Investment Adviser Compliance with SEC's Amended Form ADV

09.21.17

Beginning October 1, 2017, investment advisers filing Form ADV with the Securities and Exchange Commission (the "SEC") must file using the amended form adopted by the SEC on August 25, 2016 (the "Amended Form ADV"). According to the staff of the SEC, the Amended Form ADV is intended to modernize and enhance disclosure requirements while expanding the SEC's use of technology. Additionally, the SEC updated the Form ADV to enhance the reporting requirements for separately managed accounts ("SMAs") and stream-line the registration of advisers to private funds operating as a single advisory business ("Umbrella Registration"). Additionally, while the SEC specifically declined to adopt a clear definition of the term "separately managed account", it did provide some additional guidance on the scope of this term. The Amended Form ADV will have a relatively minimal practical effect on advisers that file as exempt reporting advisers ("ERAs"), but significant effect on registered investment advisers ("RIAs") and on certain state-reporting advisers (collectively, "Filing Advisers").

Specifically, changes reflected in the Amended Form ADV include the following:

- Increased reporting requirements for Filing Advisers who manage SMAs;
- Simplified registration for investment advisers of private funds operating as a single advisory business;
- Amended Rule 204-2 under the Investment Advisers Act of 1940 (the "Advisers Act") to require maintenance of additional records indicating performance calculations or rates of return; and
- Various other disclosure requirements and clarifying changes.

Amendments to Form ADV

1. Advisers of Separately Managed Accounts

Several important changes reflected in the Amended Form ADV are intended to collect more detailed information regarding SMAs. While the SEC specifically declined in the adopting release to adopt a clear definition of the term "separately managed account," the SEC did state that it considers "advisory accounts other than those that are pooled investment vehicles (i.e., registered investment companies, business development companies and pooled investment vehicles that are not registered, including private funds) to be separately managed accounts."[1] Additionally, the SEC has previously stated that "[w]hether a single-investor fund could be a private fund for purposes of the exemption depends on the facts and circumstances," and that a fund that seeks to raise capital from multiple investors but only has a single, initial investor for a period of time could be a private fund, as could a fund in which all but one of the investors have redeemed their interests.[2] However, it appears that, absent facts that would suggest otherwise (such as those previously described by the SEC), a single-investor vehicle should be considered a separately managed account, and not a private fund, in light of this recent guidance from the SEC.

Regarding the changes to Form ADV applicable to separately managed accounts, Filing Advisers must now report the percentage of any SMA assets across twelve distinct asset categories, including exchange traded funds, non-exchange traded securities, bonds, derivatives, securities issued by registered investment companies, and cash and cash equivalents. This information must be reported at year-end by Filing Advisers with less than $10 billion in regulatory assets under management ("RAUM") attributable to SMAs, while Filing Advisers with RAUM equal to or exceeding $10 billion attributable to SMAs must report this information mid-year and year-end.

Filing Advisers that advise SMAs having aggregate RAUM in excess of $500 million are required to report information about the use of borrowing and derivatives with respect to the SMAs. Advisers of SMAs having at least $500 million but less than $10 billion of RAUM in the aggregate must report the amount of RAUM attributable to SMAs and the amount of borrowings attributable to those assets that correspond to three levels of gross notional exposures. For Filing Advisers to SMAs with at least $10 billion in RAUM, the advisers must also report, at mid-year and year-end, the derivatives

exposures within six derivative categories. Investors may, but are not required to, limit such reporting to individual accounts of at least $10 million.

Filing Advisers must also identify in the Form ADV any custodian that accounts for at least 10% of the total RAUM attributable to the SMA, the custodian's office location and the amount of RAUM held by each custodian.

2. Umbrella Registration

The SEC has streamlined the Umbrella Registration process to simplify filing by related advisers operating as a single advisory business. For example, Amended Form ADV includes a new Schedule R on which the Filing Adviser will provide ownership information for each relying adviser (similar to the former requirements of Schedules A and B). According to the SEC, it sought to simplify the registration process consistent with its guidance published since 2012. [3] In order for a group of investment advisers to qualify as a "single advisory business" and therefor for Umbrella Registration under Amended Form ADV, the investment advisers must meet the following requirements:

- The Filing Adviser and each relying adviser advise only private funds and clients in SMAs that are (1) qualified clients (as defined in rule 205-3 under the Advisers Act) and (2) are otherwise eligible to invest in the private funds advised by the filing adviser or a relying adviser and (3) whose accounts pursue investment objectives and strategies that are substantially similar or otherwise related to those private funds;
- The Filing Adviser's principal office and place of business is in the United States, and all substantive provisions of the Advisers Act apply to the Filing Adviser and each relying adviser;
- Each relying adviser, its employees and persons acting on its behalf are subject to the Filing Adviser's supervision and control;
- Each relying adviser's advisory activities are subject to the Advisers Act and are subject to SEC examination; and
- The Filing Adviser and each relying adviser operate under a single set of written compliance policies and procedures that are administered by a single chief compliance officer (the "CCO").

3. Amendment to Books and Records Rule

The SEC adopted two amendments to Rule 204-2 under the Advisers Act. As amended Rule 204-2 now requires advisers to maintain certain additional materials related to the calculation and distribution of performance information.

- Prior to amendment, Advisers Act Rule 204-2 required advisers to maintain records supporting any performance claims contained in any communication that is distributed or circulated to ten or more persons.The amended Rule 204-2 removes the "ten or more persons" limitation and replaces it with the phrase "any person," so advisers will be required to maintain the materials listed in Rule 204-2(a)(16) that demonstrate the calculation of performance in any communication that the investment adviser circulates or distributes to any person.
- Prior to amendment, Rule 204-2 required advisers to maintain certain enumerated categories of written communications received, and copies of written communications sent, by such advisers. Amended Rule 204-2 requires advisers to maintain, in addition to those categories, originals of all written communications received and copies of written communications sent by an investment adviser relating to the performance or rate of return of any managed accounts or securities recommendations.

4. Additional Identifying Information and Clarification Amendments to Form ADV

a. Online Activity.

In addition to listing all addresses for each website maintained by the adviser, Amended Form ADV requires disclosure of all publicly available social media platforms where the adviser has a presence and controls the content, including without limitation Twitter, Facebook and LinkedIn. The filing Adviser must disclose this information even if the online presence is directed at non-U.S. persons or outside of the United States.

b. Offices.

The Amended Form ADV requires that Filing Advisers provide the total number of offices at which they conduct investment advisory business and provide certain information about their 25 largest offices (measured by the number of employees at such office).

c. Chief Compliance Officer.

In addition to providing the name and contact information for the CCO, the SEC requires RIAs to report whether the CCO is compensated or employed by any other person other than the Filing Adviser or a related person or a registered investment company advised by the Filing Adviser. If the CCO is employed by another person, then the Adviser must also provide the employer identification number for that person, unless the person is an investment company registered under the Investment Company Act of 1940, as amended.

d. Balance Sheets.

Advisers with assets in excess of $1 billion will now report their asset within three ranges: (1) $1 billion to less than $10 billion; (2) $10 billion to less than $50 billion; and (3) $50 billion or more.

e. Advisory Business Information.

The SEC, in addition to the amendments related to advisers of SMAs (discussed above), amended Item 5 of the Form ADV Part 1A to require more detail regarding the firm's advisory business. The Amended Form ADV requires the adviser to state the number of clients it advises and the amount of RAUM associated with its clients (instead of a range of RAUM) and the number of clients to which it provides advisory services that are not in the Adviser's calculation of RAUM. Advisers must now provide the amount of RAUM attributable to non-United States persons. Additionally, the Amended Form ADV now requires the Advisers to disclose whether they calculate assets under Form ADV Part 2A differently than RAUM under Item 5 of Part 1A.

f. Financial Industry Affiliations and Private Funds.

The Amended Form ADV requires Filing Advisers to (1) provide identifying numbers, such as CIK and PCOAB numbers, of any "related persons" (as defined in Form ADV), and (2) private fund advisers will be required to report in Schedule D whether sales of interests issued by the fund are limited to qualified clients.

g. Solicitation.

For advisers to investment funds structured in a master-feeder arrangement, the Amended Form ADV, Item 7.B, now clarifies that these advisers should not consider their feeder funds as "clients" of the Adviser when considering whether the investment advisers' "clients" are solicited to invest in the private fund.

h. Audited Financials.

Advisers should use their most recent completed fiscal years financials when answering whether the financial statements have been delivered to investors.

Compliance Deadline

Beginning on October 1, 2017, a Filing Adviser that is either filing its initial Form ADV or an other-than-annual amendment to its Form ADV must use the Amended Form ADV for that purpose. Otherwise, assuming the Filing Adviser has a fiscal year end of December 31, the Filing Adviser must use the Amended Form ADV for its regular annual amendment filing in March 2018.

Conclusion

Beginning October 1, 2017, investment advisers filing Form ADV with the SEC must file using the Amended Form ADV which, according to the SEC, is intended to modernize and enhance certain disclosure requirements. The Amended Form ADV, and its accompanying guidance from the SEC, has notable new requirements applicable to Filing Advisers who manage SMAs. Additionally, the Amended Form ADV simplifies and clarifies certain disclosures required by Filing Advisers to private funds that operate as a single advisory business. Filing Advisers should carefully consider how these new disclosures will impact their filing requirements.

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[1] “Amendments to Form ADV and Investment Advisers Act Rules,” Investment Advisers Act Release No. 4091 (May 20, 2015).
[2] “Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers With Less Than $150 Million in Assets Under Management, and Foreign Private Advisers,” Release No. 3222; (June 22, 2011).
[3] See, e.g., American Bar Association, Business Law Section, SEC No-Action Letter, January 18, 2012.