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SEC Adopts Rules for Reporting Separately Managed Accounts on Form ADV and Revised Recordkeeping Rules

By Beth Clark, Christopher J. Martini and Cary J. Meer

AMENDMENTS TO FORM ADV

Information Regarding Separately Managed Accounts

The SEC's final amendments to Part 1A of Form ADV include items intended to collect more information about each adviser's SMAs.[1] The amendments are intended to help the SEC make risk assessments with respect to SMAs and their investment advisers. The SEC defines a "separately managed account" as an advisory account that is not a pooled investment vehicle (i.e., a registered investment company, business development company or private fund[2]). Under the final amendments, Item 5.K.(1) was added to Item 5 of Part 1A, asking advisers if they have regulatory assets under management ("RAUM") attributable to SMAs. If so, the adviser is required to complete additional questions in Item 5.K. of Part 1A and accompanying disclosure in Schedule D. The information collected will be based on the amount of the adviser's RAUM attributable to SMAs and the value of those accounts, as follows:

- All advisers are required to report annually the approximate percentage of RAUM attributable to SMAs invested in 12 broad asset categories (rather than 10, as proposed), such as exchange-traded equity securities and U.S. government/agency bonds. Definitions of asset categories included in the revised Glossary to Proposed Form ADV are consistent with those in Form PF. In response to industry comments, the SEC added an instruction to Item 5.K.1 stating that an adviser may use its own internal methodologies and the conventions of its service providers in determining how to categorize assets, so long as such methodologies are consistently applied and consistent with the adviser's report internally and to current and prospective clients.[3] Additionally, the SEC added an instruction to the effect that investments in derivatives, funds and/or ETFs should be reported in those categories, rather than based on related or underlying portfolio assets.

[1] Neither the Proposing Release nor the Adopting Release clarified the question of whether the SEC considers a "fund of one" a separately managed account. The Adopting Release includes instructions in the text preceding Section 5.K.(1) and (2) to clarify that any RAUM reported in Item 5.D. with respect to investment companies, business development companies and other pooled investment vehicles should not be reported in Sections 5.K.(1) or (2) of Schedule D.

[2] Part 1A of Form ADV defines a "private fund" as "[a]n issuer that would be an investment company as defined in section 3 of the Investment Company Act of 1940 but for section 3(c)(1) or 3(c)(7) of that Act." It is the same definition used in Form PF filed quarterly or annually by advisers to private funds.

[3] This instruction is modeled after General Instruction 15 in Form PF.

  - Advisers with at least $10 billion in RAUM attributable to SMAs would provide annually both midyear and year-end data.[4]

- All advisers to SMAs are required to report the percentage of SMA assets held in borrowings and in derivatives.
  - The Adopting Release requires advisers with at least $500 million (rather than $150 million, as proposed) but less than $10 billion in RAUM attributable to SMAs to report the amount of SMA RAUM and the dollar amount of borrowings[5] attributable to those assets that correspond to three levels of gross notional exposures[6] (rather than four levels, as proposed).
  - In addition to the reporting described in the bullet point above, advisers with at least $10 billion in RAUM attributable to SMAs are required to report derivatives exposures across the same six derivatives categories that were proposed.[7]
  - The reporting in the two bullet points above is required solely with respect to an SMA with a net asset value of at least $10 million.
- Advisers are required to identify any custodians that account for at least 10% of RAUM attributable to SMAs and the amount of RAUM attributable to SMAs held at such custodian.[8]

In response to industry concerns that reporting on SMAs would result in disclosure of client-identifying information or confidential or proprietary information about investment strategy, the SEC revised Item 5.D, which lists the number of advisory clients in categories, to include the option to check a "fewer than 5 clients" column, and removed reporting of the number of accounts in Section 5.K.(2), as proposed.

Information Regarding an Adviser's Business and Affiliations

The SEC adopted several amendments as proposed to add several new questions and revise existing questions on Form ADV regarding an adviser's identifying information, advisory business and affiliations. The changes are designed to enhance the SEC's understanding of investment advisers and aid the SEC in its risk-based examination program. They:

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[4] Advisers need not file information semiannually. Rather, when filing its annual amendment, an adviser with $10 billion in RAUM attributable to SMAs will be required to provide information as of each semiannual period. *See* the Adopting Release at footnote 63.

[5] "Borrowings" is defined as "[s]ecured borrowings and unsecured borrowings, collectively. Secured borrowings are obligations for borrowed money in respect of which the borrower has posted collateral or other credit support and should include any reverse repos (i.e., any sale of securities coupled with an agreement to repurchase the same (or similar) securities at a later date at an agreed price). Unsecured borrowings are obligations for borrowed money in respect of which the borrower has not posted collateral or other credit support."

[6] "Gross notional exposure" of an account is "the percentage obtained by dividing (i) the sum of (a) the dollar amount of any borrowings and (b) the gross notional value of all derivatives, by (ii) the regulatory assets under management of the account."

"Gross notional value" is defined as "[t]he gross nominal or notional value of all transactions that have been entered into but not yet settled as of the reporting date. For contracts with variable nominal or notional principal amounts, the basis for reporting is the nominal or notional principal amounts as of the reporting date. For options, use delta adjusted notional value."

[7] The six categories of derivatives are: interest rate derivatives, foreign exchange derivatives, credit derivatives, equity derivatives, commodity derivatives and other derivatives. *See* amended Schedule D to Part 1A of Form ADV.

[8] The information provided would be with respect to all custodians, not solely qualified custodians. Accordingly, the information would not be duplicative of the information provided in Item 9.F. of Part 1A.

- Require an adviser to provide all of its Central Index Key numbers ("CIK Numbers"), if applicable, rather than solely an adviser's CIK Number as a public reporting company under Sections 12 or 15(d) of the Securities Exchange Act of 1934.
- In addition to providing the adviser's website address in Schedule D, require an adviser to disclose its websites for social media platforms (e.g., Twitter, Facebook and LinkedIn), if applicable. The SEC limited the disclosure solely with respect to accounts on publicly available social media platforms where the adviser controls the content and the social media platform is used to promote the business of the SEC-registered adviser. An account on a social media platform used solely to promote the business of a registered adviser's unregistered affiliate is not required to be disclosed.[9]
- Require that an adviser provide the total number of offices at which the adviser conducts investment advisory business and provide information in Schedule D about the 25 largest offices (measured by number of employees), including each office's CRD branch number, if applicable, the number of employees performing advisory functions from each office and a description of any other investment-related business activities conducted from each office.
- In addition to providing the name and contact information for the adviser's chief compliance officer ("CCO"), require an adviser to disclose whether the CCO is compensated or employed by any person other than the adviser (or a related person of the adviser) for providing CCO services. However, the adviser will not be required to report the name and Internal Revenue Service Employer Identification Number, if any, of the CCO's employer if such employer is an investment company registered under the Investment Company Act of 1940 (the "Company Act") advised by the adviser.
- Require an adviser to report its own assets within a range ($1 billion to less than $10 billion, $10 billion to less than $50 billion, and $50 billion or more), rather than simply indicate if it has assets of $1 billion or more.[10]
- Require an adviser to report the number of clients and amount of RAUM attributable to each category of clients as of the date the adviser determines its RAUM.[11]
- Require an adviser to report on the number of clients for whom an adviser provided advisory services, although the assets of such clients do not count toward the adviser's RAUM because, for example, the adviser provides advice on a nondiscretionary basis.
- An adviser that elects to report client assets in Part 2A of Form ADV differently from the RAUM the adviser reports in Part 1A of Form ADV would be required to check a box noting that election.
- Require an adviser to report on the approximate amount of an adviser's RAUM attributable to non-U.S. clients[12] in addition to the current requirement that each adviser report the percentage of its clients that are non-U.S. persons.

[9] *See* Item 1.I. of Part 1A and Section 1.I. of Schedule D. Note that this information must be updated promptly if the information becomes inaccurate in any way.

[10] *See* Form ADV, Part 1A, Item 1.O.

[11] *See* Form ADV, Part 1A, Item 5.D.(1)-(2). The categories of clients are the same as those currently in Item 5.D. of Form ADV, except "sovereign wealth funds and foreign official institutions" have been added as a client category, state or municipal government entities specifically include government pension plans, and pension and profit-sharing plans specifically exclude government pension plans.

- Require an adviser to report RAUM of all "parallel managed accounts" related to a registered investment company or business development company that is advised by the adviser.[13]
- Rather than simply identifying itself as a sponsor of or portfolio manager for a wrap fee program and listing the name and sponsor of each wrap fee program for which an adviser serves as portfolio manager, advisers are required to report the total amount of RAUM attributable to acting as a sponsor and/or portfolio manager of a wrap fee program and provide any SEC File Number and CRD Number for sponsors to those wrap fee programs.[14]
- Require an adviser to provide identifying numbers (e.g., Public Company Accounting Oversight Board ("PCAOB") registration numbers and CIK Numbers) in several questions.
- Require an adviser to a private fund that qualifies for the exclusion from the definition of investment company under section 3(c)(1) of the Company Act to disclose whether or not such adviser limits sales of such fund to qualified clients, as defined in Rule 205-3 under the Advisers Act.

Umbrella Registration

The Adopting Release adopted, as proposed, amendments to Part 1A that provide a more efficient method of registering multiple private fund adviser entities operating a single advisory business on one Form ADV. Umbrella registration is not mandatory, but the SEC believes it will simplify registration for private fund advisers that operate a single advisory business through multiple legal entities and will allow for greater comparability across such advisers.

As discussed in the Proposing Release, the current Form ADV, which is designed for registration by a single legal entity, limits the utility of the existing staff guidance for filing Form ADV on behalf of multiple entities.[15] Under amended Form ADV, umbrella registration is available where a filing adviser and one or more relying advisers conduct a single private fund advisory business and each relying adviser is controlled by or under common control with the filing adviser, such that the private fund adviser is operating as a single business

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[12] *See* Form ADV, Part 1A, Item 5.F.(3). The Glossary to Form ADV provides that "United States person" has the same meaning as in Rule 203(m)-1 under the Advisers Act.

[13] *See* Form ADV, Part 1A, Section 5.G.(3) of Schedule D. The definition of "parallel managed account" in the amended Glossary to Form ADV is "[w]ith respect to any registered investment company or business development company, a parallel managed account is any managed account or other pool of assets that you advise and that pursues substantially the same investment objective and strategy and invests side by side in substantially the same positions as the identified investment company or business development company that you advise." It is the same definition of "parallel managed account" used in Form PF with respect to private funds.

[14] *See* Form ADV, Part 1A, Item 5.I. and Section 5.I.(2) of Schedule D. The definition of "wrap fee program" stayed the same as it is in the Glossary to the current Form ADV, "[a]ny advisory program under which a specified fee or fees not based directly upon transactions in a client's account is charged for investment advisory services (which may include portfolio management or advice concerning the selection of other investment advisers) and the execution of client transactions."

[15] In American Bar Association, Business Law Section, SEC Staff Letter (Jan. 19, 2012), available at http://www.sec.gov/divisions/investment/noaction/2012/aba01182.htm (the "2012 ABA Letter"), the SEC staff provided guidance to private fund advisers regarding umbrella registration within the confines of the current form. Pursuant to this guidance, a filing adviser would report in its Form ADV (Miscellaneous Section of Schedule D) that it and its relying adviser(s) are together filing a single Form ADV in reliance on the 2012 ABA Letter and identifies each relying adviser in a separate Section 1.B., Schedule D, of Form ADV, by noting "relying adviser."

unit through multiple legal entities.[16] The conditions for an adviser to avail itself of umbrella registration are the same as those in the SEC staff's guidance.[17]

A filing adviser availing itself of umbrella registration will be required to file and update a single Form ADV (Parts 1 and 2) that takes into account all information about the filing adviser and each relying adviser. Additionally, the filing adviser must include this same information in any other reports required under the Advisers Act, such as Form PF. The revisions to Form ADV's instructions now specify which questions should be answered by the filing adviser and those that also apply to its relying adviser(s).[18] Finally, definitions for "filing adviser," "relying adviser" and "umbrella" registration have been added to the Glossary.[19]

Additionally, the SEC adopted as proposed a new schedule -- Schedule R to Part 1A -- that must be filed for each relying adviser.[20] Schedule R will require identifying information, basis for SEC registration, form of organization and ownership information about each relying adviser.[21] Finally, the filing adviser or relying adviser, as appropriate, must be identified as advising the private funds reported on in Section 7.B.(1) of Schedule D.[22]

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[16] In the Proposing Release, the SEC noted that the filing of a single Form ADV for exempt reporting advisers in a manner similar to the filing of an umbrella registration for registered advisers would not be available because certain requirements applicable to registered investment advisers do not apply to exempt reporting advisers, such as the requirement for compliance policies and procedures and code of ethics under Rules 206(4)-7 and 204A-1 of the Advisers Act, respectively. An exempt reporting adviser qualifies for exemption from registration as an investment adviser under section 203(l) of the Advisers Act because it is an adviser solely to one or more venture capital funds, or under Rule 203(m)-1 of the Advisers Act because it is an adviser solely to private funds and has assets under management in the United States of less than $150 million. *See* Form ADV Glossary. In the Adopting Release, the SEC noted that several commenters argued that the SEC should expand the concept of umbrella registration to include "umbrella reporting" by exempt reporting advisers, but the SEC declined to make such changes at this time.

[17] The conditions set forth in the 2012 ABA Letter are:

1.The filing adviser and each relying adviser only advise private funds and clients in SMAs that are parallel managed accounts to those private funds and such SMA clients are qualified clients (as defined in Rule 205-3 under the Advisers Act) or otherwise eligible to invest in those private funds;

2.The filing adviser has its principal office and place of business in the United States;

3.Each relying adviser, its employees and the persons acting on its behalf are "persons associated with" the filing adviser (as defined in section 202(a)(17) of the Advisers Act);

4.The advisory activities of each relying adviser are subject to the Advisers Act and examination by the SEC; and

5.The filing adviser and each relying adviser operate under a single code of ethics and set of written policies and procedures, adopted in accordance with rules 204A-1 and 206(4)-7 of the Advisers Act, respectively, and administered by a single CCO.

[18] *See*, e.g., statements added to Form ADV, Instructions and Part 1A, Items 1, 2, 3, 7, 10 and 11.

[19] "Filing Adviser" means: "[a]n investment adviser eligible to register with the SEC that files (and amends) a single umbrella registration on behalf of itself and each of its relying advisers."

"Relying Adviser" means: "[a]n investment adviser eligible to register with the SEC that relies on a filing adviser to file (and amend) a single umbrella registration on its behalf."

"Umbrella Registration" means: "[a] single registration by a filing adviser and one or more relying advisers who collectively conduct a single advisory business and that meet the conditions set forth in General Instruction 5." See Form ADV, Glossary.

[20] *See* Form ADV, Part 1A, Item 1.B.(2).

[21] Categories that would make a relying adviser ineligible for umbrella registration, such as serving as an adviser to a registered investment company, will not be available as a basis for SEC registration on Schedule R to Part 1A of Form ADV.

[22] *See* Form ADV, Part 1A, Section 7.B.(1) of Schedule D, Question 3(b).

Clarifying, Technical and Other Amendments to Form ADV

The Adopting Release adopts, largely as proposed, several amendments to Form ADV that are designed to clarify the form and its instructions. These amendments are based on the questions the SEC staff receives on a regular basis and are intended to make the filing process easier and more understandable. Among them are the following:

- The addition of text to Item 7.B. clarifying that Section 7.B.(1) of Schedule D should not be completed if another SEC-registered adviser or SEC exempt reporting adviser reports the information.[23]
- The deletion of text in question 10 in Section 7.B.(1) of Schedule D that asks the adviser to identify the category of the private fund with reference to the underlying funds in the case of a fund of funds, in order to provide consistency with Form PF, which permits advisers to disregard any private fund's equity investment in other private funds.[24]
- The addition of text to Question 19 in Section 7.B.(1) of Schedule D to clarify that feeder funds should not be considered clients of the adviser when answering whether the adviser's clients are solicited to invest in the private fund.[25]
- Clarification of Question 21 in Section 7.B.(1) of Schedule D to ask if the private fund has ever relied on an exemption from registration of its securities under Regulation D, so the SEC will receive the Form D file numbers.[26]
- Revisions to Item 8.H. of Part 1A to break out compensation paid to non-employees for client referrals versus compensation paid to employees for client referrals in addition to the employees' salaries.[27]
- The addition of text to ask for the PCAOB registration number of the adviser's independent public accountant in Section 9.C. of Schedule D.[28]

No additional amendments were adopted that were not originally proposed.

AMENDMENTS TO INVESTMENT ADVISERS ACT RULES

Amendments to Books and Records Rule

The SEC adopted, as proposed, two amendments to Rule 204-2 under the Advisers Act that will require investment advisers to maintain certain materials related to the calculation and distribution of performance information. The purpose of the amendments is to provide the SEC examination staff with additional information in reviewing advisers' compliance with Rule 206(4)-1 and the SEC's enforcement of such rule in cases of fraudulent advertising.

First, the amendments remove the 10-person threshold for the requirement that an adviser make and preserve records containing performance information necessary to support performance claims when a communication regarding such performance is made to 10 or

[23] *See* amended Form ADV, Part 1A, Item 7.B.

[24] *See* amended Form ADV, Part 1A, Section 7.B.(1) of Schedule D, Question 10. *See* also General Instruction 7 to Form PF.

[25] *See* amended Form ADV, Part 1A, Section 7.B.(1) of Schedule D, Question 19.

[26] *See* amended Form ADV, Part 1A, Section 7.B.(1) of Schedule D, Question 21.

[27] *See* amended Form ADV, Part 1A, Item 8.H.(1)-(2).

[28] *See* amended Form ADV, Part 1A, Section 9.C.(3) of Schedule D.

more persons. Rather, advisers will be required to maintain the materials set forth in Rule 204-2(a)(16) with respect to the calculation of performance or rate of return communicated to anyone.

Second, the SEC amended Rule 204-2(a)(7) to 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 Amendments to Advisers Act Rules

The SEC also adopted certain technical amendments to eliminate certain transition periods that have expired.

Please contact the following attorneys or your regular K&L Gates attorney if you have questions about this Alert.

Authors:

Beth Clark
beth.clark@klgates.com
+1.202.778.9432

Christopher J. Martini
christopher.martini@klgates.com
+1.202.778.9479

Cary J. Meer
cary.meer@klgates.com
+1.202.778.9107