

ALERTS

SEC Announces “Presence Exams” for Newly-Registered Investment Advisers

October 9, 2012

The staff of the U.S. Securities and Exchange Commission (the “SEC”) has announced its new National Exam Program (“NEP”) initiative to conduct “Presence Exams” of newly-registered investment advisers. In a letter sent today from various regional offices of the SEC to newly-registered advisers, the staff described the new exams as “focused” and “risk-based” and highlighted the following five “higher-risk” areas that may be covered during an exam:

- Marketing
- Portfolio Management
- Conflicts of Interest
- Safety of Client Assets
- Valuation

The letter makes it clear that the NEP staff will contact advisers separately if and when their firm is selected for an examination. The letter also explains that the Presence Exams are part of a two-year initiative that will include (1) an Engagement Phase — involving outreach to newly registered advisers, (2) an Examination Phase — during which the exams will occur and (3) a Reporting Phase — during which the NEP will report to the SEC and the public its observations from the examinations (including common practices identified in the higher-risk areas, industry trends and significant issues).

The higher-risk areas identified in the letter are consistent with many of the issues we are seeing in recent SEC examinations. Fund managers should be prepared to address these issues in detail with the SEC staff, for example, by explaining their procedures, disclosures and testing with respect to allocation of investment opportunities and allocation of expenses among funds and other accounts. Supporting materials for all factual statements made in marketing materials (including pitch books, DDQs and other communications) should be identified and their accuracy confirmed. Advisers should be prepared to explain their valuation methodologies, particularly for fair valuing illiquid or difficult-to-value instruments. In preparation for examination, fund managers should review the accuracy of their management- and performance-fee calculations, as well as the means by which they satisfy the custody rule taking into consideration all categories of instruments and other investments.

Identifying and addressing the types of issues raised in today's letter should be a priority for all registered advisers.

Authored by Marc E. Elovitz.

Attorneys in Schulte Roth & Zabel's Regulatory & Compliance Group regularly advise private fund managers with respect to preparing for and undergoing an SEC examination.

If you have any questions concerning this *Alert*, please contact your attorney at Schulte Roth & Zabel or the author.

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