

# ***FS Regulatory Brief***

## ***OCIE sends new advisers a letter describing “presence exams”***

October 2012

On October 9, the SEC’s Office of Compliance Inspections and Examinations posted an open letter to new adviser registrants on its website, and its regional offices sent the same letter to new registrants in the region.

The open letter is addressed to the senior executive or principal of a “newly registered adviser” – described as those that have registered as advisers since July 2011, as was required for advisers to private funds, i.e., advisers to hedge and private equity funds. See PwC’s *Closer Look* describing the new rules “*Impact on Asset Managers*” (December 2010).

The OCIE letter describes what it terms its “Presence Exams initiative” for these advisers. The initiative will run two years and include three phases: engagement, examination, and reporting.

Engagement phase: the SEC will inform newly-registered advisers about their obligations under the Advisers Act through compliance outreach materials on its website, and its Compliance Outreach program.

Examination phase: The examination staff will conduct examinations of newly-registered firms. (Previously, the SEC staff had indicated that it intended to perform examinations of a significant percentage of newly registered firms). In these examinations, it will review “one or more” of the following areas:

- *Marketing:* Examiners will look for evidence of false or misleading statements, and how advisers solicit investors, including the use of placement agents.

- *Portfolio Management:* Examiners will “review and evaluate investment advisers’ portfolio decision-making practices, including the allocation of investment opportunities and whether advisers’ practices are consistent with disclosures provided to investors.”
- *Conflicts of Interest:* Examiners will review the process used by the adviser to identify, mitigate and manage conflicts, e.g., related to allocations, fees, expenses, revenue sources, payments to related persons, and employees’ outside business activities, personal trading and transactions with affiliates.
- *Custody:* Examiners will review compliance with the Custody Rule, and the safety of client assets.
- *Valuation:* Examiners will review a firm’s valuation policies, procedures and methodology, including for fair valuing illiquid or difficult to price instruments, procedures for calculating management and performance fees, and allocation of expenses to private funds.

Reporting phase: Examiners will report their observations to the Commission and to the public, along with common practices identified, industry trends and significant issues.

The letter reflects the SEC staff’s priority – to conduct many examinations of newly registered firms in the next two years, and thereby to have a “presence” with this population. It also indicates that, to accomplish this, the staff will narrow the scope for these “Presence Exams,” to include the areas identified above. These are known areas of compliance risk, and advisers should ensure that their compliance and controls in each area is robust and effective.

# Additional information

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