

CLIENT ALERT

# SEC Division of Examinations Releases Its 2022 Examination Priorities

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On March 30, 2022, the SEC’s Division of Examinations (the “Division”) released its 2022 examination priorities (the “Priorities”).<sup>1</sup> The Priorities include five significant focus areas: (i) private funds; (ii) environmental, social and governance (“ESG”) investing; (iii) standards of conduct, including Regulation Best Interest, fiduciary duty and Form CRS; (iv) information security and operational resiliency; and (v) emerging technologies and crypto-assets.

In addition, the Priorities include specific examination topics under the Investment Adviser and Investment Company Examination Program, including mutual funds and exchange traded funds (“ETFs”), and under the Broker-Dealer and Exchange Examination Program, including microcap, municipal fixed income and over-the-counter securities, broker-dealer operations, national securities exchanges, security-based swap dealers, municipal advisors, and transfer agents. Below is a summary of highlights from the Division’s release, which encompasses Priorities stemming from recent rulemaking proposals and echoes long-standing areas of focus.

## **A. Significant Focus Areas**

### **1. Private Funds**

The Division will continue to prioritize its review of registered investment advisers (“RIAs”) to private funds, pointing to the size, complexity and significant growth of private funds over the past several years. The Division also noted the

<sup>1</sup> 2022 Examination Priorities, Division of Examinations (Mar. 30, 2022), available [here](#).

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significance of examination findings over the past several years in identifying RIAs to private funds as an area of focus. The Division identified that it will review issues under the Investment Advisers Act of 1940 (the “Advisers Act”), including an adviser’s fiduciary duty, compliance programs, fees and expenses, custody, fund audits, valuation, conflicts of interest, disclosures of investment risks, and controls around material nonpublic information (“MNPI”).

Specifically, the Division will review: (i) the calculation and allocation of fees and expenses, including the calculation of post-commitment period management fees and the impact of valuation practices at private equity funds; (ii) the potential preferential treatment of certain investors by RIAs to private funds that have experienced issues with liquidity, including imposing gates or suspensions on fund withdrawals; (iii) compliance with the custody rule under the Advisers Act, including the “audit exception” to the surprise examination requirement and related reporting and updating of Form ADV; (iv) the adequacy of disclosure and compliance with any regulatory requirements for cross trades, principal transactions, or distressed sales; and (v) conflicts around liquidity, such as RIA-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.<sup>2</sup> While this list includes many long-standing priorities, including the custody rule generally, the Division’s mention of the “audit exception” in the custody rule appears to be a more targeted area of focus in 2022.

The Division will also review private fund advisers’ portfolio strategies, risk management, and investment recommendations and allocations, focusing on conflicts and disclosures around those areas. During the course of an examination, the Division said that it will review private funds’ investments in Special Purpose Acquisition Companies (“SPACs”), particularly where the private fund adviser is also the SPAC sponsor.<sup>3</sup> In addition, the Division indicated that it will review the practices, controls, and investor reporting around risk management and trading for private funds with indicia of systemic importance, such as outsized counterparty exposure or gross notional exposure when compared to similarly situated firms. We note that a 2021 priority to focus on private fund advisers that have a higher concentration of structured products is not included in the private fund adviser section of the 2022 Priorities.

### **2. ESG Investing**

Compared to the Division’s 2021 priorities, ESG investing appears to be of greater focus for the Division in 2022. The Division recognized that RIAs and registered funds are increasingly offering and evaluating investments that employ ESG strategies or incorporate certain ESG criteria.<sup>4</sup> The Division stated that disclosure regarding an adviser’s portfolio

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<sup>2</sup> These focus areas track the SEC’s recently proposed new rules under the Advisers Act specific to private fund advisers. See *SEC Proposes Significant Rule Changes for Private Fund Advisers*, Willkie Client Alert (Feb. 16, 2022), available [here](#).

<sup>3</sup> On March 30 2022, the SEC announced a proposed rulemaking to increase investor disclosures in initial public offerings by SPACs. See *SEC Proposes Rules to Enhance Disclosure and Investor Protection Relating to Special Purpose Acquisition Companies, Shell Companies, and Projections*, SEC Press Release (Mar. 30, 2022), available [here](#).

<sup>4</sup> See *The Division of Examinations’ Review of ESG Investing*, Risk Alert (Apr. 9, 2021), available [here](#).

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management practices could involve materially false and misleading statements or omissions.<sup>5</sup> Disclosure pitfalls could be compounded by a lack of standardization in ESG investing terminology,<sup>6</sup> a variety of approaches to ESG investing,<sup>7</sup> or failing to address legal and compliance issues effectively. The Division explained that examinations will typically focus on whether RIAs and registered funds are: (i) accurately disclosing their ESG investing approaches and have adopted and implemented policies, procedures, and practices designed to prevent violations of the federal securities laws in connection with their ESG-related disclosures, including review of their portfolio management processes and practices; (ii) voting client securities in accordance with proxy voting policies and procedures and whether the votes align with their ESG-related disclosures and mandates; or (iii) overstating or misrepresenting the ESG factors considered or incorporated into portfolio selection (e.g., greenwashing),<sup>8</sup> such as in their performance advertising and marketing.

### **3. Standards of Conduct: Regulation Best Interest, Fiduciary Duty, and Form CRS**

Similarly to the 2021 Division of Examinations Priorities, the Division will continue to address standards of conduct issues for broker-dealers and RIAs. Reviews will focus on how broker-dealers and RIAs are satisfying their obligations under Regulation BI<sup>9</sup> and the Advisers Act fiduciary standard<sup>10</sup> to act in the best interests of retail investors and not to place their own interests ahead of retail investors' interests. Examinations will include assessments of practices regarding consideration of alternatives (e.g., with regard to potential risks, rewards, and costs), management of conflicts of interest (e.g., incentive practices that favor certain products or strategies over others), trading (e.g., RIA best execution obligations), disclosures (e.g., disclosures provided in Form ADV and Form CRS and made pursuant to Regulation BI), account selection (e.g., brokerage, advisory, or wrap fee accounts), and account conversions and rollovers. The

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<sup>5</sup> The SEC's Division of Enforcement created a Climate and ESG Task Force to coordinate and develop initiatives for identifying ESG-related misconduct. See *SEC Announces Enforcement Task Force Focused on Climate and ESG Issues*, SEC Press Release (Mar. 4, 2021), available [here](#).

<sup>6</sup> For example, strategies that are referred to as "sustainable," "socially responsible," "impact investing" or "environmental, social, and governance conscious."

<sup>7</sup> For example, a portfolio may be labeled as ESG because of consideration of ESG factors alongside traditional financial, industry-related, or macroeconomic indicators. Other portfolios may use ESG factors as the driving or main consideration in selecting investments. Some portfolios engage in impact investing seeking to achieve measurable ESG impact goals.

<sup>8</sup> The Director of the SEC's Division of Enforcement, Gurbir Grewal, has indicated that greenwashing will be a Division of Enforcement ESG Task Force focus area. See *2021 SEC Regulation Outside the United States – Scott Friestad Memorial Keynote Address*, SEC Speech (Nov. 8, 2021), available [here](#).

<sup>9</sup> *Regulation Best Interest: The Broker-Dealer Standard of Conduct*, Rel. No. 34-86031 (June 5, 2019), available [here](#). See also *Examinations that Focus on Compliance with Regulation Best Interest*, OCIE Risk Alert (Apr. 7, 2020), available [here](#).

<sup>10</sup> *Commission Interpretation Regarding Standard of Conduct for Investment Advisers*, Rel. No. IA-5248 (June 5, 2019), available [here](#). See also *Standards of Conduct for Broker-Dealers and Investment Advisers Account Recommendations for Retail Investors*, SEC Staff Bulletin (Mar. 29, 2022) available [here](#) (Question and answer bulletin from the SEC Staff covering broker-dealer and investment adviser standards of conduct when making account recommendations to retail investors).

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effectiveness of compliance programs, testing, and training that are designed to support retail investors receiving recommendations and advice in their best interests will also be a focus of the Division.

### **a. Broker-Dealers**

For broker-dealer examinations, the Division will review firms' recommendations and sales practices related to SPACs, structured products, leveraged and inverse exchange traded products ("ETPs"), REITs, private placements, annuities, municipal and other fixed income securities, and microcap securities. The Division will review practices, policies, and procedures concerning the evaluation of costs and reasonably available alternatives as they relate to recommendations of these products being in the investor's best interest. Examinations will also evaluate the compensation structures for financial professionals, including the conflicts created by such structures, and may focus examinations on the sales of securities by financial professionals that are highly compensated.

### **b. RIAs**

For RIA examinations, the Division will focus on whether advisers are acting consistently with their fiduciary duty to clients, looking at both duties of care and loyalty, including best execution obligations, financial conflicts of interest and related impartiality of advice, and any attendant client disclosures. Specifically, the Division highlighted revenue sharing arrangements, recommending or holding more expensive classes of investment products when lower cost classes are available,<sup>11</sup> recommending wrap fee accounts without assessing whether such accounts are in the best interests of clients, including the impact of the move to zero commissions on certain types of securities transactions by a number of broker-dealers, and recommending proprietary products resulting in additional or higher fees. The multiple references to wrap fee accounts is a notable change from the Division's 2021 priorities, which did not specifically include wrap accounts as an area of focus. The Division will also assess the adequacy of RIAs' compliance policies and procedures designed to address conflicts and ensure advice in the best interests of clients (including the cost of investing) and disclosures to enable investors to provide informed consent.

### **c. Dually Registered RIAs and Broker-Dealers**

For examinations of dually registered RIAs and broker-dealers, the Division will particularly emphasize potential conflicts of interest present at these dually registered firms, including account recommendations and allocation of investments

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<sup>11</sup> RIAs that recommend no transaction fee mutual fund share classes that have 12b-1 fees in wrap fee accounts where the RIA may be responsible for paying transaction fees would be an example of recommending a more expensive class of an investment product when a lower cost class is available. Then Director of the SEC's Division of Examinations, Peter Driscoll, stated that the SEC's systems can review trade blotters and automatically flag trades that have a cheaper share class alternative. See *SEC 2021 Examination Priorities, A Conversation with SEC Examinations Director Peter Driscoll* (Mar. 4, 2021), available [here](#).

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across different accounts. For example, examinations will focus on the sale or recommendation of high fee products or proprietary products of the firms or their affiliates, incentives for financial professionals to place their own or their firms' interests ahead of customers/clients,<sup>12</sup> and compensation structures that inappropriately influence investment recommendations. The Division will review whether these firms have implemented written policies and procedures to mitigate and address conflicts effectively and to minimize the risk of, and monitor for, misaligned incentives that may result in recommendations and advice to retail investors that is not in their best interest.

### **4. Information Security and Operational Resiliency**

The Division explained that applying information security controls is critical to ensuring business continuity and that the vigilant protection of data is critical to the operation of the financial markets and the confidence of its participants. The Division will review broker-dealers' and RIAs' practices to prevent interruptions to mission-critical services and to protect investor information, records, and assets.<sup>13</sup> Specifically, the Division said that it will continue to review whether firms have taken appropriate measures to: (i) safeguard customer accounts and prevent account intrusions, including verifying an investor's identity to prevent unauthorized account access; (ii) oversee vendors and service providers; (iii) address malicious email activities, such as phishing or account intrusions; (iv) respond to incidents, including those related to ransomware attacks; (v) identify and detect red flags related to identity theft; and (vi) manage operational risk as a result of a dispersed workforce in a work-from-home environment. Where applicable, the Division will also focus on compliance with Regulations S-P and S-ID.<sup>14</sup>

The Division will again be reviewing registrants' business continuity and disaster recovery plans, with particular focus on the impact of climate risk and substantial disruptions to normal business operations. As the Division described last year, these efforts build on previous examinations and outreach in this area. In some cases, particularly in regard to systemically important registrants, examinations will account for certain climate-related risks. The scope of these examinations will include a focus on the maturation and improvements to business continuity and disaster recovery plans

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<sup>12</sup> Transactions that reduce costs to the adviser and increase expenses borne by the client would be an example of a financial professional placing its own interests ahead of a customer or client.

<sup>13</sup> See *Cybersecurity: Safeguarding Client Accounts against Credential Compromise*, OCIE Risk Alert (Sept. 15, 2020), available [here](#); *Select COVID-19 Compliance Risks and Considerations for Broker-Dealers and Investment Advisers*, OCIE Risk Alert (Aug. 12, 2020), available [here](#); *Cybersecurity: Ransomware Alert*, OCIE Risk Alert (July 10, 2020), available [here](#).

<sup>14</sup> The SEC recently proposed rules related to cybersecurity risk management for RIAs, registered investment companies and business development companies, as well as amendments to certain rules that govern disclosures. See *Cybersecurity Risk Management for Investment Advisers, Registered Investment Companies, and Business Development Companies*, Release No. 34-94197 (Feb. 9, 2022), available [here](#); see also *SEC Proposes Cybersecurity Rules and Amendments for Registered Investment Advisers, Registered Investment Companies and BDCs*, Willkie Client Alert (Feb. 18, 2022), available [here](#).

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over the years as well as these registrants' resiliency as organizations to anticipate, prepare for, respond to, and adapt to both sudden disruptions and incremental changes stemming from climate-related situations.

### **5. Emerging Technologies and Crypto-Assets**

The Division has observed a significant increase in the number of RIAs choosing to provide automated digital investment advice to their clients (often referred to as “robo-advisers”), continued growth in the use of mobile apps by broker-dealers, and a proliferation of the offer, sale, and trading of crypto-assets.<sup>15</sup> The Division will conduct examinations of broker-dealers and RIAs that are using developing financial technologies to review whether the unique risks these activities present were considered by the firms when designing their regulatory compliance programs.

The Division will focus on RIAs and broker-dealers that are offering new products and services or employing new practices (e.g., fractional shares, “Finfluencers,” or digital engagement practices) to assess whether: (i) operations and controls in place are consistent with disclosures made and the standard of conduct owed to investors and other regulatory obligations; (ii) advice and recommendations, including by algorithms, are consistent with investors' investment strategies and the standard of conduct owed to such investors; and (iii) controls take into account the unique risks associated with such practices.

For market participants engaged with crypto-assets, the Division will review the custody arrangements for such assets and will assess the offer, sale, recommendation, advice, and trading of crypto-assets during the course of an examination. In particular, the Division will review whether market participants involved with crypto-assets: (i) have met their respective standards of conduct when recommending to or advising investors with a focus on duty of care and the initial and ongoing understanding of the products (e.g., blockchain and crypto-asset feature analysis); and (ii) routinely review, update, and enhance their compliance practices (e.g., crypto-asset wallet reviews, custody practices, anti-money laundering (“AML”) reviews, and valuation procedures), risk disclosures, and operational resiliency practices (i.e., data integrity and business continuity plans). In addition, the Division will conduct examinations of mutual funds and ETFs offering exposure to crypto-assets to assess, among other things, compliance, liquidity, and operational controls around portfolio management and market risk.

### **B. Investment Adviser and Investment Company Examination Program**

#### **a. RIAs**

During a typical examination, the Division explained that it reviews the compliance programs of RIAs in the following core areas: marketing practices, custody and safety of client assets, valuation, portfolio management, brokerage and execution, conflicts of interest, and related disclosures. The Division will assess whether policies and procedures are

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<sup>15</sup> For an in-depth summary on the SEC's focus on digital assets, see Willkie's client alert from March 4, 2021, available [here](#).

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reasonably designed to prevent violations of the Advisers Act and its rules, including breaches of the RIA's fiduciary duty in violation of the antifraud provisions. Additionally, the Division will review compliance programs to examine whether they address that: (i) investment advice is in each client's best interest; (ii) oversight of service providers is adequate; and (iii) sufficient resources exist to perform compliance duties. In addition, for RIAs using alternative data or data gleaned from non-traditional sources, reviews will include examining whether appropriate compliance has been implemented around the creation, receipt, and use of potentially MNPI.

As part of its assessment of the effectiveness of a compliance program, the Division will review whether the firm has implemented oversight practices to mitigate any heightened risks. For example, reviews will include whether the RIAs are: (i) employing individuals with prior disciplinary histories implemented heightened oversight practices for these individuals; (ii) migrating from the broker-dealer business model reviewed whether recommendations to transition investor accounts to advised accounts were in the clients' best interests; and (iii) operating from multiple branch offices have appropriately adapted their compliance programs to oversee the activities in their branches. Items (ii) and (iii) each represent a new stated focus for the Division, compared to its 2021 priorities.

The Division will also continue to focus on RIA disclosures and other issues related to fees and expenses. In particular, the Division will concentrate on issues associated with: (i) advisory fee calculation errors, including, but not limited to, failure to adjust management fees in accordance with investor agreements; (ii) inaccurate calculations of tiered fees, including failure to provide breakpoints and aggregate household accounts; and (iii) failures to refund prepaid fees for terminated accounts or pro-rated fees for onboarding clients.

### ***b. Registered Investment Companies, Including Mutual Funds and ETFs***

The Division explained that it will continue to prioritize examinations of registered investment companies, including mutual funds and ETFs. The Division typically will review certain "perennial" focus areas during its assessments of registered funds' compliance programs and governance practices which include: disclosures to investors, accuracy of reporting to the SEC, compliance with the new rules and exemptive orders (including ETF rules and exemptive orders for non-transparent, actively managed ETFs, and custom baskets). As part of its review of registered funds' liquidity risk management programs, the Division will consider whether the programs are reasonably designed to assess and manage the funds' liquidity risk and review the implementation of required liquidity classifications, including firms' oversight of third party service providers.

Certain types of registered funds, portfolio investments, and fund practices will be prioritized. Examples of the types of funds include money market funds (which will be reviewed for compliance with applicable requirements, including stress-testing, website disclosures, and board oversight) and business development companies (which will be reviewed for valuation practices, marketing activities, and conflicts of interest with underlying portfolio companies). The Division's focus on portfolio investments will include examinations of mutual funds investing in private funds to assess risk disclosure and

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valuation issues. The Division will also prioritize examinations of certain fund practices, including a focus on advisory fee waivers to assess the sustainability of services for firms that provide such waivers, and trading activities of portfolio managers that may be designed to inflate fund performance. Many of the above items represent items of continued focus from 2021, although the specific reference to business development companies represents a change from the Division's 2021 priorities.

### ***C. Broker-Dealer and Exchange Examination Program***

#### ***a. Microcap, Municipal, Fixed Income, and Over-the-Counter Securities***

The Division will seek to deter microcap fraud, or fraud in connection with securities of companies with a market capitalization under \$250 million. The Division will continue to prioritize examinations of broker-dealers for compliance with their obligations in the offer, sale, and distribution of microcap securities. Focus areas for examinations will include: (i) transfer agent handling of microcap distributions and share transfers; (ii) broker-dealer sales practices and their consistency with Regulation BI; and (iii) broker-dealer compliance with certain regulatory requirements, including the locate requirement of Regulation SHO, penny stock disclosure rules (*i.e.*, Rules 15g-2 through 15g-6 of the Securities Exchange Act of 1934 (the "Exchange Act")), and the obligation to monitor for and report suspicious activity and other anti-money laundering obligations.

The Division will also examine the activities of broker-dealers, underwriters, and municipal advisors to assess whether these firms are meeting their respective obligations regarding municipal issuer disclosure.

In addition, the Division will examine broker-dealer trading activity in fixed income securities with a focus on sales practices; 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.

The Division's focus on products and services will also include the sale of over-the-counter securities and whether broker-dealers recommending these securities are meeting their obligations under Regulation BI. In a new area of focus compared to the 2021 priorities, examinations will also assess compliance with revised Exchange Act Rule 15c2-11, which generally requires broker-dealers to refrain from publishing quotations in a quotation medium for an issuer's security when current issuer information is not publicly available.

#### ***b. Broker-Dealer Operations***

The Division highlighted that broker-dealers holding 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, and that examinations will continue to focus on compliance with these rules, including the adequacy of internal processes, procedures, and controls, and compliance with requirements for borrowing fully paid and excess margin securities from

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customers. The Division might also assess broker-dealer funding and liquidity risk management practices to assess whether firms have sufficient liquidity to manage stress events.

With respect to broker-dealer trading practices, the Division will focus on broker-dealer compliance with best execution obligations in a zero commission environment and compliance with Exchange Act Rule 606 order routing disclosure rules. The Division will continue to review potential conflicts of interest in order routing, such as conflicts arising from payment for order flow, including wholesaler payments or exchange rebates, and the possible effect any conflicts of interest may have on order routing decisions and best execution obligations. Examinations will also focus on large trader reporting obligations and broker-dealer 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 compliance with Regulation ATS, and in particular will focus on consistency with their disclosures provided in Form ATS-N. As in previous years, the Division will review firms engaged in activities that appear to require broker-dealer registration, and those that may be involved in the illegal distribution of unregistered securities, to ensure investors are receiving the benefits of the federal securities laws.

### ***c. National Securities Exchanges***

The Division will examine the national securities exchanges<sup>16</sup> to assess whether they are meeting their obligations under the federal securities laws and will focus on exchange regulatory programs to detect and discipline violations and participation in National Market System (“NMS”) Plans. Examinations may also assess and compare any exchange advisory services offered to issuers regarding ESG initiatives.

### ***d. Security-Based Swap Dealers (“SBSDs”)***

The compliance date for registration of SBSBDs and several other SBSBD requirements was October 6, 2021.<sup>17</sup> Initial examinations of these new registrants will focus on the policies and procedures related to compliance with the security-based swap rules generally (*e.g.*, trade acknowledgement and verification, recordkeeping and reporting, and risk management requirements).

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<sup>16</sup> 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.

<sup>17</sup> *Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital and Segregation Requirements for Broker-Dealers*, Release No. 34-86175 (June 21, 2019), available [here](#); see also *SEC Adopts Final Capital, Margin and Segregation Rules for Security-Based Swaps*, Willkie Client Alert (July 25, 2019), available [here](#).

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### ***e. Municipal Advisors***

The Division will examine whether municipal advisors have met their fiduciary duty and conflict disclosure obligations to municipal entity clients. The Division will also examine whether municipal advisors have satisfied their registration, professional qualification, continuing education, and supervision requirements.

### ***f. Transfer Agents***

The Division will continue to examine transfer agents' core functions: the timely turnaround of items and transfers, recordkeeping and record retention, safeguarding of funds and securities, and filing obligations with the SEC. Examination candidates will include, among others, never-before-examined transfer agents and transfer agents that service microcap or municipal bond issuers, use novel technologies (e.g., blockchain or online crowdfunding portal applications), or engage in significant paying agent activity.

### ***D. Clearance and Settlement Examination Program***

The Division will conduct, as required by Title VIII of the Dodd-Frank Act, at least one risk-based examination of each clearing agency designated as systemically important and for which the SEC serves as the supervisory agency. These examinations will focus on core risks, processes, and controls and will cover the specific areas required by statute, including the nature of clearing agencies' operations and assessment of financial and operational risk. Additionally, the Division will conduct risk-based examinations of other registered clearing agencies which have not been designated as systemically important. The Division will also examine both groups of clearing agencies for compliance with the SEC's Standards for Covered Clearing Agencies, which 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.

The Division will also conduct risk-based examinations of SEC-registered clearing agencies to: (i) determine whether their respective risk management frameworks comply with the Exchange Act, and serve the needs of their members and the markets they serve; (ii) assess the adequacy and timeliness of their remediation of prior deficiencies, including, for example, the role of senior leadership in the remediation process; and (iii) examine other risk areas identified in collaboration with the SEC's Division of Trading and Markets and other regulators. Areas of focus highlighted by the Division include margin, counterparty credit risk, disclosure framework, governance, recovery and wind-down, default management, liquidity risk management, and project management, among other things.

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### ***E. Regulation Systems Compliance and Integrity***

The Division also indicated that it will evaluate whether SCI entities<sup>18</sup> have established, maintained, and enforced written policies and procedures. Areas of focus will include: (i) whether the incident response policies and procedures of SCI entities are reasonably designed, with a particular focus on ransomware; (ii) the use of third-party network infrastructure services to support critical functions; (iii) policies and procedures pertaining to the return to the workplace or further hybridization of the workplace after the extended telework posture caused by the COVID-19 pandemic; and (iv) whether SCI entities have established reasonably designed policies and procedures to identify and mitigate software supply chain risks, including secure code development practices of SCI entities.

### ***F. FINRA***

The Division conducts risk-based oversight examinations of FINRA. It selects areas within FINRA to examine through a risk assessment process designed to identify those aspects of FINRA's operations important to the protection of investors and market integrity, including FINRA's implementation of new investor protection initiatives. The analysis is informed by collecting and analyzing extensive information and data, regular meetings with key functional areas within FINRA, and outreach to various stakeholders, including broker-dealers and investor groups. Based on the outcome of this risk-assessment process, the Division conducts inspections of FINRA's major regulatory programs. The Division also conducts oversight inspections of FINRA's examinations of certain broker-dealers and municipal advisors. From its observations during all of these inspections and examinations, the Division makes detailed recommendations to improve FINRA's programs, its risk assessment processes, and its future examinations.

### ***G. Municipal Securities Rulemaking Board ("MSRB")***

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

### ***H. LIBOR Transition***

The Division highlighted that RIAs, broker-dealers, investment companies, municipal advisors, transfer agents and clearing agencies could be significantly impacted by the discontinuation of the London Inter-Bank Offered Rate ("LIBOR"), explaining that preparation for the transition away from LIBOR is essential for minimizing any potential adverse effects

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<sup>18</sup> Regulation SCI applies to "SCI entities," which includes self-regulatory organizations (including stock and options exchanges, registered clearing agencies, FINRA and the MSRB), alternative trading systems, that trade National Market System ("NMS") stocks and non-NMS stocks exceeding specified volume thresholds, disseminators of consolidated market data, and certain exempt clearing agencies.

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associated with LIBOR discontinuation. The Division will engage with registrants through examinations and outreach efforts to assess their exposure to LIBOR and their transition to an alternative reference rate, preparations for the cessation of many LIBOR rates beginning immediately after December 31, 2021, and the transition to an alternative reference rate, in connection with registrants' own financial operations, the exposures of their clients and customers, and their obligations when recommending LIBOR-linked instruments.<sup>19</sup>

### ***I. 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 customers they serve, the type of products and services offered, and the means by which those products and services are offered. These programs must, among other things, include policies and procedures reasonably designed to identify and verify the identity of customers and beneficial owners of legal entity customers, perform customer due diligence (as required by the Customer Due Diligence rule), monitor for suspicious activity, and, where appropriate, file Suspicious Activity Reports (SARs) with the Financial Crimes Enforcement Network. SARs are used to detect and combat terrorist financing, public corruption, market manipulation, and a variety of other fraudulent behaviors.

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 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.

### ***J. Conclusion***

The 2022 Priorities provide a roadmap to the Division's areas of focus in ongoing and future examinations. Although the SEC is addressing certain of these Priorities via proposed rulemaking, firms should evaluate their business activities and enhance their compliance policies and procedures in light of the Gensler administration's increased regulatory scrutiny over the financial services industry.

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<sup>19</sup> See *Examination Initiative: LIBOR Transition Preparedness*, OCIE Risk Alert (June 18, 2020), available [here](#).

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