

SEC Announces New “Presence Examinations” Targeted at Newly Registered Investment Advisers

The Office of Compliance Inspections and Examinations (“OCIE”) of the U.S. Securities and Exchange Commission (the “SEC”) announced last month that it would soon begin conducting “presence examinations” of newly registered investment advisers to hedge funds, private equity funds and real estate funds (each, a “registered adviser”). On October 9, 2012, the SEC began mailing a form letter to newly registered advisers to notify them of the new examination program and to prepare them for possible examination (the “SEC Letter”).¹ Unlike traditional OCIE examinations, the new presence examinations are expected to be risk-based and cover two to three topic areas, selected on the basis of each registered adviser’s business. Communications from the OCIE staff, including the SEC Letter, indicate that the following areas will be of particular focus: (i) marketing / advertising; (ii) portfolio management; (iii) conflicts of interest; (iv) safety of client assets and (v) valuation.

Following sweeping regulatory reform ushered in by the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act in 2010, the SEC has regulatory authority over approximately 1,400 new investment advisers that were previously exempt from registration. According to Andrew Bowden, the Deputy Director of OCIE charged with running the new examination program, the OCIE staff intends to examine approximately 25% of the newly registered advisers in the next 18 to 24 months. At the end of the 24-month examination period, OCIE intends to use the data collected from the approximately 350 presence examinations to prepare a report for the broader investment management community. OCIE will use the report, in part, as an educational tool designed to establish best practices with respect to compliance procedures and risk management.

Registered advisers should read the SEC Letter closely and be prepared to address the specific issues on which the presence examinations will focus. In particular, we suggest registered advisers focus on the calculation and accuracy of the fees charged to their funds and other clients, as well as their valuation policies and procedures, especially with respect to illiquid or hard-to-value assets.

1. A copy of this letter is available [here](#).

Implications for Non-U.S. Registered Advisers

While not stated explicitly in the SEC Letter, we believe that any registered adviser, whether operating from a place of business in the United States or abroad, may be subject to a presence examination. Due to OCIE’s budgetary limitations, however, we believe registered advisers that have a principal place of business in the United States will be significantly more likely to be selected for presence examinations than non-U.S. registered advisers. *We note that the SEC has **not** indicated that investment advisers relying on the “private fund adviser” exemption from registration, and which file truncated Form ADVs as exempt reporting advisers, will be subject to presence examinations.*

We hope this information is helpful. As you are well aware, presence examinations are yet another aspect of the rapidly changing regulatory environment to which registered advisers must adapt. Clifford Chance has prepared a mock examination program to help our registered adviser clients prepare for, and make the necessary adjustments to, this new regulatory landscape. Tailored to the risk profile of your individual firm, the mock examination seeks to replicate the OCIE examination process—whether for the abbreviated presence examination or a more traditional OCIE examination—and to identify strengths and weaknesses within the firm’s compliance infrastructure. The SEC has suggested that such proactive testing of compliance programs, including responses to examination, will help mitigate risks associated with the examination process. Should you have any questions about our mock examination program, or any other regulatory matter, please feel free to contact us.

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