Welcome to the November issue of Investments & Wealth Institute’s Washington Insights. This month’s column reviews the Securities and Exchange Commission’s (SEC or Commission) recently released exam priorities by the Division of Examinations (the Division). Washington Insights also provides a brief wrap-up of other public policy topics of interest to wealth and institutional managers.

ESG Missing from 2024 SEC Priority List; Also, Less Focus on “Fiduciary” Practices?

With the shift in recent years to environmental, social, and governance (ESG) investing by investors—and in a separate, momentous upgrade to a quasi-fiduciary, or “best interest” standard for the brokerage and insurance industries—one might conclude that both would remain intense areas of focus by SEC’s examiners in fiscal year 2024.\(^1\)

However, since the SEC began releasing annual priorities for inspections in 2013, the list of priorities understandably has evolved. However, the omission of a topic from the list doesn’t mean they’re ignoring it, according to at least some compliance experts and the SEC.

That said, word counts can provide a snapshot of the agency’s regulatory concern with certain industry practices from year to year. In recent years, there has been a fair amount of buzz around “fiduciary” and “best interest” market conduct standards, especially since 2020 when Regulation Best Interest (Reg BI) went into effect for brokerage reps. At the same time, the Commission also issued new fiduciary guidance for the rapidly growing number of registered investment advisers (RIAs), even though RIAs have been accorded that status since 1940.

Based on word counts, figure 1 suggests that the SEC’s recent interest in examining appropriate, broad market conduct standards for various brokerage and RIA firms has shifted to other issues in fiscal year 2024.

From figure 1, the term “fiduciary” was accorded little attention by the SEC until 2020, the year after the SEC approved Reg BI with a compliance deadline of June 30, 2020, before dropping off in 2024. Several related fiduciary terms—the twin duties of care and loyalty as well as best interest—also garnered more attention. Apparently, the best interest standards for RIAs and brokers will continue to occupy examiners’ attention in 2024, but perhaps not as much as in previous years.
As shown in figure 2, a fair number of other examination priorities remain constant year after year. These other compliance concerns—a firm’s cybersecurity practices, recommendations involving cryptocurrency transactions, fee disclosures, retirement advice, and related recommendations to vulnerable senior investors—occasionally drop off the charts. Such was the case for seniors and share-class selection in the past couple of years.

FIGURE 2: SEC EXAMINATION PRIORITIES, 2020–2024

<table>
<thead>
<tr>
<th>Year</th>
<th>ESG</th>
<th>Cybersecurity</th>
<th>Digital Assets</th>
<th>Fees*</th>
<th>Retirement Advice</th>
<th>Seniors</th>
<th>Share-class Selection</th>
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<tr>
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Source: SEC Annual Examination Priorities. Limited to compliance issues related to investment advice.  
*Fee issues referenced in the releases include disclosure problems, fee calculations, allocation of fees, and excessive fees, among others.
However, many of these core compliance topics appear year after year. For example, in the 2022 priorities release, the Division noted that “although the word ‘cyber’ was not used until 2014, risks related to data compromises were highlighted as well as what has become a perennial focus on addressing ... the use of new and emerging technologies across registrant types.” Although it may have been an examination concern of lesser importance years earlier, from 2014 through 2024 “cybersecurity” has been near the top of the priority list.

The issues listed in figure 2 are not the only topics Division examiners will review during inspections. Included on the 2024 priority list are:

- Complex products, such as derivatives and leveraged exchange-traded funds recommended by RIAs;
- High-cost and illiquid products, such as variable annuities and non-traded real estate investment trusts;
- Unconventional strategies, including those involving rising interest rates;
- Processes used by RIAs in making initial and ongoing suitability assessments;
- Evaluating costs and risks;
- Identifying and addressing conflicts of interest;
- How investments are allocated to various types of client accounts, e.g., fee-based, brokerage, wrap-fee accounts, and between taxable and non-taxable accounts.

The perennial focus on the above topics is not to imply that the Division will ignore other red flags when inspecting RIAs and other SEC registrants. In a recent interview with InvestmentNews, an SEC spokesperson confirmed that the “published priorities are not exhaustive and will not be the only issues addressed in FY24 examinations.”

When the SEC released its exam priorities for 2024, a number of news outlets highlighted the fact that ESG had dropped off the priority list at a time when regulatory concerns over greenwashing—the practice of inflating the importance of ESG investments in a client’s portfolio—are growing and also highly controversial in a political context.²

**FIGURE 3: SEC FOCUS ON ESG LABELS MISSING IN FISCAL YEAR 2024**

Source: 2020–2024 SEC Annual Examination Priorities
As illustrated in figure 3, the contrast in word counts between 2022—when “ESG” was referenced 18 times, and 2024, when it disappeared completely—might seem to be a curious omission. However, the 2022 references can be explained, at least in part, by the fact that in 2022 the SEC proposed three new ESG rules: the so-called “Names Rule” placing additional restrictions on fund names employing ESG strategies—approved last month—as well as a new rule requiring carbon emission disclosures by publicly traded companies, and a third rule requiring additional disclosures by RIAs utilizing ESG investment strategies. The latter proposals still are pending but are likely to be approved later this year or in 2024.

Once the RIA rule is approved, expect the Commission to come out with additional risk alerts and an official return of ESG to the annual priority list.

THE WRAP-UP

Congress

SEC Chair Gensler “obstructing” House oversight of SEC efforts to advance climate agenda. Rep. James Comer (R-KY), chair of the House Oversight and Accountability Committee, on October 12 threatened to issue a subpoena to SEC Chair Gary Gensler for information “about the SEC’s efforts to advance a progressive European climate and social agenda on American companies,” according to a committee press release.

Comer said that since June 5, 2023, the SEC had failed to respond to requests for information “by continuously delaying and misdirecting” his committee.

“As the SEC Chair, you have obstructed and continue to obstruct congressional oversight,” Comer said. In his letter to Gensler, Comer set a deadline of October 19 for the Commission to produce the requested documents. Otherwise, “I will consider other measures, including the use of the compulsory process, to gain compliance,” Comer said.

FINRA

Fiduciary breach, suitability claims up slightly in 2023. A modest uptick in fiduciary breach and suitability claims, tracked by the Financial Industry Regulatory Authority (FINRA) in its arbitration forum, has interrupted a steady downward trend over the previous four years (see figure 4).

Although FINRA and the SEC have ramped up enforcement actions this year for violations of Reg BI, a quasi-fiduciary standard, the number of private investor claims has dropped steadily after it went into effect in June 2020—that is until this year. Out of 2,023 cases filed in FINRA arbitration through September 2023, 1,127 included a fiduciary breach claim, compared to 967 in 2022.

SEC Commissioner Hester Peirce once tagged Reg BI as a “suitability-plus standard,” but private investor claims alleging unsuitable recommendations under Reg BI also have dropped—until a corresponding blip upward in 2023. This year through September 2023, 687 suitability claims were filed, compared to 680 for the same period in 2022.
Long before Reg BI was approved, “breach of fiduciary duty” claims were, and continue to be, the most common claim filed by unhappy brokerage customers, even though securities brokers have no statutory fiduciary duty under the Securities Exchange Act of 1934. However, over the years some state courts that reviewed investor disputes, depending on the specific facts involved in a case, determined that a fiduciary duty exists when customers repose a relationship of trust and confidence in their broker.

No official explanation for the drop and sudden uptick in fiduciary and suitability claims has been offered by FINRA, but a volatile stock market this year may have something to do with it.

FIGURE 4: FINRA: SLIGHT UPTICK IN FIDUCIARY BREACH CLAIMS

![Bar chart showing slight uptick in fiduciary breach claims from 2019 to 2023.]

Source: FINRA
*All fiduciary breach and suitability claims through September of each year.

**ERISA Excessive Fee Litigation**

**2023 class-action settlements nearly double over last year.** Class-action settlements related to excessive fee complaints in 401(k)-type plans nearly doubled this year through mid-October compared to the same period in 2022. According to data tracking by Potomac Strategies, a consulting firm, 41 class-action settlements were approved, or nearing court approval by mid-October, compared to 23 for the same period in 2022.

Monetary settlements this year ranged from $200,000 to $61 million in General Electric’s 401(k) plan, a monetary settlement that plaintiffs’ attorneys called the largest ever in an ERISA case in which plan sponsors offered their own proprietary funds in the lineup.

Most of the settlements filed this year were limited to monetary conditions, although nine included “prospective” conditions such as requiring annual fiduciary training for the plan’s investment committee, conducting a search for a new recordkeeper, and retaining independent consultants to review the current lineup of plan investments.
SEC Regulation

**New SEC rule requires short sales positions.** The SEC on October 13 adopted a new rule requiring greater disclosure of short sales-related positions to the agency, principally by hedge funds.

Investment managers that carry large short positions of equities of at least $10 million, or the equivalent of 2.5 percent or more of total shares outstanding on average during a month, would have to be reported to the Commission, SEC Chair Gary Gensler said in a statement at the Commission’s October 13 meeting.

After a four-week lag, the Commission would then publish the filings of aggregated, anonymous data of the gross, end-of-month large short positions, he said.

The rule is intended to provide more transparency of short sales activity to help distinguish between conventional hedging activity by businesses and speculative bets against a company as occurred in January 2021 during the so-called “GameStop short squeeze.”

Trade Associations

**NAIFA and FSP announce merger.** The National Association of Insurance and Financial Advisors and the Society of Financial Services Professionals have announced a merger following membership approval by both organizations.

According to a joint news release, the partnership will represent more than 20,000 members spanning “every practice area in financial services” across the country, and will provide expanded education, advocacy, and professional networking opportunities.

Research

**Nearly half of retirees and near-retirees have little confidence in investment acumen.** A recent survey by Western & Southern Financial Group, in collaboration with LIMRA, found that many current and future retirees doubt their ability to manage their investments throughout retirement. Top concerns among respondents include potential Social Security cuts (61 percent), inflation (60 percent), running out of money (54 percent), and healthcare costs (46 percent).

ABOUT WASHINGTON INSIGHTS

The purpose of this column, prepared by Potomac Strategies for Investments & Wealth Institute, is to give members legislative, regulatory, and other public policy news and analysis. It is strictly informational and should not be relied upon as legal or compliance advice. Investments & Wealth Institute, as an education and credentialing organization, does not lobby Congress and generally does not advocate for any particular legislative or regulatory position either on its own or through its relationship with Potomac Strategies.

If you have questions after reading this update, please contact the Institute’s general counsel, Robert (Rob) Frankel at rfrankel@i-w.org.
ENDNOTES

1. This year the SEC also moved its release up from calendar year to October of the previous year to align more closely with the federal government’s fiscal year, which begins on October 1.