

Stradley Ronon Stevens & Young, LLP
2005 Market Street
Suite 2600
Philadelphia, PA 19103-7018
215.564.8000 Telephone
215.564.8120 Facsimile
www.stradley.com

With other offices in:
Washington, D.C.
New York, N.Y.
Chicago, IL
Malvern, Pa.
Harrisburg, Pa.
Cherry Hill, N.J.
Wilmington, Del.

Information contained in this publication should not be construed as legal advice or opinion or as a substitute for the advice of counsel. The enclosed materials may have been abridged from other sources. They are provided for educational and informational purposes for the use of clients and others who may be interested in the subject matter.

Copyright © 2016
Stradley Ronon Stevens & Young, LLP
All rights reserved.

SEC Adopts Amendments to Form ADV and Investment Advisers Act Rules

On August 25, 2016, the U.S. Securities and Exchange Commission (SEC) adopted amendments to Form ADV and to certain recordkeeping rules under the Investment Advisers Act of 1940 (Advisers Act).¹ The amendments to Form ADV relate specifically to Part 1A and are designed to: (i) expand the scope of data the SEC collects from investment advisers; (ii) streamline umbrella registration² for private fund advisers; and (iii) clarify certain existing items and instructions. The amendments to the rules under the Advisers Act are intended to improve the quality of performance calculation records advisers retain, and to remove certain provisions that no longer are applicable. The effective date for the amendments will be 60 days after publication in the Federal Register, and the compliance date will be October 1, 2017.

I. Amendments to Form ADV

1. Data Collection

(a) Enhanced Reporting on Advisory Clients, Including Separately Managed Accounts (SMAs)

Item 5 of Form ADV currently requires an adviser to disclose general information about its advisory business, including the number and types of clients it serves, along with the range of regulatory assets under management (RAUM) attributable to each category of client.³ In order to collect more precise information and enhance the SEC's ability to analyze that data, the amendments to Item 5 require an adviser to report the exact number of clients it advises and the specific amount of RAUM attributable to each category of client,⁴ rather than providing ranges as previously required. In addition, the amendments require new disclosures regarding: (i) the number of clients advised by the adviser that do not have RAUM;⁵ (ii) the approximate amount of RAUM attributable to non-U.S. clients; (iii) the RAUM of all parallel managed accounts related to a registered investment company or business development company that is advised by the adviser;⁶ and (iv) the total RAUM attributable to wrap fee programs for which the adviser acts as a sponsor and/or portfolio manager, along with any SEC file numbers and CRD numbers for sponsors to wrap fee programs for which the adviser itself is not the sponsor.

The amendments also require advisers to report detailed information about their SMA businesses. Under the amendments, advisers will be required to disclose the approximate percentage of SMA assets that are invested across 12 broad asset categories.⁷ In addition, advisers with SMA RAUM between \$500 million and \$10 billion will be required to report the amount of SMA RAUM and the dollar amount of borrowings attributable to assets of SMAs that correspond to one of three levels of gross notional exposure (which takes into account borrowings and the use of derivatives).⁸ Advisers with at least \$10 billion in SMA RAUM also

will be required to report their derivatives exposure across six different categories.⁹ The release notes that these requirements are designed to provide data to assist the SEC staff in identifying and monitoring the use of borrowings and derivatives in SMAs. In addition, advisers will be required to identify any custodian accounting for at least 10 percent of RAUM attributable to SMAs and the amount of RAUM held at such custodian.

(b) Publicly Available Social Media Accounts

The amendments also seek to obtain more information on the social media presence of advisers. As amended, Item 1.I of Form ADV solicits information on all websites and social media accounts maintained by an adviser on various publicly available platforms, including, but not limited to, Twitter, Facebook and LinkedIn. The required reporting is limited to accounts on social media platforms where the adviser controls the content, and excludes employee accounts and accounts of unregistered advisory affiliates used exclusively to promote the affiliate's business. The Adopting Release states that the SEC staff may use this information to help prepare for adviser examinations and to compare information that advisers disseminate across different social media platforms, as well as to identify and monitor new platforms.

(c) Branch Offices

Item 1.F of Form ADV currently requires an adviser to provide certain information about its principal office and place of business, and the address of its five largest offices (in terms of the number of employees). The amendments revise this item to require disclosure regarding the total number of offices from which an adviser conducts its advisory business, along with additional information about its 25 largest offices (also in terms of number of employees). Information to be reported about each of the adviser's 25 largest offices would include: (i) contact information; (ii) CRD branch number, if applicable; (iii) the number of employees who perform advisory functions from each office; (iv) identification of securities-related activities conducted from the office (based on a list provided); and (v) a description of any other investment-related business conducted from the office.

(d) Additional Information About Financial Industry Affiliations and Private Fund Reporting

The amendments require additional identifying information about an adviser and its financial service providers, including: (i) the Central Index Key (CIK) numbers for an adviser that has obtained one or more such numbers; (ii) the Public Company Accounting Oversight Board (PCAOB) registration numbers of the adviser's auditing firms; and (iii) the name and IRS



For more information, contact Miranda Sturgis at msturgis@stradley.com or 215.564.8131.

Employer Identification Number of any other persons who employ the adviser's chief compliance officer. In addition, the amendments require an adviser that has balance sheet assets of \$1 billion or more to report its balance sheet assets within one of the following ranges: (i) \$1-\$10 billion; (ii) \$10-\$50 billion; or (iii) \$50 billion or more. Lastly, Item 7 currently requires an adviser to report whether it is an adviser to any private funds, and if so, to provide specified additional information about such funds. Under new Question 15(b) to Section 7.B.(1) of Schedule D, an adviser to a private fund that qualifies for the exclusion from the definition of investment company pursuant to section 3(c)(1) of the Investment Company Act of 1940 will be required to report whether it limits sales of the fund to "qualified clients"¹⁰ as defined under the Advisers Act.

2. Umbrella Registration for Private Fund Advisers

The current format of Form ADV is designed to accommodate the registration of an adviser structured as a single legal entity. The amendments codify umbrella registration for certain advisers to private funds operating a single advisory business through multiple legal entities. The Adopting Release states that the streamlined umbrella registration process will allow for greater comparability across private fund advisers. The conditions for reliance on an umbrella registration are the same as those previously set forth in the SEC staff's prior guidance. Specifically, under the amendments, umbrella registration is available where: (i) a "filing adviser"¹¹ and one or more "relying advisers"¹² who advise only private funds and certain SMAs of qualified clients collectively conduct a single private fund advisory business; (ii) the filing adviser has its principal place of business in the United States; (iii) each relying adviser, its employees and the persons acting on its behalf are subject to the filing adviser's supervision and control; (iv) the advisory activities of each relying adviser are subject to the Advisers Act and the rules thereunder, and each relying adviser is subject to examination by the SEC; and (v) the filing adviser and each relying adviser operate under a single code of ethics and a single set of written policies and procedures, each adopted and implemented in accordance with the Advisers Act and administered by a single chief compliance officer.¹³

Advisers electing to use umbrella registration will be required to file and update a single Form ADV relating to both the filing adviser and each relying adviser.¹⁴ Information for each relying adviser will be required to be included in new Schedule R.

3. Clarifying Amendments

The amendments also include clarifying and technical changes to certain items and instructions in Form ADV. These amendments address inquiries frequently received by the SEC staff regarding issues of interpretation with respect to Form ADV, and are generally designed to increase the reliability and consistency of information reported.

II. Amendments to Rules Under the Advisers Act

The amendments revise rule 204-2 under the Advisers Act, known as the "Books and Records Rule." The amendments require advisers to retain additional materials related to the calculation and distribution of performance information. Rule 204-2(a)(16) currently requires advisers to maintain records supporting performance claims in communications that are distributed or circulated to 10 or more persons. The amendments expand this requirement to apply to communications distributed or circulated to "any person." The amendments also include changes to rule 204-2(a)(7), which currently requires advisers to maintain records of certain categories of written communications received and copies of written communications sent. As revised, the rule will require that advisers maintain original copies of all written communications received and sent relating to the performance or rate of return of managed accounts or securities recommendations. The Adopting Release states that the SEC believes these records will be useful in evaluating the accuracy of adviser performance claims.

Lastly, the amendments remove transition provisions that were added in connection with the implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act and two other provisions added when the SEC amended Form ADV and other Advisers Act rules to require electronic filing.

¹ Form ADV and Investment Advisers Act Rules, Investment Advisers Act Release No. 4509 (August 25, 2016) (Adopting Release), available at <https://www.sec.gov/rules/final/2016/ia-4509.pdf>. The amendments were proposed on May 20, 2015. See Amendments to Form ADV and Investment Advisers Act Rules, Investment Advisers Act Release No. 4091 (May 20, 2015) (Proposing Release), available at <https://www.sec.gov/rules/proposed/2015/ia-4091.pdf>.

² "Umbrella registration" is defined as "the registration on one Form ADV of multiple private fund adviser entities operating a single advisory business."

³ An adviser may use a different methodology to calculate and report its assets under management in Part 2A than what is required for reporting RAUM in Item 5 of Part 1A. The amendments include the addition of Item 5.J(2), which requires an adviser to report whether it has elected to use a different methodology in calculating client assets in Part 2A.

⁴ The categories of clients are the same as those provided in Item 5.D of the current Form ADV, except that the amendments add "sovereign wealth funds and foreign official institutions" as a client category. The Adopting Release also clarifies that state or municipal government entities include government pension plans, and that government pension plans should not be counted as pension and profit sharing plans.

⁵ According to the Adopting Release, this is intended to cover, for example, nondiscretionary accounts or clients for whom the adviser prepared a one-time financial plan, among other situations.

⁶ A "parallel managed account" is "any managed account or other pool of assets . . . that pursues substantially the same investment objective and strategy and invests side by side in substantially the same positions as [an] investment company . . . or business development company."

⁷ The 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) corporate bonds — investment grade; (vii) corporate bonds — non-investment grade; (viii) derivatives; (ix) securities issued by registered investment companies or business development companies; (x) securities issued by other pooled investment vehicles; (xi) cash and cash equivalents; and (xii) other.

⁸ The gross notional exposure categories are: (i) less than 10 percent; (ii) 10-149 percent; and (iii) 150 percent or more.

⁹ The derivatives categories are: (i) interest rate derivatives; (ii) foreign exchange derivatives; (iii) credit derivatives; (iv) equity derivatives; (v) commodity derivatives; and (vi) other derivatives.

¹⁰ A "qualified client" is a client that satisfies the definition of qualified client in rule 205-3 under the Advisers Act.

¹¹ A "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."

¹² A "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."

¹³ Umbrella registration is generally not available for exempt reporting advisers. The Adopting Release notes, however, that the views of the SEC staff expressed in previously issued Frequently Asked Questions permitting certain exempt reporting advisers to file a single Form ADV on behalf of multiple special purpose entities were not withdrawn in connection with the amendments. See Frequently Asked Questions on Form ADV and IARD, Reporting to the SEC as an Exempt Reporting Adviser (Mar. 2012), available at <https://www.sec.gov/divisions/investment/iard/iardfaq.shtml#exemptreportingadviser>.

¹⁴ This information would also need to be included in any other reports or filings that are required under the Advisers Act, such as on Form PF.