

Client Alert

Private Equity and Investment Management Practice Group

February 27, 2014

SEC Launches New Initiative to Focus Exams on Never-Before Examined Investment Advisers

On Thursday, February 20, 2014, the SEC's Office of Compliance Inspections and Examinations (OCIE) issued a news release detailing its plans to conduct examinations of a significant percentage of investment advisers that have not been examined since they registered with the SEC as part of the "Never-Before Examined (or NBE) Initiative." The examinations will focus on investment advisers that have been registered for more than three years and are not subject to examination under the Presence Exam initiative.¹

Examinations will concentrate on the investment advisers' compliance programs, filings and disclosure, and safekeeping of client assets, among others issues. The SEC provided additional details relating to the examinations in the form of a letter directed to the Senior Executive or Principal of a Registered Investment Adviser (the "Letter"). The letter can be found at the following link: <http://www.sec.gov/about/offices/ocie/nbe-final-letter-022014.pdf>.

The Never-Been Examined Initiative will include: (i) a risk-assessment approach aimed at obtaining a better understanding of a registrant, with a focus on the overall business activities of an investment adviser, and (ii) a focused review approach which will involve comprehensive risk-based examinations of certain areas of the adviser's business and operations deemed to be "higher-risk" areas by the SEC staff.

The Letter also provides information about the National Exam Program ("NEP") administered by OCIE generally. The National Examination Program published its 2014 examination priorities on January 9, 2014, which can be found at: <http://www.sec.gov/about/offices/ocie/national-examination-program-priorities-2014.pdf>. Of particular interest to the OCIE in connection with the examination of registered investment advisers are:

- Safety of Client Assets and Custody
- Conflicts of Interest
- The Accuracy and Completeness of Marketing and Performance Information
- Wrap Fee Programs
- Quantitative Trading Models
- Payments to Distributors and Intermediaries

For more information, contact:

Matthew J. Bromberg
+1 212 556 2317
mbromberg@kslaw.com

Kathryn M. Furman
+1 404 572 3599
kfurman@kslaw.com

John D. Wilson
+1 212 556 2277
jdwilson@kslaw.com

King & Spalding

Atlanta

1180 Peachtree Street, NE
Atlanta, Georgia 30309-3521
Tel: +1 404 572 4600
Fax: +1 404 572 5100

New York

1185 Avenue of the Americas
New York, New York 10036-4003
Tel: +1 212 556 2100
Fax: +1 212 556 2222

www.kslaw.com

- Fixed Income Investment Companies, Money Market Funds, “Alternative” Investment Companies and Securities Lending Arrangements

Although the NBE Initiative excludes advisers to private funds, these advisers will continue to be a focus of the Presence Exams initiative and, as a result, between the two initiatives, there is a significant likelihood that your firm will be contacted by the NEP staff. With this in mind consider taking the opportunity to do the following:

- Review the effectiveness of your compliance program with particular attention to advisory books and records relating to the identification and mitigation of conflicts of interest and compliance related risks;
- Review your disclosure generally and as it relates to material facts regarding conflicts of interest;
- Review your marketing materials for accuracy and completeness;
- Review your portfolio management decision making practices, with additional focus on allocation of investment opportunities and consistency with disclosure provided to clients; and
- Review arrangements relating to safekeeping of client assets, taking particular care to consider compliance obligations when you have or are deemed to have custody of client assets.

Advisers should consider consulting experienced counsel if they have any uncertainty as to whether their compliance programs are appropriately drafted and implemented in light of their particular business and the SEC’s areas of focus.



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This alert provides a general summary of recent legal developments. It is not intended to be and should not be relied upon as legal advice. In some jurisdictions, this may be considered “Attorney Advertising.”

¹ Presence Exams, which were first announced in 2012 to examine private fund advisers registered since the effective date of Section 402 of the Dodd-Frank Act, focus on marketing, portfolio management, conflicts of interest, safety of client assets and valuation.