



UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
OFFICE OF COMPLIANCE INSPECTIONS AND EXAMINATIONS  
100 F STREET, NE  
WASHINGTON, DC 20549

October 9, 2012

Dear Senior Executive or Principal of a Newly Registered Investment Adviser:<sup>1</sup>

We are sending you this letter to introduce you to the National Exam Program (“NEP”), which is administered by the Office of Compliance Inspections and Examinations (“OCIE”) within the United States Securities and Exchange Commission (“Commission”), and to provide you with information about upcoming examinations of certain newly registered investment advisers and the topical areas that may be examined.<sup>2</sup> *The NEP staff will contact you separately if your firm is selected for an examination.*

**I. Information About the NEP**

An investment adviser registered with the Commission has an obligation to comply with the Investment Advisers Act of 1940 (the “Advisers Act”) and the rules adopted by the Commission thereunder. OCIE examines registered advisers, including firms that advise private funds, to assess whether they are operating in a manner consistent with the federal securities laws. OCIE administers such examinations through the NEP, which is comprised of staff in the Commission’s 11 regional offices and the home office in Washington, D.C. The NEP’s mission is to protect investors and maintain market integrity through risk-focused examinations that promote compliance, prevent fraud, monitor risk, and inform policy.

**II. Presence Exams of Certain Newly Registered Investment Advisers**

Consistent with our mission and objectives, the NEP is launching an initiative to conduct focused, risk-based examinations of investment advisers to private funds that recently registered with the Commission (“Presence Exams”). The Presence Exams initiative will take place over the next two years and it has three primary phases: engagement; examination; and reporting. Each phase is described further below.

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<sup>1</sup> For purposes of this letter, we distinguish an investment adviser as “newly registered” if it registered with the Commission after the definitional and transitional rules under Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 became effective (July 21, 2011). In addition, this letter is specifically directed to senior officers of investment advisers that manage private funds.

<sup>2</sup> The Commission, as a matter of policy, disclaims responsibility for any publication or statement by any of its employees. The views expressed herein are those of the staff and do not necessarily reflect the views of the Commission or the other staff members of the Commission.

## **A. Engagement Phase**

The NEP is engaged in a nationwide outreach to inform newly registered firms about their obligations under the Advisers Act and related rules, the Presence Exams initiative, and OCIE's practice of engaging directly with firms' senior management. As part of our outreach initiatives, the NEP has published compliance outreach materials, staff letters, risk alerts, special studies, speeches, and other documents that are available on the Commission's website.<sup>3</sup> The Commission's website also contains information and links to relevant laws and rules, staff guidance, enforcement cases, and staff issued no-action and interpretive letters (generally from 2001 to present).<sup>4</sup> Some of these resources and their reference links are provided at the end of this letter.<sup>5</sup>

In addition, the Commission's staff engages in compliance outreach for investment advisers through initiatives such as our Compliance Outreach Program. This program is designed to provide senior officers, including Chief Compliance Officers, with a forum to discuss compliance issues, share experiences, engage in discussions with Commission staff, and learn about effective compliance practices. The program features both regional meetings at various locations across the country and national seminars in Washington D.C.

## **B. Examination Phase**

During the examination phase of the Presence Exams initiative, NEP staff will review one or more of the following higher-risk areas of the business and operations of advisers selected for an examination:<sup>6</sup>

**Marketing.** Investment advisers may utilize marketing materials to solicit new investors or retain existing investors. NEP staff will review marketing materials to evaluate whether the investment adviser has made false or misleading statements about its business or performance record; made any untrue statement of a material fact; omitted material facts; made any statement that is

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<sup>3</sup> In particular, you are encouraged to review the staff's letter to newly registered investment advisers that was sent to your firm when it registered through IARD. For a more detailed overview of the NEP and the issues of focus for the examination staff, see recent speeches by OCIE's Director, Carlo di Florio, and former Deputy Director, Norm Champ.

<sup>4</sup> Staff interpretations and no-action letters provided by the Commission's Division of Investment Management are informal interpretative and advisory assistance and represent the views of persons who are continuously working with the provisions of the Advisers Act. Opinions expressed by the staff, however, are not an official expression of the Commission's views and they do not have the force of law. You may wish to speak with an attorney or a compliance professional about specific provisions and how they apply to your firm.

<sup>5</sup> This letter does not provide a complete description of all of the legal obligations of SEC-registered advisers nor does it provide a comprehensive inventory of resources that may be available.

<sup>6</sup> The books and records of all registered investment advisers are subject to compliance examinations by Commission staff, including the records and reports of any private funds to which investment advisers registered under Advisers Act provide investment advice. If your firm is examined, you are required to provide examiners with access to all requested advisory records that are maintained by your firm (under certain conditions, documents may remain private under the attorney-client privilege).

otherwise misleading; or engaged in any manipulative, fraudulent, or deceptive activities. In addition, NEP staff will review how investment advisers solicit investors for the private funds they manage, including the use of placement agents.

***Portfolio Management.*** An investment adviser has an obligation to act in the best interests of its advisory clients and to identify, mitigate, and disclose any material conflict of interest. NEP staff 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.*** The NEP staff will review the procedures and controls that advisers use to identify, mitigate, and manage certain conflicts of interest within their firms. Some areas of the conflicts of interest that NEP staff will review includes: allocation of investments, fees, and expenses; sources of revenue; payments made by private funds to advisers and related persons; employees' outside business activities and personal securities trading; and transactions by advisers with affiliated parties.

***Safety of Client Assets.*** Registered investment advisers that have "custody" of client assets must take specific measures to protect client assets from loss or theft. NEP staff will review advisers' compliance with the relevant provisions of the Advisers Act and related rules that are designed to prevent the loss or theft of client assets. When obtained, NEP staff also will review independent audits of private funds for consistency with the Advisers Act custody rule.

***Valuation.*** Investment advisers must have effective policies and procedures regarding the valuation of client holdings and assessment of fees based on those valuations. NEP staff will review advisers' valuation policies and procedures, including their methodology for fair valuing illiquid or difficult to value instruments. NEP staff also will review advisers' procedures for calculating management and performance fees, and allocation of expenses to private funds.

If your firm is selected for an examination, after the completion of the on-site portion of the examination, NEP staff may send you a letter indicating that the examination has concluded without findings or a letter that describes the deficiencies identified and asks your firm to undertake corrective action. If serious deficiencies are found, in addition to sending an examination summary letter, NEP staff may refer the problems to the Commission's Division of Enforcement, or to a self-regulatory organization, state regulatory agency, or other regulator for possible action.

### **C. Reporting Phase**

At the conclusion of the Examination Phase, the NEP intends to report its observations to the Commission and the public. These observations may include common practices identified in the higher-risk focus areas, industry trends, and significant issues. In sharing examiners' observations from Presence Exams, the NEP staff hopes to encourage firms to review compliance in these areas and to promote improvements in investment adviser compliance programs.

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We hope that this letter was useful in introducing you to the Presence Exams initiative and the examination program generally, and will better acquaint you and your personnel with compliance resources. Should you have any questions regarding this letter, please identify the Commission's regional office that is assigned to your advisory firm and contact any member of NEP management in that office.<sup>7</sup>

Sincerely,



Drew Bowden  
Deputy Director

cc: Chief Compliance Officer

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<sup>7</sup> Instructions regarding identifying the Commission's office applicable to your firm are provided in the attached "Additional Information: Reference Materials" guide in the section titled "Information Regarding the NEP and Examinations."

## **Additional Information: Reference Materials**

You may find the following non-exclusive list of informational sources to be helpful. Items referenced by a “✓” below are highlighted in the letter.

### Information About the Advisers Act

- The Advisers Act and rules are available on the Commission’s website at <http://www.sec.gov/divisions/investment.shtml>).
- Overview of the Regulation of Investment Advisers (April 2012), available on the Commission’s website at [http://sec.gov/about/offices/oia/oia\\_investman/rplaze-042012.pdf](http://sec.gov/about/offices/oia/oia_investman/rplaze-042012.pdf)
- SEC-Staff Issued Interpretive Guidance and Studies, available on the Commission’s website at <http://www.sec.gov/divisions/investment.shtml>.
- ✓ Information for Newly-Registered Investment Advisers, available on the Commission’s website at <http://www.sec.gov/divisions/investment/advoverview.htm>.

### Information Regarding the NEP and Examinations

- Overview of Examinations by the Securities and Exchange Commission’s Office of Compliance Inspections and Examinations (February 2012), available on the Commission’s website at <http://www.sec.gov/about/offices/ocie/ocieoverview.pdf>
- Examination Brochure, available on the Commission’s website at [http://www.sec.gov/about/offices/ocie/ocie\\_exambrochure.pdf](http://www.sec.gov/about/offices/ocie/ocie_exambrochure.pdf).
- NEP website, available at <http://www.sec.gov/about/offices/ocie.shtml>.
- ✓ Listing of local Commission office (contact information for senior examination staff) is available at [http://www.sec.gov/about/offices/ocie/ocie\\_org.htm](http://www.sec.gov/about/offices/ocie/ocie_org.htm). The Commission’s regional office designated for an adviser can be found by first identifying the adviser’s Principal Office and Place of Business on its Form ADV (as used in: Form ADV, Part 1A, Instructions, Items 1 and 2; Schedule D; Form ADV-W, Item 1) and then identifying the Commission’s regional office assigned to that state jurisdiction (which can be found at <http://www.sec.gov/contact/addresses.htm>).

### Information Relevant to the Higher-Risk Topical Areas

- ✓ Speech by Commission Staff Carlo di Florio, “Address at the Private Equity International Private Fund Compliance Forum” (May 2, 2012), available on the Commission’s website at [http://sec.gov/news/speech/2012/spch050212cvd.htm#\\_ftnref2](http://sec.gov/news/speech/2012/spch050212cvd.htm#_ftnref2).

- ✓ Speech by Commission Staff Norm Champ, “What SEC Registration Means for Hedge Fund Advisers” (May 11, 2012), available on the Commission’s website at <http://sec.gov/news/speech/2012/spch051112nc.htm>.

#### Information Regarding the Role of Senior Management in Compliance and Ethics

- Speech by Commission Staff Carlo di Florio, “The Role of Compliance and Ethics in Risk Management” (October 17, 2011), available on the Commission’s website at <http://www.sec.gov/news/speech/2011/spch101711cvd.htm>.
- Speech by Commission Staff Stephen M. Cutler, “Second Annual General Counsel Roundtable: Tone at the Top: Getting it Right” (December 4, 2004), available on the Commission’s website at <http://www.sec.gov/news/speech/spch120304smc.htm>.

#### Information About the Compliance Outreach Program

- Information about the Compliance Outreach Program for investment advisers and any scheduled events is available at [http://www.sec.gov/info/complianceoutreach\\_ia-funds.htm](http://www.sec.gov/info/complianceoutreach_ia-funds.htm).

#### Historical Observations by Commission Staff Regarding Hedge Funds

- Commission Staff report regarding the “Implications of the Growth of Hedge Funds” (September 2003), available on the Commission’s website at <http://www.sec.gov/news/studies/hedgefunds0903.pdf>.