



UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

THE CHAIR

December 16, 2014

The Honorable Jeb Hensarling
Chairman
Committee on Financial Services
United States House of Representatives
2129 Rayburn House Office Building
Washington, D.C. 20515

Dear Chairman Hensarling:

Thank you for your November 24, 2014 letter regarding the Securities and Exchange Commission's examination coverage of registered investment advisers. As you know, I share your view of the priority to examine a greater portion of the more than 11,000 investment advisers currently registered with the SEC.

The SEC continues to strive to find ways using existing resources to increase coverage of investment advisers without sacrificing quality or important coverage in other areas. Among other measures, we have created within the Commission's Office of Compliance Inspections and Examinations (OCIE) an Office of Risk Analysis and Surveillance, which systematically reviews a variety of information (including regulatory filings, past examination reports, and information in publicly available databases) on every registered investment adviser and broker-dealer to refine firm risk profiles and to better identify potential examination candidates for on-the-ground examinations. OCIE examiners have conducted thousands of desk reviews – analyses of registrants' business and risk profiles using information available to staff – of registered investment advisers, which also provides a more informed assessment of whether an on-site examination should be conducted. OCIE has recruited industry experts to enhance its ability to identify issues of particular vulnerability, conduct more focused exams, and train staff in areas such as derivatives, valuation, hedge funds, private equity, and quantitative analysis. It also has strengthened its examiner training program, including adding extensive training for new examiners with case studies and a mock exam. In addition, the SEC has enhanced its use of advanced quantitative techniques to enable staff to more quickly and systematically analyze large amounts of data to detect potential misconduct, and has launched an examination initiative directed at non-private fund investment advisers that have never been examined, focusing on those that have been registered with the SEC for at least three years.

As a result of these and other efforts, the number of investment adviser examinations conducted in fiscal year 2014 increased approximately 20% to 1,164 from 964 in fiscal year 2013, with staffing levels remaining relatively stable.¹ In those two fiscal years, the investment

¹ These numbers include examinations conducted by the Division of Investment Management.

advisers examined by OCIE staff managed approximately 25% and 30% respectively of the total assets under management by all registered investment advisers.

Despite the staff's improved ability to analyze data and monitor investment advisers through desk reviews, there is no substitute for conducting on-site examinations. On-site examinations greatly assist OCIE's mission to promote compliance and provide the most thorough, reliable information possible. In seeking to best determine how to utilize limited resources, staff regularly evaluates whether to reallocate resources across examination programs to maximize coverage where it is most needed. For example, over the last several years, examiners in the broker-dealer examination program have been deployed to conduct examinations of investment advisers and broker-dealers which are dually registered as investment advisers. While I have instructed the staff to continue exploring and developing this strategy as appropriate, a more significant reallocation of examination resources from coverage of broker-dealers to the investment adviser program would not be advisable given the demonstrated need to maintain existing coverage of broker-dealers.

The staff also has been considering ways to supplement the examination program, including potentially by permitting third party audits or compliance reviews of investment advisers. In 2003, the Commission requested comment on several private sector options, including a requirement that advisers undergo third party compliance reviews. As noted in the release, third party compliance reviews could be used to quickly identify areas that require attention, permitting us to allocate examination resources better and, as a result, to increase the frequency with which our staff could examine funds and advisers. In response to the request for comment, a number of commenters, including investment advisers, raised concerns as to, among other things, the costs of a third party review (particularly as it relates to small advisers), standards for or expertise of the reviewers, and potential conflicts of interest which may impact the quality of reviews given that third parties may be incentivized to maintain their professional relationships. I have asked the staff to do a current evaluation of the third party compliance review concept.

You also requested information on the average of investment adviser examinations per examiner. The number of firms that the staff examine each year depends on many factors, including, most significantly, the type and scope of examinations conducted, the size and complexity of firms examined, market events, and staffing levels. A metric dividing the number of investment adviser examinations by the number of investment adviser examiners does not accurately account for the fact that examiners work in teams, typically two to three examiners per examination (and sometimes more), and does not factor in other work that increases our examination coverage, such as desk reviews, training, enforcement assistance, and examinations of investment companies and transfer agents. In response to your specific request, however, the staff estimates the average number of investment adviser examinations per examiner in FY 2013 was approximately 3.2 and for FY 2014 was 3.9, with the typical investment adviser examiner working on an average of 6 to 9 examinations per fiscal year in FY 2013 and FY 2014. As further context for these figures, it should be noted that examiners are assigned to examinations throughout the year, often balancing multiple examinations at the same time.

The Honorable Jeb Hensarling
Page 3

Thank you again for your letter. Please do not hesitate to contact me at (202) 551-2100, or have a member of your staff contact Tim Henseler, Director of the Office of Legislative and Intergovernmental Affairs, at (202) 551-2010, if we can be of further assistance.

Sincerely,

A handwritten signature in blue ink, appearing to read "Mary Jo White".

Mary Jo White
Chair