WINSTON & STRAWN LLP

CLIENT ALERT

2021 SEC Examination Priorities

MARCH 22, 2021

On March 3, 2021, the Securities and Exchange Commission's ("SEC") newly renamed Division of Examinations (the "Division") released its annual list of examination priorities for 2021.[1] As has been true for several years now, the Division continues to focus on issues relating to retail investors, including risks specific to elderly investors and investors saving for retirement, information security and financial technology ("FinTech"). The Division's 2021 priorities also reflect new scrutiny on climate and Environmental, Social and Governance ("ESG")-related matters.

Of course, these priorities are not exhaustive, and the Division's examinations are likely to focus on many areas beyond this list. Moreover, the Division continues to characterize its examination selection process and scope determinations as a risk-based approach that provides it with sufficient flexibility to allow for coverage of emerging and exigent risks as they arise.

Examination priorities particularly relevant to investment advisers and private equity, hedge, credit, and other private funds are summarized below.

Retail Investors. The Division will again focus on the appropriateness of recommendations and advice provided to retail investors, with a particular emphasis on seniors, including recommendations and advice made by entities and individuals targeting retirement communities, teachers, military personnel, and individuals saving for retirement. Certain securities products can pose elevated risks when marketed or sold to retail investors. Therefore, the Division will continue to prioritize examinations of issues regarding mutual funds, exchange-traded funds ("ETFs"), municipal and other fixed income securities and microcap securities given their importance to retail investors. 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 types of private offerings.

Standards of Conduct. The Division will continue to examine registered investment advisers ("RIAs") to assess whether they have fulfilled their duty of care and duty of loyalty as fiduciaries. This will include assessing whether RIAs provide advice that is in the best interests of their clients and based on their client's objectives and whether all conflicts of interest are fully and disclosed. The Division will pay close attention to risks associated with fees and expenses, complex products, best execution, and undisclosed or inadequately disclosed compensation arrangements. As it relates to disclosures regarding conflicts of interest, particularly those related to fees and expenses, one area the Division will prioritize is the examination of RIAs operating and utilizing turnkey asset management platforms. The Division's examinations will seek to assess whether such fees and revenue sharing arrangements are adequately disclosed. Further, in reviewing fees and expenses, Division staff will review for advisory fee calculation errors, inaccurate calculations of tiered fees and failures to refund prepaid fees for terminated accounts.

Information Security and Operational Resiliency. The Division is focused on working with firms to identify and address information security risks, including cyber-attack related risks. 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, the Division will 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. Further, in light of substantial disruptions as a result of the COVID-19 pandemic, the Division will again be reviewing registrants' business continuity and disaster recovery plans.

FinTech and Innovation. The use of technology to facilitate compliance with regulatory requirements ("Reg Tech") has experienced immense growth in recent years. However, misused or improperly configured Reg Tech may lead to compliance deficiencies. Therefore, examinations will focus on the implementation and integration of Reg Tech in firms' compliance programs. Additionally, alternative data, or data gleaned from non-traditional sources, is increasingly being used by firms as part of their business and investment decision-making processes. Examinations will consider whether firms are implementing appropriate controls and compliance around the creation, receipt and use of such information.

Digital Assets. 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.

LIBOR Transition. The Division 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.

RIA Compliance Programs. The Division will continue to review the compliance programs of RIAs, including whether these programs and their policies and procedures are reasonably designed, implemented, and maintained, 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. Further, in evaluating the effectiveness of a compliance program, the Division will frequently review whether RIAs appear to have sufficient resources to perform core compliance responsibilities.

Dually Registered RIAs. 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.

RIAs to Private Funds. The Division will continue to focus on advisers to private funds, and will assess compliance risks, including a focus on liquidity and disclosures of investment risks and conflicts of interest. Specifically, the Division will review for preferential treatment of certain investors by advisers to private funds that have experienced issues with liquidity (including the imposition of 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. Further, 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.

ESG and Social Impact. Due to investor demand, RIAs are increasingly offering ESG and social impact investment strategies. The Division will focus on products in these areas that are widely available to investors and will review the consistency and adequacy of disclosures RIAs and fund complexes provide to clients regarding these strategies to determine whether the firms' processes and practices match their disclosures. Additionally, the Division will review fund advertising for false or misleading statements and will review proxy voting policies and procedures and votes to assess whether they align with these strategies. The Division will also review business continuity and disaster recovery plans, particularly those of systematic important registrants, to ensure that they 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,[2] with heightened focus on improvements to these plans over the intervening years. Relatedly, on March 4, 2021, the SEC announced the creation of the Climate and ESG Task Force in the Division of Enforcement[3] that will, among other things, work to identify material gaps or misstatements in issuers' disclosure of climate risks under existing rules and analyze disclosure and compliance issues relating to investment advisers' and funds' ESG strategies. In addition, the Climate and ESG Task Force will evaluate and pursue tips, referrals, and whistleblower complaints on ESG-related issues, and will provide expertise and insight to teams working on ESG-related matters across the Division of Enforcement.

For further information, please contact the authors or your Winston relationship attorney.

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[1] *2021 Examination Priorities*, Division of Examinations, U.S. Securities and Exchange Commission (Mar. 3, 2021), *available* here.

[2] *See* Joint SEC, FINRA, and CFTC Business Continuity Planning Observations (Aug. 7, 2013) *available* here.

[3] *See* Press Release, U.S. Securities and Exchange Commission, SEC Announces Enforcement Task Force Focused on Climate and ESG Issues (Mar. 4, 2021), *available* here.

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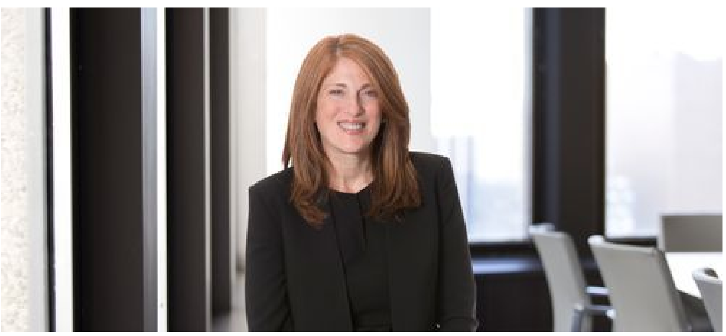

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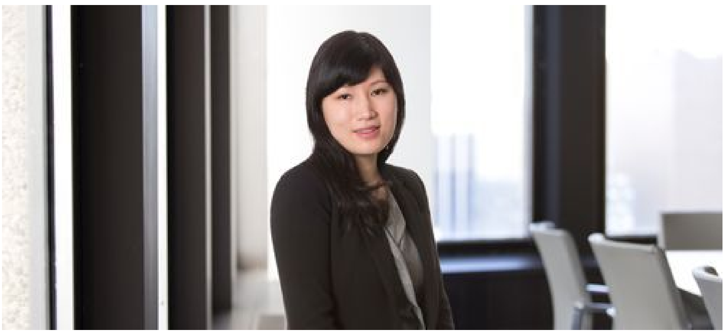

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