

SEC Adopts Amendments to Form ADV and Investment Advisers Act Rules

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PRACTICES Fund Formation and Management, Private Equity, Investment Management

On August 25, 2016, the Securities and Exchange Commission (the “SEC”) adopted amendments (the “Amendments”) to Form ADV and the books and records rule under the Investment Advisers Act of 1940, as amended (the “Advisers Act”). The Amendments are designed primarily to: (i) expand the amount of information reported by investment advisers (including information about separately managed account businesses), (ii) streamline and facilitate umbrella registration for private fund advisers, (iii) make clarifying and technical amendments to certain Form ADV items and instructions, and (iv) broaden the scope of performance calculation records to be maintained by advisers. The Amendments will become effective on October 31, 2016, but advisers will not be required to comply with the Amendments until October 1, 2017 (the “Compliance Date”). Only those advisers filing an initial or amended Form ADV on or after the Compliance Date will be required to comply with the Amendments and, as a result, most advisers will not be subject to the revised Form ADV requirements until filing their annual amendments in early 2018.

Separately Managed Account (“SMA”) Information

The Amendments require investment advisers to provide more detailed information about SMAs that they manage in Form ADV Part 1A. Although the SEC did not specifically define the term “separately managed account,” SMAs are generally deemed to include advisory accounts other than those that are pooled investment vehicles. As of the Compliance Date, advisers will be required to disclose information about the types of assets held in SMAs and the use of derivatives and borrowings by such SMA clients in the aggregate. Under the Amendments, advisers will also be required to report on the approximate percentage of SMA regulatory assets under management (“RAUM”)¹ invested in twelve asset categories.² The SEC did not provide definitions for these categories but stated that advisers may use their own methodologies in determining which of the relevant asset categories are applicable to their advisory business.

The SEC also separately delineated the reporting requirement deadlines based on an adviser’s RAUM. Advisers with at least \$10 billion in RAUM attributable to SMAs will be required to report this information on both a mid-year and year-end basis in their annual Form ADV filing (in accordance with their fiscal year filing requirements), while advisers with less than \$10 billion in RAUM attributable to SMAs will only be required to report this information on a year-end basis.

The Amendments also require advisers with at least \$500 million in RAUM attributable to SMAs to provide information on the use of derivatives and borrowings by such SMAs on a year-end basis, including the dollar amount of borrowings attributable to SMA assets that correspond to three levels of gross notional exposures (less than 10 percent, 10-149 percent and 150 percent or more). Advisers with at least \$10 billion in RAUM attributable to SMAs are required to report the above information as well as the derivative exposures across six derivative categories on a mid-year and year-end basis in their annual Form ADV filing. Note that advisers may limit their reporting of derivatives and borrowings information to individual accounts of at least \$10 million.

Finally, the Amendments require advisers to identify any custodians on Form ADV that account for at least 10 percent of the adviser's RAUM attributable to SMAs and the amount of the adviser's RAUM attributable to SMAs held with such custodians.

Umbrella Registration

The Amendments codify (and modify in certain instances) the SEC's position set forth in its January 18, 2012 no-action letter to the American Bar Association by allowing for "umbrella registration" for certain investment advisers to private funds. Under this umbrella registration regime, related advisers that are separate legal entities but effectively operate as (and appear to investors and regulators to be) a single advisory business will be allowed to file under a single registration with the SEC as of the Compliance Date. Under the Amendments, the primary adviser and each related adviser may register with the SEC under a single registration if the following conditions are met:

1. The filing adviser and each relying adviser advise only private funds and clients in SMAs that are "Qualified Clients" (as defined in Rule 205-3 under the Advisers Act) and are otherwise eligible to invest in the private funds advised by the advisers (and whose SMAs pursue investment objectives and strategies that are substantially similar to those private funds);
2. The filing adviser has its principal office and place of business in the U.S. and, as a result, all of the substantive provisions of the Advisers Act and the rules thereunder apply to the filing adviser and each relying adviser (regardless of whether any of the advisers or their clients are U.S. persons);
3. Each relying adviser, its employees and the persons acting on its behalf are subject to the filing adviser's supervision and control;
4. Each relying adviser's advisory activities are subject to the Advisers Act and the rules thereunder and are subject to SEC examination; and
5. The filing adviser and each relying adviser operate under a single code of ethics and written policies and procedures adopted and implemented in accordance with Rule 206(4)-7 under the Advisers Act and are administered by a single chief compliance officer.

Each relying adviser registering as part of an umbrella registration regime must also file new Schedule R to Form ADV. Schedule R requires the following information on behalf of each relying adviser:

1. identifying and contact information;
2. location of principal office and place of business and mailing address;
3. basis for SEC registration;
4. identification of control persons; and
5. identification of direct and indirect owners.

The Amendments also revise the instructions to Form ADV to note that all information in the Form should be answered on behalf of the filing adviser and each relying adviser unless otherwise indicated. The SEC declined to permit a non-U.S. adviser (an adviser with a principal office or place of business outside of the U.S.) to be a primary filing adviser under the Amendments, although a non-U.S. adviser may file as a relying adviser. The Amendments also did not expand the scope of umbrella registration to include "umbrella reporting" by exempt reporting advisers.

Additional Reporting Requirements

The Amendments require filing advisers to provide additional information on the following items in Form ADV Part 1A:

1. the total number of offices in which the adviser conducts business (including specific information about its 25 largest offices);
2. the number of employees performing advisory functions from each office of the adviser and information about the type of securities-related activities the adviser conducts in each office;
3. all websites used by the adviser and its use of publicly available social media platforms on which the adviser controls the content (excluding any social media accounts used by employees of the adviser);
4. whether the adviser limits sales in private funds relying on the exclusion from the definition of an investment company under Section 3(c)(1) of the Investment Company Act of 1940, as amended, to Qualified Clients;
5. whether the adviser's chief compliance officer is compensated or employed by any person other than the adviser (or a related person of the adviser) for providing chief compliance officer services to the adviser;
6. for advisers with RAUM of at least \$1 billion, the adviser's RAUM range: \$1-10 billion, \$10-50 billion, or \$50 billion or more;
7. information on the adviser's RAUM attributable to each category of client and the approximate RAUM attributable to non-U.S. clients;
8. the identifying numbers of the adviser's auditing firm for those advisers relying on the annual audit or annual surprise examination to satisfy compliance with Rule 206(4)-2 under the Advisers Act; and
9. the adviser's total RAUM attributable to affiliations with wrap fee programs.

Performance Information Recordkeeping

The Amendments modify Rule 204-2 under the Advisers Act to require registered advisers to maintain materials supporting performance or rate of return calculations that are distributed, directly or indirectly, to any person in written communications as of the Compliance Date (previously only communications distributed to ten or more people would trigger the requirement under Rule 204-2 of the Advisers Act). The Amendments also require advisers to maintain originals of all written communications received and copies of written communications sent by the adviser for communications related to performance or rates of return.

If you have any questions about this topic, please contact one of the lawyers of our Investment Management Practice Group below.

1 RAUM is calculated on a gross basis consistent with the definition of "regulatory assets under management" in Form ADV.

2 These asset categories are: (i) exchange-traded equity securities; (ii) non exchange-traded equity securities; (iii) U.S. Government/agency bonds; (iv) U.S. state and local bonds; (v) sovereign bonds; (vi) investment grade corporate bonds; (vii) non-investment grade corporate bonds; (viii) derivatives; (ix) securities issued by registered investment companies ("RICs") and business development companies ("BDCs"); (x) securities issued by pooled investment vehicles (other than RICs and BDCs); (xi) cash and cash equivalents; and (xii) other.