

Chapman Client Alert

August 31, 2016

Current Issues Relevant to Our Clients

SEC Adopts Disclosure, Reporting and Recordkeeping Changes for Registered Investment Advisers

The Securities and Exchange Commission (the “SEC”) recently adopted changes to certain aspects of the reporting, disclosure and recordkeeping obligations of registered investment advisers including changes to Form ADV. The changes to Form ADV and the books and records rules will apply to filings and communications made on or after October 1, 2017 although most advisers’ first filing on the updated Form ADV will occur with their annual filings in the first quarter of 2018. A copy of the SEC’s release summarizing the final rule is available [here](#). A Client Alert on the SEC’s original proposal is available [here](#).

Overview

The SEC is amending Form ADV to require additional information about advisers’ separately managed account (“SMA”) businesses along with making certain other changes, including specific changes allowing for private fund advisers operating a single advisory business through multiple entities to register using a single Form ADV. The SEC is also amending the Investment Advisers Act of 1940 (“Advisers Act”) books and records rule and making several other technical amendments to various other rules and forms as part of its proposals relating to registered investment advisers. The changes to Form ADV and the Advisers Act rule changes were largely adopted as proposed in December 2015 although the SEC made certain changes and clarifications in the final rules in response to comments. These changes are intended to help modernize and enhance information reported by investment advisers and enhance the SEC staff’s ability to effectively carry out its risk-based examination and monitoring programs. The staff also hopes that these changes will improve the ability of existing and potential clients of investment advisers to make more informed decisions about the selection and retention of investment advisers.

Amendments to Form ADV

The SEC’s amendments to Form ADV focus on enhancing registered investment adviser (along with exempt reporting adviser) reporting requirements, incorporating “umbrella registration” for private fund advisers into Form ADV and making certain clarifying and technical amendments to existing items and instructions. These changes will apply to advisers

filing Form ADV on or after October 1, 2017. As a result, most advisers will be first filing on the amended Form ADV with their annual updates in the first quarter of 2018.

Information on SMAs

Most of the amendments to Form ADV focus on collecting more specific information about advisers’ SMAs. The SEC is targeting this additional information because, while the staff currently collects detailed information about pooled investment vehicles through a range of reporting and disclosure requirements (e.g. registration statements, shareholder reports, Form PF), very little specific information is currently collected on SMA holdings and exposures. For purposes of this additional data, the SEC considers advisory accounts to be those accounts other than pooled investment vehicles (i.e. registered investment companies, business developments companies and pooled investment vehicles that are not investment companies). The changes to Form ADV targeting SMA data include requiring:

- Reporting of more detailed information about the types and percentages of the types of assets in an adviser’s SMAs (e.g. exchange-traded equity securities, U.S. government/agency bonds, securities issued by registered investment companies or business development companies, etc.) with the instructions clarifying that advisers have some discretion in making categorization determinations and with such information to be provided annually for advisers with SMA regulatory assets under management (“AUM”) of less than \$10 billion and semiannually for advisers with SMA AUM of \$10 billion or more;

- For advisers with SMA AUM of \$500 million (increased from \$150 million in the original proposal) or more, annual reporting of information about the use of borrowings and derivatives in those SMAs, including gross notional exposure and amount of borrowings as a percentage of AUM (instead of net assets as in the original proposal) in those accounts;
- For advisers with SMA AUM of \$10 billion or more, semi-annual reporting of detailed information about the use of borrowings and derivatives in those SMAs, including information about gross notional exposure, amount of borrowings as a percentage of AUM (instead of net assets as in the original proposal), and more detailed information about specific categories of derivatives exposure (e.g. equity derivatives, commodity derivatives, interest rate derivatives, etc.); and
- Identification of custodians accounting for at least ten percent of an adviser's SMA AUM along with the percentage of an adviser's SMA AUM held with any such custodian.

The reporting is designed to line up with many of the categories and thresholds for the current reporting requirements for private fund advisers on Form PF. The final version made certain minor changes to categories and ranges and eliminated certain questions about numbers of accounts resulting in less granular information than originally proposed. This was done in response to comments received by the SEC regarding concerns about confidentiality. Additional instructions have been included clarifying that a sub-adviser to an SMA should provide information about the portions of accounts that it sub-advises.

Additional Information About Investment Advisers

Several new questions are being added to Form ADV and several existing questions are being changed regarding advisers' identifying information, advisory businesses and affiliations. The changes to collect additional information about investment advisers include requiring the following, among other things:

- Reporting of all of an adviser's CIK numbers, if any;
- Reporting of all of an adviser's websites, usage of websites for publicly available social media platforms (e.g. Twitter, Facebook, LinkedIn), and all publicly available social media addresses (a change from the current Form ADV which only requires reporting of an adviser's website) where the adviser controls the content;
- For any adviser that conducts its advisory business from more than one location, reporting of the adviser's 25 largest offices (by number of employees) along with the total number of offices (instead of reporting only the five largest offices under current the Form ADV) with updates only required to be made as part of the annual ADV filing;
- For each of an adviser's 25 largest offices, reporting of additional information about each office, including each office's Central Registration Depository ("CRD") branch number, number of employees who performed advisory functions from each office and descriptions of securities-related and other investment-related business conducted from each office with updates only required to be made as part of the annual ADV filing;
- Reporting of additional information about an adviser's chief compliance officer ("CCO"), including whether the CCO is compensated by any person other than the adviser (other than a registered investment company advised by the adviser) in an effort to identify firms with CCOs supplied by third-party compliance services providers;
- Reporting of an adviser's own assets;
- More specific information in Item 5 about AUM and number of clients by client type (rather than just reporting by ranges as required under the current Form ADV) although advisers with fewer than five clients in a category will be able to check a box for fewer than five clients rather than provide the number;
- Reporting of the amount of an adviser's AUM attributable to non-U.S. clients;
- More detailed identification (including reporting of AUM) of all registered investment companies, business development companies and parallel accounts related to such investment companies advised by an adviser;
- Additional information about AUM attributable to an adviser acting as sponsor and/or portfolio manager of a wrap fee program along with the SEC file number and CRD number for sponsors to any such wrap fee programs; and
- Requiring additional identifying numbers (e.g. CIK numbers and Public Accounting Oversight Board registration numbers) relating to private funds advised by an adviser along with whether an adviser to any private funds relying on the Investment Company Act of 1940 Section 3(c)(1) exclusion from the definition of investment company limits sales of its interests to qualified clients.

The SEC is also making certain updates to the IAPD system to simplify reporting of certain information for dually-registered broker-dealer/investment advisers by cross referencing information submitted to FINRA (e.g. branch office information).

Umbrella Registration

Advisers to many private funds are organized as a group of related advisers that are separate legal entities but effectively operate as a single advisory business. Many advisers currently rely on a 2012 SEC Division of Investment Management no-action letter providing certain conditions where a related investment adviser (a “relying adviser”) may rely on the registration of a registered investment adviser (the “filing adviser”) rather than registering on its own separate Form ADV. However, the current Form ADV is not designed to accommodate such collections of entities to register under a single registration and has resulted in many groups of advisers registering under multiple registration forms. This has increased costs for these advisers and made information they have reported on Form ADV less useful to the SEC and investors. The amendments to Form ADV’s general instructions establish conditions for an adviser to assess whether umbrella registration is available in line with the 2012 no-action relief. These conditions include:

- The filing adviser and each relying adviser advise only private funds and clients in SMAs that are “qualified clients” (as defined in Advisers Act Rule 205-3) and are otherwise eligible to invest in private funds advised by the filing adviser or a relying adviser and whose SMAs pursue investment objectives and strategies substantially similar or otherwise related to those private funds;
- The filing adviser has its principal office and place of business in the U.S. and all of the substantive provisions of the Advisers Act and rules thereunder apply to the filing adviser and each relying adviser’s dealings with each of its clients;
- Each relying adviser, its employees and persons acting on its behalf are subject to the filing adviser’s supervision and control and are “persons associated with” the filing adviser as defined in the Advisers Act;
- The advisory activities of each relying adviser are subject to the Advisers Act and rules thereunder and are subject to examination by the SEC; and
- The filing adviser and each relying adviser operate under a single code of ethics and written policies and procedures which are administered by a single CCO in accordance with the Advisers Act.

Umbrella registration will not be available to exempt reporting advisers. The changes to Form ADV include certain items and questions specifically focused on advisers relying on umbrella registration including items specific both to relying advisers and filing advisers.

Technical and Clarifying Amendments

The amendments to Form ADV also clarify certain items on the form and the associated instructions based on questions frequently received by the staff and certain items related to the implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”) that are no longer necessary. Advisers should review the form and instructions carefully to ensure that their answers are consistent with the amended form and instructions.

State Registered Advisers

The SEC noted that while the Form ADV changes target SEC registered investment advisers, state securities authorities intend to consider similar changes affecting advisers registered with the states which are also required to complete Form ADV Part 1B as part of their state registrations.

[Amendments to Advisers Act Rules](#)

Changes to the Books and Records Rule

Rule 204-2(a)(16) under the Advisers Act currently requires registered investment advisers to maintain records supporting performance claims in communications that are distributed or circulated to ten or more persons. The rule is being amended to replace “ten or more persons” with “any person” which would result in advisers being required to maintain those records for any communications that demonstrate the calculation of the performance or rate of return, regardless of the number of recipients. Rule 204-2(a)(7) is also being amended and will require advisers to maintain 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 or all managed accounts or securities recommendations. These amendments will apply to communications circulated after October 1, 2017.

Technical and Clarifying Amendments

Other Advisers Act provisions related to the implementation of the Dodd-Frank Act and transitions to electronic filings are being removed. These provisions are being removed because they are no longer necessary.

What's Next?

Firms should begin preparing for these changes to Form ADV and the amended recordkeeping obligations.

For More Information

To discuss any topic covered in this Client Alert, please contact a member of the Investment Management Group or visit us online at chapman.com.

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