 ushered in many challenges and changes.

There has been change in almost every facet of our lives, including in the delivery of financial services and the operations of the financial services industry. Generally, we observed that the financial markets' operations and systems continued to work as designed, with exchanges, clearing agencies, investment advisers, broker-dealers, and other market participants adapting to significant remote work and continuing to operate largely without incident. While there certainly were challenges, and we observed adjustments to many processes, particularly those that involved manual processing or were not automated, overall, the delivery of financial services continued in the pandemic environment as it should have and as investors and other market participants have come to rely and depend upon.

Early on in the pandemic, we issued a statement on our own operations noting the shift to correspondence examinations and our outreach efforts to registered firms to assess pandemic-related operational resiliency challenges.² The Division pivoted to focus on the most pressing risks—including examining whether registered firms' business continuity plans were updated, operational and effective, and addressing increased cybersecurity risks facing firms and investors. We published a COVID-19 Risk Alert to share observations from this work and provided observations and recommendations to assist firms' pandemic response.³

² <https://www.sec.gov/ocie/announcement/ocie-statement-operations-health-safety-investor-protection-and-continued>.

³ <https://www.sec.gov/files/Risk%20Alert%20-%20COVID-19%20Compliance.pdf>.

In addition to the cybersecurity recommendations in the COVID-19 Risk Alert, we published two cyber-specific risk alerts in conjunction with the Division's heightened focus in this area since the onset of the pandemic. First, our Ransomware Risk Alert highlights the risk and provides observations regarding ransomware attacks, which are when perpetrators typically hack into a victim's computer system, seizing control and encrypting data, then demand compensation (a ransom) in exchange for maintaining the integrity and/or confidentiality of customer data, or for the return of control over the firm's systems.⁴ Second, our Credential Compromise Risk Alert highlights observations and responses to credential stuffing attacks, which exploit the tendency for people to reuse their passwords across multiple websites and systems, by cyber attackers who obtain lists of previously compromised usernames, email addresses, and corresponding passwords from the dark web in an attempt to log in and gain unauthorized access to a customer account.⁵ These risk alerts built on a special report published early in 2020 on Cybersecurity and Resiliency Observations that highlighted the importance of strong cyber-hygiene and protections.⁶

As we look beyond the pandemic, although uncertainties remain, we know that both firms and the Division will continue to adapt, innovate, and work to ensure strong compliance and investor protection.

⁴ <https://www.sec.gov/files/Risk%20Alert%20-%20Ransomware.pdf>.

⁵ <https://www.sec.gov/files/Risk%20Alert%20-%20Credential%20Compromise.pdf>.

⁶ <https://www.sec.gov/files/OCIE-Cybersecurity-and-Resiliency-Observations-2020-508.pdf>.

Regulation Best Interest and Form CRS

This past year saw the implementation of Regulation Best Interest⁷ and over 13,000 Form CRS filings. EXAMS, working closely with the SEC's other divisions and offices, carefully developed new examination approaches to both promote compliance and inspect firms in both our broker-dealer and investment adviser/investment company programs. To do so, we began by communicating our intentions. In April, we issued two risk alerts: [Examinations that Focus on Compliance with Regulation Best Interest](#)⁸ and [Examinations that Focus on Compliance with Form CRS](#).⁹ These risk alerts provided firms and their chief compliance officers (CCOs) with sample request lists and identified key areas we planned to focus on in our initial examinations.

We also communicated our results. In October, after completing many initial examinations, we shared preliminary observations at a [Roundtable on Regulation Best Interest and Form CRS](#).¹⁰ This public roundtable highlighted to firms and CCOs initial observations on Regulation Best Interest and Form CRS implementation. For Regulation Best Interest, we observed that firms generally responded by updating their written supervisory procedures (WSPs) and conducted training. Some firms' WSPs incorporated specific processes to comply with the requirements of Regulation Best Interest, whereas we noted potential concerns with WSPs that simply restated the standards, but did not provide any meaningful guidance as to how these should be implemented.

For Form CRS, we saw a wide variety of approaches that firms used to comply with the requirements of Form CRS, and generally observed firms complying with the Form's requirements. Many firms appeared to make effective use of hyperlinks in their digital

Form CRSs. We also observed that many firms are generally avoiding legalese and generic boilerplate language, but we also noted the readability of some Form CRSs could still be improved. Some firms did not adequately respond to the Form CRS disciplinary disclosure requirements, an area all firms should ensure they address. In addition, we identified and notified hundreds of firms that they had failed to timely file a Form CRS.

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⁷ <https://www.sec.gov/rules/final/2019/34-86031.pdf>.

⁸ <https://www.sec.gov/files/Risk%20Alert-%20Regulation%20Best%20Interest%20Exams.pdf>.

⁹ <https://www.sec.gov/files/Risk%20Alert%20-%20Form%20CRS%20Exams.pdf>.

¹⁰ https://www.sec.gov/video/webcast-archive-player.shtml?document_id=102620-best-interest-roundtable.

In December, staff from the Division issued a [Statement on Recent and Upcoming Regulation Best Interest Examinations](#).¹¹ The statement identified components of Regulation Best Interest that may be the subject of focus in the next phase of examinations, including how firms have considered costs in making a recommendation and the processes firm personnel have used to recommend complex products.

EXAMS continues to participate in the agency's Inter-Divisional Standards of Conduct Implementation Committee, and would also like to remind market participants and other members of the public that they are encouraged to send questions to IABDQuestions@sec.gov. In addition, staff FAQs have been issued on Regulation BI ([FAQs on Regulation Best Interest](#)) and Form CRS ([FAQs on Form CRS](#)).

Importance of Compliance

We continue to believe it is important to emphasize that compliance programs, CCOs and other compliance staff play critically important roles at firms. Indeed, culture and tone from the top are key. In the course of conducting thousands of examinations of many different types of firms, the hallmarks of effective compliance become apparent. One such hallmark includes compliance's active engagement in most facets of firm operations and early involvement in important business developments, such as product innovation and new services. Another is a knowledgeable and empowered CCOs with full responsibility, authority, and resources to develop and enforce policies and procedures of the firm. In a November speech, Director Driscoll highlighted his views on what it means to have an empowered CCO in a position of sufficient seniority and with the necessary authority.¹² The speech also addressed firms' continued need to address compliance, such that it has adequate resources commensurate with the role. And importantly, a commitment to compliance from C-level and similar executives to set a tone from the top that compliance is integral to the organization's success and that there is tangible support for compliance at all levels of an organization.

¹¹ <https://www.sec.gov/news/public-statement/examinations-regulation-best-interest-2020-12-21>.

¹² <https://www.sec.gov/news/speech/driscoll-role-cco-2020-11-19>.

FY2020 Results

The Division of Examinations is mindful that numbers never tell the complete story of our effectiveness and efficiency. While certain statistics are discussed below, they do not completely capture or measure the quality of our examination program. Statistics do, however, convey certain reference points that provide some insights into our examination program. The Division completed 2,952 examinations in FY2020, which is a 4.4 percent decrease from FY2019. This small decrease, when viewed in light of the impact of the pandemic, is illustrative of the staff's hard work, resiliency and dedication to the SEC's and the Division's mission to protect investors.

The Investment Adviser/Investment Company (IA/IC) Program

The Division of Examinations reports annually the percentage of the population of registered investment advisers (RIAs) examined each year. This metric is important as the Division is the primary, and often only, regulator responsible for examining this segment

of our registered firm population. The population of RIAs has grown significantly in recent years, as has the amount of assets those RIAs manage. More specifically, in just the last five years, the number of RIAs the Division oversees increased from about 12,000 to more than 13,900, and the assets under management of RIAs increased from approximately \$67 trillion to \$97 trillion.

In addition to this significant growth, the financial industry and marketplace are constantly evolving and responding to investor needs, regulatory changes, technology, and

competition. RIAs' complexity, interconnectivity, and dependency on a variety of market participants also continue to grow: more than 3,900 RIAs manage over \$1 billion in assets; approximately 36 percent of RIAs manage a private fund; more than 55 percent of RIAs have custody of client assets; more than 60 percent of RIAs are affiliated with other financial industry firms; and approximately 11 percent of RIAs provide advisory services to a mutual fund, exchange-traded fund, or other registered investment company. Despite this significant growth and complexity, the Division has made significant strides over the past several years to increase its RIA coverage, including through: (1) implementation of program efficiencies, both through process and technology; (2) realignment of internal staffing to address the coverage rates for RIAs; and (3) continued investment in our human capital, through ongoing training of staff and the onboarding of experienced subject matter experts. These efforts continue to pay dividends: The Division has increased its examination

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coverage of RIAs over the past several years from 10 percent in 2014 to a high of 17 percent in 2018. The Division's coverage of RIAs in 2020, a year in which the RIA population continued to increase and the pandemic necessitated a mid-year shift to remote examining, was 15 percent.

The Division also prioritizes the examinations of investment company complexes, which will remain a core focus for examinations in FY2021. In FY2020, the Division completed more than 100 examinations of investment company complexes, as well as conducting hundreds of outreach calls to both investment company complexes and RIAs to assess market impacts from the pandemic.

While the Division will continue to make improvements in efficiency, there remains a significant risk that, in light of industry growth and increased complexity and other factors, it does not have sufficient resources to adequately cover the RIA space. The Division's coverage rates will likely not keep pace with the continued growth in the population and complexity, without corresponding staffing increases. While the Division has made great strides to improve the coverage rate, the risks of diminished coverage, quality, and effectiveness are possible without further support. Ultimately, this trend is concerning and a focus for the Division of Examinations.

Broker-Dealer and Exchange (BDX) Program

BDX devoted significant time to preparing for the implementation, and conducting its first examinations, of Regulation Best Interest. This involved working in close coordination both within the Commission as well as with the Financial Industry Regulatory Authority (FINRA) to develop examination materials such as toolkits and other resources to provide guidance and extensive training to examination staff. BDX also began preparations for the security-based swap regulations through the development of examination materials and evaluation of necessary data sources. Even with these significant work-streams and the disruptions caused by the pandemic, BDX completed over 330 examinations of broker-dealers, over 110 examinations of national securities exchanges, and over 90 examinations of municipal advisors and transfer agents.

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Other Program Areas

The FINRA and Securities Industry Oversight group (FSIO) completed over 150 examinations of FINRA, including inspections of critical FINRA program areas and oversight reviews of FINRA's examinations. FSIO also held frequent monitoring meetings with FINRA departments to assess the effectiveness of FINRA's programs, including monitoring FINRA's exam program transformation and the many adjustments to approaches and operations that were necessary across FINRA due to the pandemic. In addition, FSIO completed examinations and similar monitoring of the Municipal Securities Rulemaking Board (MSRB).

The Clearance and Settlement Examination Program (CS), working with the Technology Controls Program (TCP), completed 28 examinations of clearing agencies, nearly double the number completed in FY2019. TCP completed over 70 examinations in addition to providing technical support to all other program areas within EXAMS as well as to other Commission divisions and offices. Leveraging its expertise in information security, business continuity and incident response, TCP staff supported efforts ranging from responding to account take-overs to contributing to the development of international cybersecurity best practices, and enhancing domestic and international cyber incident response. Finally, while not widely known, the Office of Risk and Strategy (ORS) houses the registrations team, which processed and reviewed over 50,000 filings from registered firms in 2020, including over 13,000 Forms CRS.

Impact of Examinations

Through its work, the Division is promoting compliance and making a difference for investors and our securities markets. For example, during FY2020, the Division issued more than 2,000 deficiency letters, with many firms taking direct corrective actions in response to those letters, including by amending compliance policies and procedures or a regulatory filing; enhancing their disclosures; or returning fees back to investors, among other things. To fight against fraud and misappropriation of investor assets, the Division also commits significant resources to verify the existence of investor assets at custodians and to ensure that they are valued properly, a process called asset verification. In FY2020, the Division verified over 4.8 million investor accounts, totaling over \$3.4 trillion in assets—an increase of more than 50 percent of investor accounts, and more than twice the value of assets verified in FY2019. Similarly, when RIAs have access to client funds

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or securities, the Division prioritizes examination for compliance with the Custody Rule (Rule 206(4)-2 under the Investment Advisers Act of 1940 (Advisers Act)), which includes important client safeguards like third party audits and surprise examinations. For broker-dealers, the Division reviews for compliance with the Customer Protection Rule (Rule 15c3-3 under the Securities Exchange Act of 1934 (Exchange Act)) and the Net Capital Rule (Rule 15c3-1 under the Exchange Act) to help ensure that customer securities and assets exist and are protected from misappropriation and that firms are adequately capitalized.

Another way we promote compliance and protect investors is by encouraging firms to make investors whole when we identify during an examination that fees have been improperly calculated and charged. Examinations closed in FY2020 have so far resulted in firms returning more than \$32 million to investors. We may refer certain matters to the Division of Enforcement when findings are significant with respect to such improper charges or other issues.

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Many important Enforcement matters have resulted from our Division's exams and referrals, including, for example: numerous settled matters involving RIAs' selection of higher cost mutual fund share classes for clients when lower cost options were available; settled actions against advisers for failing to disclose conflicts of interest, fraudulently inflating net asset values and performance results of managed funds, and violating the Custody Rule; settled actions against broker-dealers for net capital deficiencies, violating Regulation SHO, failing to report suspicious activity reports, and failing to supervise registered representatives who made unsuitable recommendations to retail customers; and a settled matter with a large fintech firm who misrepresented that it provided essentially cost free trading and obtained execution equal to or better than its competitors, when in fact customers received inferior execution due, in part, to the firm receiving substantial payment for order flow. More than 130 Enforcement referrals from FY2020 exams were made so far, and we anticipate more to come from our 2020 examinations. Recoveries and referral metrics may lag fiscal year reporting as we continue to work to get results for harmed investors, which, included more than 20 additional referrals in FY2020 from examinations that were completed in FY2019.

Risk, Technology, and Industry Trends

In FY2021, the Division of Examinations will focus on, and respond to, market events and adjust its risk-based examination program as new and emerging risk areas develop. The Division has already had to adjust course this fiscal year to respond to market events. For example, examination staff across the country and across all of the Division's program areas have, and continue to be, engaged with registrants reviewing and assessing operations, federal securities law compliance, and assessing risk regarding the wide-spread compromise of commonly used network management software and activities around the so called "meme stocks."

The Division has expanded its ability to respond to new and emerging risk areas with the newly created Event and Emerging Risks Examination Team (EERT). The Division will leverage this new team to proactively engage with registered firms and other market participants about emerging threats and current market events and quickly mobilize to provide expertise and resources to the SEC's regional offices when critical matters arise. The EERT will help ensure, through examinations and other firm engagement and monitoring activities, firms are better prepared to address exigent threats, incidents, and emerging risks. The EERT will also work with Division staff to provide expertise and support in response to significant market events that could have a systemic impact or that place investor assets at risk. As always, EXAMS will coordinate closely with other SEC divisions and offices, as well as other domestic and foreign regulatory authorities to better assess impact and mitigate burden on firms.

With an increasing number of staff of registered firms working remotely, additional emphasis also will be focused on compliance and operational challenges that may arise, especially in the area of supervision. Prior to the pandemic, firms were already adapting their business models to better meet customer needs, lower costs, look to new revenue streams, and help manage their clients' overall financial wellbeing. The pandemic may have slowed some of these efforts, but also accelerated other activities. Firms will continue to have a large remote footprint and thus may increasingly utilize new communication technologies, develop new workflows around onboarding customers, as well as expand (and in some cases close) business lines, or offer different products and services. As with any change, certain activities may result in conflicts of interest, which could require new disclosures and mitigation. Newly offered products or strategies could involve new regulatory obligations or necessitate compliance enhancements to systems, including order and portfolio management frameworks. As a result, the Division will carefully evaluate the impact of these types of firm activities.

More globally, we will continue to focus on several key themes and topics. As the financial service industry transitions away from the London Inter-Bank Offered Rate (LIBOR), the Division will continue to engage with firms around their preparedness and related transition activities. EXAMS will also engage with firms to understand the impact to operations, their business activities, and their customers relating to the United Kingdom's exit from the European Union. Firms should ensure their compliance programs and controls environment continue to adapt and provide strong protections even as business units and offerings change.

EXAMS continues to enhance its use of new technology and advanced data analytics to prioritize examination candidates and further analyze information collected during our inspections. Working with our partners in the Division of Economic and Risk Analysis (DERA), we plan to build upon existing work in predictive modeling and text-based analytics to improve our examination processes and identify risks and outlier activities correlated with compliance and control risks.

While balancing the importance of data protection with effectively protecting investors, the Division has experienced challenges examining non-U.S. based registered firms that are increasingly subject to laws on data protection and privacy, among others, that may impact the cross-border transfers of certain information to the SEC. These challenges are particularly acute with the growing population of offshore RIAs that now number over 900 RIAs, managing nearly \$12 trillion in investor assets. Under U.S. securities laws and implementing rules, RIAs are required to provide their records to SEC staff for inspection, and must certify as to this ability to comply on Form ADV. As a result, the Division in conjunction with the Office of International Affairs has been seeking additional information regarding laws that may impact the cross-border transfer of records from offshore registered firms to the SEC through various channels in order to determine whether they can comply with these inspection requirements. Notably, the United Kingdom's data protection authority has provided guidance that SEC-registered firms based in the United Kingdom can rely on the public interest derogation under the local data protections law to transfer records containing personal data to SEC staff during examinations. We continue to work with both industry and our counterparts in other countries to address these challenges.

Firm and Investor Outreach and Risk Alerts

The Division of Examinations priorities provide an overview of key areas where it intends to focus its resources. That said, the stated priorities and other examinations the Division

conducts do not encompass all of our efforts to improve compliance. To promote compliance, and to further the effective and efficient allocation of examination resources, the Division proactively engages with registered firms through outreach events, including national and regional compliance seminars. In FY2020, EXAMS staff participated in or held more than 300 such outreach events, including specific efforts directed toward teachers, vulnerable adults and seniors, and members of the military.

DID YOU KNOW?

In FY2020, EXAMS staff participated in or held more than three hundred outreach events, including specific efforts directed toward teachers, vulnerable adults and seniors, and members of the military.

The Division also engaged with and informed the industry through publications designed to raise awareness of compliance and industry risks. During FY2020, the Division published a report on Cybersecurity and Resiliency Observations¹³ and eight risk alerts.¹⁴ The risk alerts include:

- Top Compliance Topics Observed in Examinations of Investment Companies and Observations from Money Market Fund and Target Date Fund Initiatives
- Examinations that Focus on Compliance with Form CRS
- Examinations that Focus on Compliance with Regulation Best Interest
- Examination Initiative: LIBOR Transition Preparedness
- Observations from Examinations of Investment Advisers Managing Private Funds
- Cybersecurity: Ransomware Alert
- Select COVID-19 Compliance Risks and Considerations for Broker-Dealers and Investment Advisers
- Cybersecurity: Safeguarding Client Accounts against Credential Compromise

The Division will continue its publication of risk alerts that both describe its national initiatives as well as outline findings and observations from examinations in key areas with the hopes that sharing this information will further promote compliance within registered firms and ultimately further protect the investing public.

¹³ <https://www.sec.gov/files/OCIE-Cybersecurity-and-Resiliency-Observations-2020-508.pdf>.

¹⁴ All Division of Examinations Risk Alerts are available at: <https://www.sec.gov/exams>.

Informing Policy

In addition to our other work, we wanted to take a moment to discuss our important role in informing policy. This function represents a significant amount of important internal work that is not always visible, or obvious in our reported metrics. Although the Division of Examinations itself does not create policy, nearly all our work helps to inform, support, and shape policy discussions and decisions made throughout the Commission. This year, our Division's ability to inform others was never more evident, and never more important. We are immensely proud of the Division's performance during the market events this past spring, which was particularly noteworthy in light of the pandemic's impact. The Division used its expertise, experience, process, and initiative to respond to the events and to serve investors. During that time, the Division provided others within the Commission as well as other regulators, real-time updates of registered firms and market participant information on an expedited basis to provide the Commission at large with a robust view of the situation at the time.

Our ability to inform policy is driven by the knowledge that the Division gains from both the thousands of examinations it does each year, and the feedback we receive from other engagements. We collect observations from examinations, track certain risk themes within those exams, work on targeted national and local subject matter initiatives, including recent examples of inquiries focused on environmental, social, and governance investing, LIBOR transition, and pandemic-related business continuity planning assessments to over 800 firms, and accept feedback from countless engagements with registered firms, self-regulatory organizations, other regulators and market participants. Based on this large, robust, and strategic set of data points EXAMS thoughtfully cultivates and analyzes, we are uniquely able to provide the Commission and other SEC divisions and offices with current insight and valuable feedback about the practical aspects of the Commission's regulatory mandates and the real-world impacts of regulation.

The Division then uses its observations to inform others throughout the Commission. One of the most significant ways is in rulemaking. EXAMS' input is routinely provided to the SEC's rulemaking divisions and offices as they consider whether to amend current rules, draft new ones, or provide guidance. In fact, the Division of Examinations has contributed to more than 30 recent rulemakings related to the registrants that we examine.

The Division of Examinations also shares its highly technical and programmatic knowledge to inform areas beyond rulemaking. For example, TCP not only provides technical expertise to the exam staff, but also informs others throughout the Commission on the ever-increasing cybersecurity issues that firms face, and provides critical analyses of the technology-related tips, complaints and referrals the Commission receives. Similarly, our BDX program informs views of other Divisions' evaluation of requests by registered firms for transaction approvals, and CS uses clearing data to inform others of potential financial stress on firms, which was particularly critical during spring 2020. Likewise, ORS routinely informs policy by sharing information on risks and emerging issues it identifies, including through its Office of Large Firm Monitoring, which holds recurring and *ad hoc* engagements with some of the largest financial firms in the country. These efforts provided incredibly valuable information and insight to the Commission as it assessed and responded to market events through the pandemic.

The Division of Examinations is a Resource

Finally, please know that the Division of Examinations is always interested in hearing more about new and emerging risk areas and products as well as how it can be more effective in its mission. The Division's contact information can be found at: <https://www.sec.gov/contact-information/sec-directory>. Please engage with our staff. 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>. Thank you for doing your part to protect investors and promote compliance.



**THE DIVISION OF
EXAMINATIONS FY2021
EXAMINATION PRIORITIES**



EQUAL JUSTICE



INTRODUCTION

During FY2021, the Division of Examinations (the Division or EXAMS) will continue to prioritize the examination of certain practices, products, and services that it believes present heightened risks to investors or the integrity of the U.S. capital markets. Examinations of these priority areas are designed to support the SEC's mission to protect investors, facilitate capital formation, and maintain fair, orderly, and efficient markets.

Many of the themes discussed below are perennial risk areas the Division routinely covers in its examinations. Their importance to investors, the seriousness and frequency of prior years' examination findings, or both, demonstrate the need for the Division, and registrants, to continue to be vigilant in these significant areas, including continued consideration of environmental, social, and governance (ESG) matters in light of market developments and increasing awareness in this space. The Division will also prioritize emerging risks, including those relating to climate and ESG that are described more fully below. Moreover, these priorities are not exhaustive and will not be the only issues we address in our examinations, published risk alerts, and investor and industry outreach.

While the priorities drive many of the Division's examinations, we select firms for examination and the areas of focus covered during examinations according to a risk-based analysis, which varies depending on the type of firm and its business activities. For registered investment advisers (RIAs) and broker-dealers, the Division considers dozens of risk factors, which include: products and services offered, including certain products identified as having higher risk characteristics; compensation and funding arrangements; disclosures and representations made to customers; prior examination observations and regulatory history; whether the firm has never been examined, is newly registered, or has not been examined in many years; material changes in firm leadership or other key personnel; and whether a firm has access to investor assets, *i.e.*, custody. While the aforementioned characteristics and factors are not exhaustive, they provide insight into criteria the Division considers in its risk-based analysis.

DID YOU KNOW?

The Division selects firms for examination and the areas of focus covered during examinations according to a risk-based analysis, which varies depending on the type of firm and its business activities.

Our analytic efforts and examinations remain firmly grounded in the Division's four pillars: promoting compliance, preventing fraud, identifying and monitoring risk, and informing policy. The Division's risk-based approach, both in selecting registrants as examination candidates and in scoping risk areas to examine, allows the Division to be flexible and capable of covering emerging and exigent risks to investors and the marketplace as they arise. For example, since March 2020, the Division has actively engaged in ongoing dialogue and outreach efforts with many registrants to assess the impacts of the pandemic on their businesses, employees, and customers. Additionally, the Division has gathered information about, among other things, challenges with operational resiliency and the implementation and effectiveness of registrants' business continuity

plans. The Division undertook these efforts in the interests of protecting investors and the integrity of the markets, which helped inform observations in a published risk alert relating to [Select COVID-19 Compliance Risks and Considerations for Broker-Dealers and Investment Advisers](#).¹⁵ Finally, to improve our ability to respond to emerging and exigent risks, the Division established the Event and Emerging Risks Examination Team (EERT), which has recently become operational.¹⁶

DID YOU KNOW?

To improve our ability to respond to emerging and exigent risks, the Division established the Event and Emerging Risks Examination Team (EERT), which began operating this year.

¹⁵ See OCIE Risk Alert, [Select COVID-19 Compliance Risks and Considerations for Broker-Dealers and Investment Advisers](https://www.sec.gov/files/Risk%20Alert%20-%20COVID-19%20Compliance.pdf) (August 12, 2020) available at <https://www.sec.gov/files/Risk%20Alert%20-%20COVID-19%20Compliance.pdf>.

¹⁶ See Press Release, [SEC Announces Creation of the Event and Emerging Risk Examination Team in the Office of Compliance Inspections and Examinations and the Appointment of Adam D. Storch as Associate Director](https://www.sec.gov/news/press-release/2020-165) (July 28, 2020) available at <https://www.sec.gov/news/press-release/2020-165>.

RETAIL INVESTORS, INCLUDING SENIORS AND INDIVIDUALS SAVING FOR RETIREMENT

The Division will again emphasize the protection of retail investors, particularly seniors and individuals saving for retirement. EXAMS' two largest program areas—Investment Adviser/Investment Company (IA/IC) and Broker-Dealer and Exchange (BDX)—will continue to prioritize examinations of RIAs, broker-dealers, and dually-registered or affiliated firms, as more and more individuals rely on these financial intermediaries to gain access to the financial markets. EXAMS will focus on investments and services marketed to retail investors, such as mutual funds and exchange-traded products, municipal securities and other fixed income instruments, and microcap securities, such as those traded over-the-counter.

Standards of Conduct

The Commission's June 2019 adoption of Regulation Best Interest, the Form CRS Relationship Summary (Form CRS), and the Interpretation Regarding Standard of Conduct for Investment Advisers will have a direct impact on the retail investor experience with broker-dealers and RIAs.¹⁷

Regulation Best Interest

Regulation Best Interest established a new standard of conduct for broker-dealers and associated persons of a broker-dealer. Regulation Best Interest requires broker-dealers and natural persons who are associated persons of a broker or dealer to act in the best interest of their retail customers when making a recommendation of any securities transaction or investment strategy involving securities without placing their financial or other interests ahead of the interests of the retail customer. This general obligation is satisfied only if a broker-dealer complies with four component obligations: a Disclosure Obligation, a Care Obligation, a Conflict of Interest Obligation, and a Compliance Obligation. The standard of conduct draws from

DID YOU KNOW?

Regulation Best Interest established a new standard of conduct for broker-dealers and associated persons of a broker-dealer.

¹⁷ See Regulation Best Interest: The Broker-Dealer Standard of Conduct, Rel. No. 34-86031 (June 5, 2019) available at <https://www.sec.gov/rules/final/2019/34-86031.pdf>; Commission Interpretation Regarding Standard of Conduct for Investment Advisers, Rel. No. IA-5248 (June 5, 2019) available at <https://www.sec.gov/rules/interp/2019/ia-5248.pdf>; Form CRS Relationship Summary; Amendments to Form ADV, Rel. No. 34-86032 (June 5, 2019) available at <https://www.sec.gov/rules/final/2019/34-86032.pdf>.

key fiduciary principles and cannot be satisfied through disclosure alone. The Division will prioritize examinations to assess compliance with Regulation Best Interest.¹⁸ Initial examinations previously undertaken focused on the processes broker-dealers relied on to implement Regulation Best Interest.

In 2021, the Division will expand the scope of examinations to focus on assessing whether broker-dealers are making recommendations that they have a reasonable basis to believe are in customers' best interests and evaluating broker-dealer processes for compliance and alterations made to product offerings. The Division will also conduct enhanced transaction testing as part of these examinations, and will evaluate firm policies and procedures designed to meet additional elements of Regulation Best Interest, the recommendation of rollovers and alternatives considered, complex product recommendations, assessment of costs and reasonably available alternatives, how sales-based fees paid to broker-dealers and representatives impact recommendations, and policies and procedures regarding how broker-dealers identify and address conflicts of interest.

RIA Fiduciary Duty

The Interpretation Regarding Standard of Conduct for RIAs reaffirms, and in some cases clarifies, aspects of an RIA's fiduciary duty that comprises duties of care and loyalty to its clients. The Division will continue to examine RIAs to assess whether, as fiduciaries, they have fulfilled their duty of care and duty of loyalty. This will include assessing, among other things, whether RIAs provide advice, including whether account or program types continue to be, in the best interests of their clients, based on their clients' objectives, and eliminate or make full and fair disclosure of all conflicts of interest which might incline RIAs—consciously or unconsciously—to render advice which is not disinterested such that their clients can provide informed consent to the conflict. The Division will continue to focus on risks associated with fees and expenses, complex products, best execution, and undisclosed or inadequately disclosed, compensation arrangements.

¹⁸ See OCIE Risk Alert, Examinations that Focus on Compliance with Regulation Best Interest (April 7, 2020) available at <https://www.sec.gov/files/Risk%20Alert-%20Regulation%20Best%20Interest%20Exams.pdf>.

Form CRS

Form CRS and its related rules require broker-dealers and RIAs to deliver to retail investors a brief customer or client relationship summary that provides information about the firm. Firms must also file their relationship summaries (and any amendments) with the Commission, using the Web Central Registration Depository or Investment Adviser Registration Depository, as applicable, and post the current relationship summary on the firm's public website, if the firm has one. The Division will prioritize examinations of broker-dealers and RIAs to assess compliance with Form CRS.¹⁹

Fraud, Sales Practices, and Conflicts

It is critically important that broker-dealers, investment companies, and RIAs provide investors with the disclosures required by the federal securities laws, including those relating to fees and expenses, and conflicts of interest, which will help enable the investing public to make better informed choices. Conflicts of interest, particularly those with the prospect of financial gain, can improperly influence a firm's fundamental obligation to act in investors' best interest. Recent market volatility and industry pressures have impacted fees and other revenues collected by firms. These conditions may cause increased financial stress on firms and their personnel, which may, in turn, lead to increased instances of fraudulent conduct.

Against the backdrop of the standards of conduct described above, examinations will focus on the appropriateness of recommendations and advice provided to retail investors, with a particular emphasis on: (1) seniors, including recommendations and advice made by entities and individuals targeting retirement communities; (2) teachers; (3) military personnel; and (4) individuals saving for retirement.

Additionally, the Division will concentrate on recommendations regarding account type, conversions, and rollovers, as well as the sales practices used by firms for various product types, such as structured products, exchange-traded products, real estate investment trusts, private placements, annuities, digital assets, municipal and other fixed income securities, and microcap securities. In addition to the recommendation of complex products, the Division will examine broker-dealers to assess whether they are meeting their legal and compliance obligations when providing retail customers access to complex strategies, such as options trading, and complex products. The Division will also focus on how firms are complying with the recent changes to the definition of accredited investor when recommending and selling certain private offerings.

¹⁹ See OCIE Risk Alert, Examinations that Focus on Compliance with Form CRS (April 7, 2020) available at <https://www.sec.gov/files/Risk%20Alert%20-%20Form%20-%2000-%20Exams.pdf>.

The Division's examinations will review firms' disclosures regarding their conflicts of interest, including those related to fees and expenses. Fee and compensation-based conflicts of interest may take many forms, including revenue sharing arrangements between a registered firm and issuers, service providers, and others, and direct or indirect compensation to personnel for executing client transactions. One particular area the Division will prioritize is the examination of RIAs operating and utilizing turnkey asset management platforms. Such platforms provide RIAs with technology, investment research, portfolio management and other outsourcing services, and the Division's examinations will seek to assess whether such fees and revenue sharing arrangements are adequately disclosed.

In addition, concerns may arise when an RIA does not aggregate certain accounts for purposes of calculating fee discounts in accordance with its disclosures. In reviewing fees and expenses, the staff will review for: (1) advisory fee calculation errors, including, but not limited to, failure to exclude certain holdings from management fee calculations; (2) inaccurate calculations of tiered fees, including failure to provide breakpoints and aggregate household accounts; and (3) failures to refund prepaid fees for terminated accounts.

Retail-Targeted Investments

Certain securities products can pose elevated risks when marketed or sold to retail investors, whether as a result of the characteristics of those securities, the dynamics in the markets, or the significant amount or concentration of assets retail investors have invested in a product. The Division will continue to prioritize examinations of issues regarding these products given their importance to retail investors.

Mutual Funds and Exchange-Traded Funds (ETFs)

Mutual funds and ETFs are the primary investment vehicle for many retail investors. In addition to the other registered investment company priorities identified below, the Division will focus on financial intermediaries' recommendations and disclosures involving ETFs, including adequacy of risk disclosure, and suitability, particularly in niche or leveraged/inverse ETFs. The Division will also continue to prioritize the examination of incentives provided to financial services firms and professionals that may influence the selection of particular higher cost mutual fund share classes when lower cost classes are available.

Municipal Securities and Other Fixed Income Securities

The importance of timely and accurate municipal issuer disclosure has become even greater as a result of the potentially significant effects of the pandemic on the finances and operations of many municipal issuers. The Division will examine the activities of broker-dealers, underwriters, and municipal advisors to assess whether these firms are meeting their respective obligations, as and to the extent applicable, in relation to municipal issuer disclosure. In addition, the Division will examine broker-dealer trading activity in municipal and corporate bonds for compliance with best execution obligations; fairness of pricing, mark-ups and mark-downs, and commissions; and confirmation disclosure requirements, including disclosures relating to mark-ups and mark-downs.

Microcap Securities

The Division remains committed to deterring microcap fraud, or fraud in connection with securities of companies with a market capitalization under \$250 million. During the pandemic, several issuers of microcap securities made questionable claims regarding testing, treatments, and vaccines, among other things. The Commission suspended trading in certain securities, including certain microcap securities, due to concerns about the adequacy and accuracy of information in the marketplace about the issuers. The Division will continue to prioritize examinations of broker-dealers and transfer agents for compliance with their obligations in the offer, sale, and distribution of microcap securities. Focus areas for examinations will include: transfer agent handling of microcap distributions and share transfers; broker-dealer sales practices and their consistency with Regulation Best Interest; and broker-dealer compliance with certain regulatory requirements, including the locate requirement of Regulation SHO, penny stock disclosures under Rules 15g-2 through 15g-6 of the Securities Exchange Act of 1934, and the obligation to monitor for and report suspicious activity and other anti-money laundering (AML) obligations.

INFORMATION SECURITY AND OPERATIONAL RESILIENCY

Information security is critical to the operation of the financial markets and the confidence of its participants. The impact of a breach in information security, including a successful cyber-attack, may have consequences that extend beyond the firm compromised to other market participants and retail investors, who may not be well informed of these risks and the potential consequences. The Division is acutely focused on working with firms to identify and address information security risks, including cyber-attack related risks, and encourages market participants to actively and effectively engage regulators and law enforcement in this effort.

Over the past year, the increase in remote operations in response to the pandemic has increased concerns about, among other things, endpoint security, data loss, remote access, use of third-party communication systems, and vendor management. The Division will review whether firms have taken appropriate measures to: (1) safeguard customer accounts and prevent account intrusions, including verifying an investor's identity to prevent unauthorized account access; (2) oversee vendors and service providers; (3) address

malicious email activities, such as phishing or account intrusions; (4) respond to incidents, including those related to ransomware attacks; and (5) manage operational risk as a result of dispersed employees in a work-from-home environment. In particular, EXAMS will also focus on controls surrounding online and mobile application access to investor account information, the controls surrounding the electronic storage of books and records and personally identifiable information maintained with third-party cloud service providers, and firms' policies and procedures to protect investor records and information.

DID YOU KNOW?

The increase in remote operations in response to the pandemic has increased concerns about, among other things, endpoint security, data loss, remote access, use of third-party communication systems, and vendor management.

In light of substantial disruptions to normal business operations in the past year, the Division will again be reviewing registrants' business continuity and disaster recovery plans. Building on the efforts noted above concerning our business continuity plan outreach related to the pandemic, the Division will shift its focus to whether such plans, particularly those of systemically important registrants, account for the growing physical and other relevant risks associated with climate change. The scope of these examinations will be similar to the post-Hurricane Sandy work of the Division and other regulators,²⁰ with a heightened focus on the maturation and improvements to these plans over the intervening years. As climate-related events become more frequent and more intense, we will review whether systemically important registrants are considering effective practices to help improve responses to large-scale events.

FINANCIAL TECHNOLOGY (FINTECH) AND INNOVATION, INCLUDING DIGITAL ASSETS

Innovations in financial technology and capital formation continue at a rapid pace. This transformation has dramatically changed the way firms interact with their customers and clients. The Division remains committed to staying informed about how these developments impact registrants and investors. Some firms (new and existing) are providing financial services to clients or customers in innovative and evolving ways, such as firms providing advice to clients through automated investment tools and platforms (often referred to as “robo-advisers”) or firms offering automated asset allocation, fractional share purchases, customized portfolios, and mobile applications. Among other areas, examinations will focus on evaluating whether firms are operating consistently with their representations, whether firms are handling customer orders in accordance with customer instructions, and review compliance around trade recommendations made in mobile applications.

The use of technology to facilitate compliance with regulatory requirements (RegTech) has experienced immense growth in recent years. RegTech, when implemented appropriately, may increase the efficiency of compliance staff, reduce manual processes, and exponentially increase transaction review capabilities. However, misused or improperly configured RegTech may lead to compliance program deficiencies. Examinations will focus on the implementation and integration of RegTech in firms' compliance programs.

²⁰ See Joint SEC, FINRA, and CFTC Business Continuity Planning Observations (August 7, 2013) available at <https://www.sec.gov/about/offices/ocie/jointobservations-bcps08072013.pdf>.

Alternative data, or data gleaned from non-traditional sources, is increasingly being used by firms, including advisers to private funds and registered investment companies, as part of their business and investment decision-making processes. Reviews will include examining whether firms are implementing appropriate controls and compliance around the creation, receipt, and use of such information.

DID YOU KNOW?

Examinations of market participants engaged with digital assets will continue to assess the following: (1) whether investments are in the best interests of investors; (2) portfolio management and trading practices; (3) safety of client funds and assets; (4) pricing and valuation; (5) effectiveness of compliance programs and controls; and (6) supervision of representatives' outside business activities.

The digital asset market continues to evolve, and so too does the adoption of distributed ledger technology in financial services and market infrastructure. Examinations of market participants engaged with digital assets will continue to assess the following: (1) whether investments are in the best interests of investors; (2) portfolio management and trading practices; (3) safety of client funds and assets; (4) pricing and valuation; (5) effectiveness of compliance programs and controls; and (6) supervision of representatives' outside business activities.

ANTI-MONEY LAUNDERING

The Bank Secrecy Act requires financial institutions, including broker-dealers and registered investment companies, to establish AML programs that are tailored to address the risks associated with the firm's location, size, and activities, including the type of products and services offered to customers or investors, 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 (FinCEN). SARs are used to detect and combat terrorist financing, public corruption, market manipulation, and a variety of other fraudulent behaviors.

Given the importance of these requirements, the Division will continue to prioritize examinations of broker-dealers and 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 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.

THE LONDON INTER-BANK 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 RIAs, broker-dealers, investment companies, municipal advisors, transfer agents and clearing agencies. Preparation for the transition away from LIBOR is essential for minimizing any potential adverse effects associated with LIBOR discontinuation. EXAMS intends 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.

ADDITIONAL FOCUS AREAS INVOLVING RIAS AND INVESTMENT COMPANIES

RIA Compliance Programs

EXAMS typically assesses compliance programs of RIAs 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 evaluating the effectiveness of a compliance program, the Division frequently reviews whether RIAs appear to have sufficient resources to perform core compliance responsibilities.

The Division will continue to review the compliance programs of RIAs, including whether those programs and their policies and procedures are reasonably designed, implemented, and maintained. The Division will continue to prioritize examinations of RIAs that have not been examined for a number of years to focus on whether the compliance programs of RIAs have been appropriately adapted in light of any substantial growth or change in their business models. As part of its risk-based examination approach, the Division will also continue to conduct examinations of RIAs that have never been examined, including new RIAs and RIAs registered for several years that have yet to be examined, with a particular focus on firms' compliance programs.

DID YOU KNOW?

Due to investor demand, RIAs are increasingly offering investment strategies that focus on sustainability. These strategies may include products and services that are referred to by a variety of terms such as sustainable, socially responsible, impact, and ESG conscious. The Division will focus on products in these areas that are widely available to investors.

Due to investor demand, RIAs are increasingly offering investment strategies that focus on sustainability. These strategies may include products and services that are referred to by a variety of terms such as sustainable, socially responsible, impact, and ESG conscious. The Division will focus on products in these areas that are widely available to investors such as open-end funds and ETFs, as well as those offered to accredited investors such as qualified opportunity funds.²¹ 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.

²¹ See IRS, Opportunity Zones Frequently Asked Questions *available at* <https://www.irs.gov/credits-deductions/opportunity-zones-frequently-asked-questions#designated> (A QOZ is an economically distressed community where new investments, under certain conditions, may be eligible for preferential tax treatment); see also SEC, Spotlight on Opportunity Zones *available at* <https://www.sec.gov/page/spotlight-opportunity-zones>.

In addition, the Division will continue to prioritize examinations of RIAs that are dually registered as, or are affiliated with, broker-dealers, or have supervised persons who are registered representatives of unaffiliated broker-dealers. Areas of focus will include whether RIAs maintain effective compliance programs to address the risks associated with these business models, including conflicts of interest that arise from certain compensation arrangements and outside business activities, best execution, and prohibited transactions.

Registered Funds, Including Mutual Funds and ETFs

During examinations of registered investment companies, EXAMS often reviews funds' compliance programs and governance practices, with a focus on disclosures to investors, valuation, filings with the Commission, personal trading activities, and contracts and agreements. The Division will review mutual fund filings and reports to funds' boards for compliance with regulatory requirements and for valuation issues. In focusing on valuation and the resulting impact on fund performance, liquidity and risk-related disclosures, the Division will review for investments in market sectors that experienced, or continue to experience, stress due to the pandemic, such as energy, real estate, or products such as bank loans and high yield corporate and municipal bonds. The Division will also review funds' and advisers' disclosures and practices related to securities lending.

The Division will also 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 funds' 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.

Given the high degree of customization and the diversity of data analytics practices and methodologies, liquidity risk management programs (LRMPs) will be a focus area for the Division. As part of its review of funds' compliance programs, the Division will focus on mutual funds' LRMPs to determine whether they are reasonably designed to assess and manage the funds' liquidity risk. The Division will also review the implementation of required liquidity classifications, particularly in light of the recent stresses in the market due to the pandemic.

Money market funds remain an important part of the registered fund industry to retail and institutional investors for cash management. Given their importance to investors, the Division intends to review money market funds' compliance with stress-testing requirements, website disclosures and board oversight.

RIAs to Private Funds

Over 36 percent of RIAs manage private funds, which frequently have significant investments from pensions, charities, endowments, and families. EXAMS 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.

Specifically, the Division will review for, among other things: preferential treatment of certain investors by advisers to private funds that have experienced issues with liquidity, including imposing gates or suspensions on fund withdrawals; portfolio valuations and the resulting impact on management fees; adequacy of disclosure and compliance with any regulatory requirements of cross trades, principal investments, or distressed sales; and conflicts around liquidity, such as adviser led fund restructurings, including stapled secondary transactions where new investors purchase the interests of existing investors while also agreeing to invest in a new fund.

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 funds are at a higher risk for holding non-performing loans and having loans with higher default risk than that disclosed to investors. In addition, the Division will examine advisers to private funds where there may have been material impacts on portfolio companies owned by the private fund (*e.g.*, real estate related investments) due to recent economic conditions.

ADDITIONAL FOCUS AREAS INVOLVING BROKER-DEALERS AND MUNICIPAL ADVISORS

In addition to the areas focusing on Regulation Best Interest, sales practices and retail-targeted investments already discussed, the Division's broker-dealer examinations will also focus on the safety of customer cash and securities, best execution in light of the effects of evolving commissions and other cost structures, certain types of trading activity, and the operations of alternative trading systems. The Division's municipal advisor examinations will also focus on the areas described below.

Broker-Dealer Financial Responsibility

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. Examinations of broker-dealers will continue to focus on compliance with these rules, including the adequacy of internal processes, procedures, and controls, and compliance

with requirements for borrowing securities from customers. In light of the COVID-19 pandemic, examiners may also assess broker-dealer funding and liquidity risk management practices to assess whether firms have sufficient liquidity to manage stress events.

Broker-Dealer Trading Practices

The Division will continue to examine broker-dealer trading practices. Examinations will focus on broker-dealer compliance with best execution obligations in a zero commission environment and compliance with the recently amended Rule 606 order routing disclosure rules. The Division will continue its prior initiative in the area of payment for order flow and its possible effect on order routing and best execution obligations. Examinations will also focus on market maker compliance with Regulation SHO, including the rules regarding aggregation units and locate requirements. The Division will also examine the operations of certain alternative trading systems for consistency with their disclosures provided in Form ATS-N.

DID YOU KNOW?

The Division will continue its prior initiative in the area of payment for order flow and its possible effect on order routing and best execution obligations.

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 COVID-19 pandemic has affected the finances and operations of many municipal issuers. Consequently, the importance of timely and accurate municipal disclosure is critical to investors. The Division will examine, in light of the COVID-19 pandemic and its potential impacts on municipal advisors and their clients, how municipal advisors adjusted their practices, if at all. The Division will also examine whether municipal advisors have met their fiduciary duty obligations to municipal entity clients, including but not limited to disclosing and managing conflicts of interest and documentation of the scope of their client engagements. The Division will also examine whether municipal advisors have satisfied their registration, professional qualification, continuing education, and supervision requirements and whether municipal advisors have relied on relief from Form MA annual update filing requirements,²² or the temporary broker exemptive order permitting certain activities in connection with direct placements of municipal securities.²³

²² See Order Under Section 15B of the Securities Exchange Act of 1934 Granting an Exemption for Municipal Advisors from Specified Provisions of the Securities Exchange Act and Rule 15Ba1-5(a)(1) Thereunder (March 26, 2020) available at <https://www.sec.gov/rules/exorders/2020/34-88491.pdf>.

²³ See Order Granting a Temporary Conditional Exemption from the Broker Registration Requirements of Section 15(a) of the Securities Exchange Act of 1934 for Certain Activities of Registered Municipal Advisors (June 16, 2020) available at <https://www.sec.gov/rules/exorders/2020/34-89074.pdf>.

MARKET INFRASTRUCTURE

Clearing Agencies

EXAMS will conduct, as required by law, at least one risk-based exam of each clearing agency designated as systemically important and for which the SEC serves as the supervisory agency.²⁴ These exams will focus on core risks, processes, and controls and will cover the specific areas required by statute, including assessment of financial and operational risk.²⁵ The Division will also conduct risk-based examinations of other registered clearing agencies and entities exempt from registration as clearing agencies.

The Standards for Covered Clearing Agencies are rules that require covered clearing agencies to, among other things, have policies and procedures that address maintaining sufficient financial resources, protecting against credit risks, managing member defaults, and managing operational and other risks. Examinations of SEC registered clearing agencies will focus on, where applicable: (1) compliance with the SEC's Standards for Covered Clearing Agencies and other federal securities laws applicable to registered clearing agencies; (2) whether clearing agencies have taken timely appropriate corrective action in response to prior examinations; and (3) other areas identified in collaboration with the SEC's Division of Trading and Markets and other regulators. Areas of focus may include 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.

As part of its examinations, the Division will also examine registered clearing agencies' governance, legal, compliance, and risk management frameworks by reviewing these entities' 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.

²⁴ Title VIII of the Dodd-Frank Act requires the SEC to examine, at least once annually, each registered clearing agency that the Financial Stability Oversight Council has designated as systemically important and for which the SEC serves as the supervisory agency.

²⁵ EXAMS consults with the Federal Reserve Board each year on the scope and methodology of the SEC's Dodd-Frank examinations, as required by the Dodd-Frank 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.

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, as applicable, exchange rules and the federal securities laws.

Regulation Systems Compliance and Integrity (SCI)

The Commission adopted Regulation SCI to strengthen the technology infrastructure of the U.S. securities markets. Among other things, Regulation SCI requires designated entities (SCI entities), which include national securities exchanges, registered and certain exempt clearing agencies, the Financial Industry Regulatory Authority (FINRA), the Municipal Securities Rulemaking Board (MSRB), plan processors, and alternative trading systems that meet certain volume thresholds, to establish, maintain, and enforce written policies and procedures 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. When certain personnel at these entities have a reasonable basis to conclude that certain events have occurred, these entities are required to begin to take appropriate corrective action to remedy the event as soon as reasonably practicable and immediately notify the SEC of the occurrence.

EXAMS 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. EXAMS may also review whether SCI entities have taken appropriate action in response to past examination findings.

Transfer Agents

Transfer agents serve as agents for securities issuers and play a critical role in the settlement of securities transactions. Among their key functions, transfer agents are responsible for maintaining issuers' securityholder records, recording changes of ownership, canceling and issuing certificates, distributing dividends and other payments to securityholders, and facilitating communications between issuers and securityholders.

The Division will continue to examine transfer agents' core functions: the timely turnaround of items and transfers, recordkeeping and record retention, and safeguarding of funds and securities. In light of the COVID-19 pandemic, transfer agent examinations will also consider a firm's business continuity and disaster recovery programs, as well as their cybersecurity measures and account takeover precautions. Examination candidates will include those transfer agents that present the greatest possible risks to investors and investment channels (*i.e.*, where/how retail investors are more likely to invest), and will include transfer agents that service microcap or municipal bond issues, use novel technological applications (*e.g.*, blockchain or online crowdfunding portal applications), or engage in significant paying agent activity.

FOCUS ON FINRA AND MSRB

FINRA

FINRA oversees approximately 3,600 brokerage firms, 156,000 branch offices, and 630,000 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.

EXAMS 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. 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, EXAMS conducts inspections of FINRA's major regulatory programs. EXAMS also conducts oversight examinations of FINRA's examinations of certain broker-dealers and municipal advisors. From its observations during all of these inspections and examinations, EXAMS makes detailed recommendations to improve FINRA's programs, its risk assessment processes, and its future examinations.

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. EXAMS, along with FINRA and the federal banking regulators, conducts examinations of registered firms to assess compliance with MSRB rules. EXAMS also applies a risk assessment process, similar to the one it uses to oversee FINRA, to identify areas to examine at MSRB. Examinations of MSRB evaluate the effectiveness of MSRB's policies, procedures, and controls.

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 regulators. 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>.



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