

# Client Alert

Current Issues Relevant to Our Clients

May 26, 2015

## SEC Proposes Disclosure, Reporting and Recordkeeping Changes for Registered Investment Advisers

*On May 20, 2015, the Securities and Exchange Commission (the “SEC”) proposed changes to certain aspects of the reporting, disclosure and recordkeeping obligations of registered investment advisers. As we indicated in our initial Client Alert on the proposal available [here](#), the SEC is seeking to modernize and enhance the reporting and disclosure of information by registered investment advisers and investment companies in an effort to enhance the quality of information available to investors and allow the SEC to more effectively collect and use data in their oversight of the asset management industry. This Client Alert summarizes the proposed changes regarding investment advisers and a copy of the proposal is available [here](#). A Client Alert on the disclosure and reporting proposals for registered investment companies is available [here](#).*

### Overview

The SEC is proposing amendments to Form ADV that would 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 proposing amendments to the Investment Advisers Act of 1940 (“*Advisers Act*”) books and records rule and several other technical amendments to various other rules and forms as part of its proposals relating to registered investment advisers. 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.

### Proposed Amendments to Form ADV

The SEC’s proposed 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.

### Information on SMAs

Many of the proposed 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 in the proposed changes to Form ADV, 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 proposed changes to Form ADV targeting SMA data include requiring:

- Reporting of more detailed information about the types and percentages of such 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 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 \$150 million or more, annual reporting of information about the use of borrowings and derivatives in those SMAs, including gross notional exposure and weighted average amount of borrowings as a percentage of net asset value 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, weighted average amount of borrowings as a percentage of net asset value, 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.

#### Additional Information About Investment Advisers

The SEC is proposing to add several new questions and to amend existing questions on Form ADV regarding advisers' identifying information, advisory businesses and affiliations. The proposed changes to collect additional information about investment advisers include requiring the following, among other things:

- Reporting of all of an adviser's websites, usage of websites for social media platforms (e.g. Twitter, Facebook, LinkedIn), and all social media addresses (a change from the current Form ADV which only requires reporting of an adviser's website);
- 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);
- 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;
- 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 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);
- 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 the percentage of such private funds owned by qualified clients.

#### 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 proposed 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 would not be available to exempt reporting advisers. The proposed 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 proposed 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. If the proposals are adopted, 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 notes in the release that while the proposed Form ADV and rule 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.

### Proposed Amendments to Advisers Act Rules

#### Changes to the Books and Records Rule

The proposals include an amendment to Rule 204-2(a)(16) under the Advisers Act that currently requires registered investment advisers to maintain records supporting performance claims in communications that are distributed or circulated to ten or more persons. The amendment would 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. The proposals also include an amendment to Rule 204-2(a)(7)

which would 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.

#### Technical and Clarifying Amendments

The proposals include a number of amendments to Advisers Act rules to remove specific provisions related to the implementation of the Dodd-Frank Act and transitions to electronic filings. These provisions are being proposed to be removed because they are no longer necessary.

#### What's Next?

The SEC will publish these proposals in the Federal Register. Firms will have 60 days to comment from that date of publication in the Federal Register. The SEC included a variety of specific requests in the proposal release and is also generally looking for comments on anything included or not included (that commenters believe should have been included) in the proposals. Comments can be submitted 1) through the SEC's internet comment form at <http://www.sec.gov/rules/proposed.shtml>, 2) through the Federal eRulemaking portal at <http://regulations.gov> or 3) via email to [rule-comments@sec.gov](mailto:rule-comments@sec.gov) (including File No. S7-09-15 on the subject line). Firms should review the proposals and consider how the proposals may impact their reporting, disclosure and other requirements. While it is reasonable to expect that the final rules will differ from these initial proposals as a result of the comments received by the SEC, firms should begin to prepare for the possible increased compliance and disclosure 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](http://chapman.com).*

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