

SEC Releases 2024 Examination Priorities – In October for the Federal Fiscal Year

On Monday, October 16th, the SEC’s Division of Examinations (the “Division”) released its 2024 Examination Priorities Memorandum (“Exam Priorities”)¹. The Exam Priorities provide insights into the Exam Staff’s risk-based approach regarding areas Examiners believe present the greatest potential risks to investors. For the first time, the SEC is aligning the publication of Exam Priorities with the start of the federal fiscal year to better inform investors and registrants of the key risks, trends and examination topics that the Division will plan to focus on in the upcoming fiscal year ending September 30, 2024. Firms should be prepared to demonstrate how their compliance programs have made a good faith effort to comply with new rules and amendments.

As in prior years, the Exam Priorities are divided into sections addressing different registrants and a section regarding risk areas that affect all registrants. This summary highlights the sections of the Exam Priorities applicable to investment advisers, investment advisers to private funds, investment companies, and the section on industry risk areas affecting market participants broadly.

I. INVESTMENT ADVISERS

A. Examinations of Investment Advisers Generally

Fiduciary Duty. In assessing whether registered advisers are adhering to their federal fiduciary duties of care and loyalty², examinations of investment advisers generally will focus on:

- Certain products, investment strategies, and account types, such as derivatives and leveraged exchange-traded funds (ETFs).
- Protection of elderly and retirement-age investors.
- Processes for determining that investment advice is provided in clients’ best interest, including: (1) initial and ongoing suitability determinations; (2) seeking best execution; (3) evaluating costs and risks; and (4) identifying and addressing conflicts of interest.
- Conflicts of interest, including (1) potential economic incentives associated with recommending products, services, or account types where revenue sharing, markups, or other incentivizing revenue arrangements exist, (2) advisers who are dually registered as broker-dealers, use affiliated firms to perform client services, and have financial professionals servicing both brokerage customers and advisory clients, (3) whether disclosures sufficiently include material facts necessarily to provide for informed investor consent and (4) mitigating or eliminating conflicts of interest and allocation of investments.

Compliance Programs. The Division remains focused on advisers’ compliance programs, including whether their 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 examination focus on compliance policies and procedures includes the following:

1. Assessing whether policies and procedures are sufficient to support compliance with advisers’ fiduciary obligations, including policies and procedures related to third-party and affiliates services providers, branch office oversight, and obtaining informed consent from clients for materials changes to advisory agreements.
2. Reviewing annual compliance reviews pursuant to the Rule 206(4)-7 of the Investment Advisers Act of 1940 (“Advisers Act”) to ensure effectiveness of the compliance program in mitigating any conflicts of interests.³
3. Portfolio management processes.
4. Disclosures made to investors and regulators.
5. Proprietary trading by the adviser and employee personal trading.
6. Safeguarding of client assets.
7. Accurate creation, maintenance and destruction of required books and records.

¹ The SEC Press Release can be found [here](#). The 2024 Examination Priorities Memorandum can be found [here](#).

² The SEC’s “Commission Interpretation Regarding Standard of Conduct for Investment Advisers” consolidated in one place the salient attributes of a federal fiduciary standard applicable to investment advisers. Release No. IA-5248, July 12, 2019.

³ The recent passage of the Private Funds Rules (Release No. IA-6383) requires all registered advisers, including those that do not advise private funds, to document in writing the required annual review of their compliance policies and procedures effective on November 13, 2023.

8. Safeguards for the privacy protection of client records and information.
9. Trading practices.
10. Business continuity plans.
11. *Marketing*. Following the adoption in November 2022 of the new Marketing Rule, ensuring that advisers have: developed policies and procedures reasonably designed to prevent violations of the Marketing Rule; appropriately disclosed marketing related information on Form ADV; and maintained substantiation of their processes and other required books and records. The Division also will assess non-compliance with new requirements related to performance results, third-party ratings, testimonials, and endorsements.
12. *Compensation Arrangements*. The fiduciary obligation of advisers to clients when receiving compensation, alternative methods of maximizing adviser revenue and fee breakpoint calculation processes, especially when not automated.
13. *Valuation*. The Division will focus on how advisers assess value for illiquid or difficult to value assets.
14. *Regulatory Filings*. The Division remains focused on advisers accuracy and completeness of regulatory filings including registration eligibility.

B. Examinations of Investment Advisers to Private Funds

Specific topics for advisers to private funds include the following:

- Portfolio management risks due to market volatility and higher interest rates, including private funds experiencing poor performance, significant withdrawals and valuation issues, and private funds with more leverage and illiquid assets.
- Adherence to contractual requirements regarding limited partnership advisory committees or similar structures (e.g., advisory boards).
- Accurate calculation and allocation of private fund fees and expenses.
- Due diligence practices for consistency with policies, procedures, and disclosures.
- Conflicts, controls, and disclosures regarding private funds managed side-by-side with registered investment companies and use of affiliated service providers.
- Compliance with Advisers Act requirements regarding custody, including accurate Form ADV reporting, timely completion of private fund audits by a qualified auditor and the distribution of private fund audited financial statements.
- Policies and procedures for reporting on Form PF, including upon the occurrence of certain reporting

II. INVESTMENT COMPANIES

In assessing registered investment companies' compliance programs and governance practices, the Division will review:

- Boards' processes for assessing and approving advisory and other fund fees, particularly for funds with weaker performance relative to their peers.
- Valuation practices, particularly for those addressing fair valuation practices (e.g., implementing board oversight duties, recordkeeping and reporting, and overseeing valuation designees).
- Effectiveness of derivatives risk management and liquidity risk management programs.
- Fees and expenses and reviewing whether registered investment companies have adopted effective written compliance policies and procedures concerning the oversight of advisory fees and implemented any associated fee waivers and reimbursements.

III. RISK AREAS IMPACTING VARIOUS MARKET PARTICIPANTS

A. Information Security and Operational Resiliency

The Division will focus on registrants' policies and procedures, internal controls, oversight of third-party vendors (where applicable), governance practices, and responses to cyber-related incidents, including those related to ransomware attacks.

- Reviews will consider whether registrants adequately train staff regarding their identity theft prevention program and their policies and procedures designed to protect customer records and information and firms' practices to prevent account intrusions and safeguard customer records and information, including personally identifiable information, especially as it pertains to their multiple other offices.
- Following the SEC's adopted rule changes to shorten the standard settlement cycle for most broker-dealer transactions from two (2) business days after the trade date to one business day after the trade date, the Division will assess registrant preparations associated with this shortening of the settlement cycle, which has a compliance date of May 28, 2024.
- Reviews will include firm practices, policies, and procedures to promote cyber resiliency, prevent account intrusions and safeguard customer records and information, including personally identifiable information, and issues associated with the use of third-party vendors.

B. Crypto Assets and Emerging Financial Technology

Crypto Assets. Examinations of registrants will focus on the offer, sale, recommendation of, advice regarding, trading in, and other activities in crypto assets or related products, including reviewing whether registrants involved with crypto assets: (1) meet and follow their respective standards of conduct when recommending or advising customers and clients regarding crypto assets; and (2) routinely review, update, and enhance their compliance practices (including crypto asset wallet reviews, custody practices, Bank Secrecy Act (BSA) compliance reviews, and valuation procedures), risk disclosures, and operational resiliency practices (i.e., data integrity and business continuity plans), if required.

The Division also will consider whether advisers are complying with the custody requirements under the Advisers Act's Custody Rule (Rule 206(4)-2) for crypto assets that are funds or securities.

Emerging Financial Technology. The Division will focus on advisers offering new products and services or employing new practices, particularly technological and online solutions that service online accounts aimed at meeting the demands of compliance and marketing. The Division remains focused on certain services, including automated investment tools, artificial intelligence, and trading algorithms or platforms, and the risks associated with the use of emerging technologies and alternative sources of data.

C. What about ESG?

The Division has dropped ESG from its 2024 Exam Priorities following its inclusion in the last three (3) exam priorities. However, when asked about this omission, an SEC spokesperson stated that, "The published priorities are not exhaustive and will not be the only issues addressed in FY24 examinations."⁴

Please reach out to Optima to discuss whether your firm's compliance program requires any enhancements to address the risks described in the Exam Priorities.

⁴ See <https://www.pionline.com/regulation/sec-oversight-esg-will-continue-despite-exclusion-exam-priorities-experts-say>