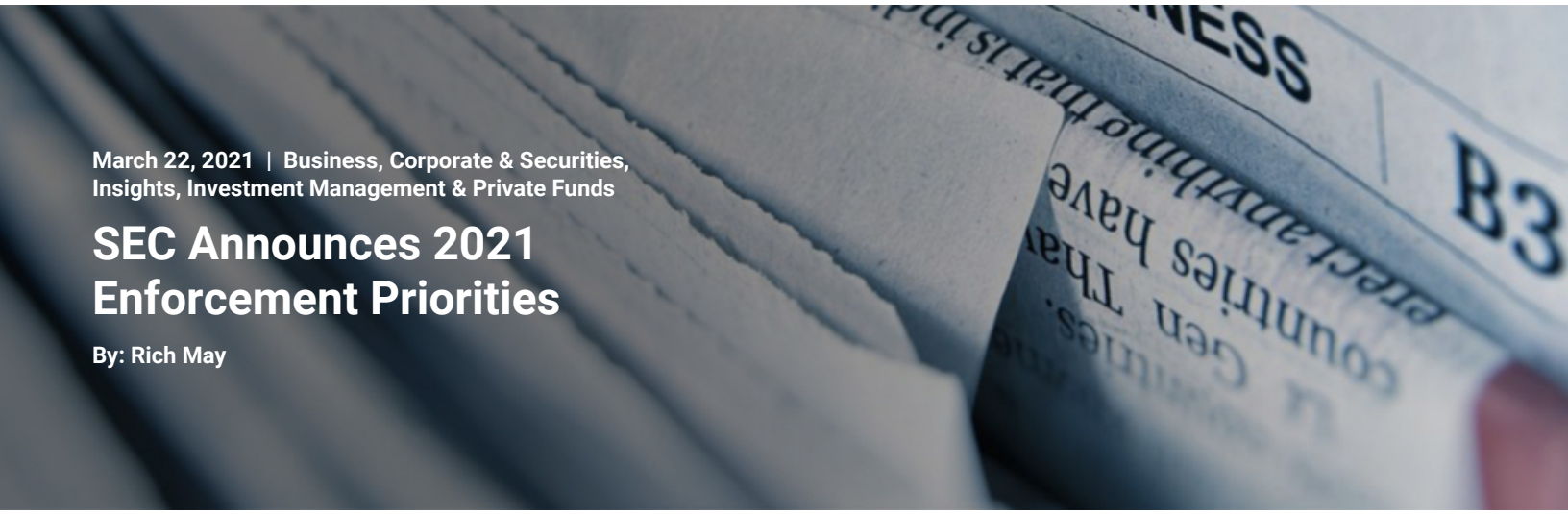

March 22, 2021 | Business, Corporate & Securities, Insights, Investment Management & Private Funds

SEC Announces 2021 Enforcement Priorities

By: Rich May

On March 3, 2021, the SEC's Division of Examinations released its 2021 Examination Priorities, announcing key areas of focus for the upcoming year, organized into eight themes:

1. Retail investors, including seniors and those saving for retirement;
2. Information Security and Operational Resiliency;
3. Financial Technology (FINTECH) and Innovation, including Digital Assets;
4. Anti-Money Laundering;
5. The LIBOR Transition;
6. Additional Focus Areas Involving RIAs and Investment Companies;
7. Additional Focus Areas Involving Broker-Dealers and Municipal Advisors; and
8. Market Infrastructure.

The Division makes clear that this list is not exhaustive, and that it will address other issues through its flexible, risk-based approach to examinations. Below are highlights from the key areas of focus that the Division expanded upon in its announcement.

In this blog, we will highlight the SEC's guidance on those of the above topics that are most germane to our clients.[1]

Retail Investors[2]

Standards of Conduct

The Division will focus on the recent adoption of Regulation Best Interest, Form CRS and the Interpretation Regarding Standard of Conduct for Investment Advisers, and their resulting impact on the retail investor experience with broker-dealers and RIAs. As a reminder, a "retail investor" is a natural person, or the legal representative of such natural person, who seeks to receive or receives services primarily for personal, family or



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Thomas H. Bilodeau, III

David Glod

Scott A. Stokes

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household purposes.

- Compliance with Standards:
  - *Broker-Dealers*: Emphasis on the four component obligations of Regulation Best Interest: Disclosure, Care, Conflict of Interest and Compliance, which cannot be satisfied through disclosure alone.
  - *RIAs*: Focus on duty of care and duty of loyalty, in light of the Interpretation Regarding Standard of Conduct for Investment Advisers.
    - Particular Attention on risks associated with fees and expenses, complex products, best execution, and undisclosed or inadequately disclosed compensation arrangements.
- Form CRS – Examinations will prioritize compliance with Form CRS, which must be filed with the SEC, delivered to retail investors, and posted on the firm's public website.

Fraud, Sales Practices and Conflicts

The Division has indicated it will give added emphasis to:

- Protection of seniors and retirement communities, teachers, military personnel, and individuals saving for retirement.
  - Concentration on recommendations regarding account type, conversions and roll overs, as well as sales practices used for various product types.
- Broker-dealer providing retail customers with access to complex strategies.
- Compliance with the revised accredited investor definition when recommending or selling certain private offerings.
- Conflict of Interest disclosures, especially for fees and expenses.
  - Emphasis on RIAs operating turnkey asset management platforms.
- Advisory fee calculation errors, inaccurate calculations of tiered fees, and failure to refund prepaid fees for terminated accounts.

Information Security and Operational Resiliency

Over the past year, the increase in remote operations due to the COVID-19 Pandemic has led to increased concerns over information security and operational resiliency.
To address these concerns, the Division will review whether firms have taken measures to:

- Safeguard customer accounts and prevent intrusions;
- Oversee vendors and service providers;

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- Address malicious email activities;
- Respond to incidents, including ransomware attacks;
- Manage operation risk as a result of dispersed employees working from home.

Additionally, the Division will again be reviewing business continuity and disaster recovery plans.

- The scope of these examinations will be similar to the post-Hurricane Sandy work of the Division and other regulators.

Financial Technology (FINTECH) and Innovation, including Digital Assets

The Division remains committed to staying abreast of innovations in Fintech and capital formation as they continue to develop at a rapid pace, including their impact on registrants and investors.

FINTECH examinations will focus on:

- Implementation and integration of technology used to facilitate regulatory compliance (RegTech) in firms' compliance programs.
- Adoption of appropriate controls and compliance around the creation, receipt, and use of alternative data or data gleaned from non-traditional sources.

Examinations of market participants engaged with digital assets will continue to focus on:

- Whether investments are in the best interests of investors;
- Portfolio management and trading practices;
- Safety of client funds and assets;
- Pricing and valuation;
- Effectiveness of compliance programs and controls; and
- Supervision of representatives' outside business activities.

Additional Focus Areas Involving RIAs

RIA Compliance Programs

With respect to RIAs, the Division will focus its efforts primarily on the following:

- RIAs that have not been examined for a number of years.
- Whether the programs of these RIAs have been adapted in light of growth or change in business models.

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- Continued focus on those RIAs that have never been examined and those that are dually registered as broker-dealers.
- The Division will also focus on investment strategies geared towards "sustainability," due to investor demand for such offerings.

RIAs to Private Funds

Over 36 percent of RIAs manage private funds, which often have significant investments from pensions, charities, endowments and families. With respect to RIAs advising private funds, the Division will prioritize:

- preferential treatment of certain investors,
- portfolio valuations and impact on management fees,
- adequacy of disclosures, and conflicts around liquidity.

Additional Focus Areas Involving Broker-Dealers

For broker-dealers, the Division intends to focus on the following topics:

- Compliance with the Customer Protection Rule and Net Capital Rule.
- Funding and liquidity risk management practices to assess sufficient capability to manage stress events.
- Payments for order flow, including the potential effect on order routing and best execution obligations.

Recommended Actions

We recommend that all our investment adviser clients review these enforcement priorities with an eye towards their own activities, policies and procedures, as well as applicable regulatory obligations. If there is any confusion or concern surrounding the Division's targets and priorities for examination in 2021, or regulatory compliance, clients should consult with a Rich May attorney.

Disclaimer: This summary is provided for educational and informational purposes only and is not legal advice. Any specific questions about these topics should be directed to attorneys Thomas Bilodeau III, Scott Stokes, David Glod, or Matthew Sweet.

1. The topics anti-money laundering; LIBOR transition; additional focus areas involving investment companies; additional focus areas involving municipal advisors; and market infrastructure are not addressed in this blog. Any client who wishes to discuss any issue or concern with respect to these topics should contact one of the Rich May attorneys listed above. [⁂]
2. The Division's further discussion of Retail-Targeted Investments is not

addressed in this blog. Any client who wishes to discuss any issue or concern with respect to this topic should contact one of the Rich May attorneys listed above. [ ]

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