

AMENDMENTS TO FORM ADV: PRACTICAL CONSIDERATIONS

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Investment Management Alert

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Beginning on October 1, 2017, all investment advisers filing Form ADV must use an amended version of Part 1A of the Form that contains several new and revised items.^[1] Among other things, the amended Form requires expanded information regarding the investment activities of separately managed accounts ("SMAs"), standardizes the registration of so-called "relying advisers" operating as a single advisory business on a single Form ADV ("umbrella registration"), and elicits more disclosure about investment advisers' business practices, such as the use of social media.

With the October 1, 2017 compliance date rapidly approaching, advisers (particularly those with substantial SMA businesses or that rely on umbrella registration or with a social media presence) should consider reviewing the changes to the Form and ensure that they have established processes to gather the newly required information.

A high-level overview of certain key changes and practical guidance regarding completion of the amended Form follows.

A. COMPLIANCE TIMELINE

Advisers that have filed an annual update prior to the compliance date are not required to file a new Part 1A merely because the Form has changed, but certain changes to an adviser's business could require the adviser to file an other-than-annual amendment, which, if filed on or after October 1, 2017, will be subject to the new Form.

With respect to certain questions, the SEC staff has provided some reprieve for advisers making unanticipated other-than-annual amendments before the adviser's next annual amendment is due. Specifically, if a registrant does not have enough data to provide a complete response with respect to certain questions in Item 5 and the related Schedule D sections that are required to be filled out on an annual basis (e.g., Schedule D, Section 5.K.(2)), the registrant may enter "0" as a placeholder in order to submit its Form ADV and note that a placeholder value of "0" was used in the Miscellaneous Section of Schedule D.^[2]

B. SEPARATELY MANAGED ACCOUNTS

Perhaps the most material amendment to the Form is a new requirement to provide aggregate information about the SMAs managed by advisers in a new section on their Form ADV filings. This information includes the percentage of SMA regulatory assets under management across different asset categories, the use of borrowings

and derivatives, and the identification of custodians that account for at least 10% of SMA regulatory assets under management. As with the rest of Form ADV Part 1A, this information will be available to the public through the SEC's Investment Adviser Registration Depository system.

I. Which Accounts Should Be Treated as SMAs?

For purposes of reporting on Form ADV, SMAs are 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, but not limited to, private funds and non-U.S. funds). Advisers that subadvise pooled investment vehicles should not treat those accounts as SMAs for purposes of this Form ADV Part 1A, even if the adviser treats such accounts as SMAs for internal reporting purposes, as many advisers do. If an adviser advises (or subadvise) only a distinct "sleeve" of an account, the adviser only needs to report on the portion of the account for which it is responsible.

Neither the Form nor the Adopting Release addresses the treatment of "funds of one" (i.e., unregistered vehicles managed by the adviser for the benefit of a single investor or a group of affiliated investors), and advisers may need to exercise some discretion to determine whether an account should be reported as an SMA or a pooled fund, depending on the circumstances surrounding each fund of one. Many advisers presently treat funds of one as "pooled investment vehicles" for purposes of Form ADV Part 1A and may determine to continue reporting them as such in Item 5.D and Schedule 7.B, as applicable. Alternatively, advisers may treat funds of one internally and for client reporting purposes as SMAs; while this option may be appropriate for vehicles with only one investor in certain circumstances, vehicles with multiple affiliated investors likely will need to be treated as pooled investment vehicles. While the absence of guidance in the Form may afford an adviser a certain degree of flexibility on this issue, any approach should treat all similarly positioned accounts consistently for Form ADV and Form PF purposes.

II. What New Information Is Required?

Currently, Form ADV requires detailed reporting on pooled investment vehicles [

3

], but little specific information on SMAs. The amended Form updates Item 5 of Part 1A and Section 5 of Schedule D. Item 5.K. is a new section that asks a registrant four questions about its SMAs. Depending upon the answers in Item 5.K., a registrant may also need to complete particular parts of three new detailed reporting sections under Section 5.K. of Schedule D.

Item 5.K.(1). — Investments by Asset Category. The first question of Item 5.K. asks if the registrant has any regulatory assets under management attributable to SMA clients (i.e., regulatory assets under management not attributable to investment companies, business development companies, and pooled investment vehicles, as reported in Item 5.D.). If the answer is "yes," the registrant will be required to report on Section 5.K.(1) of Schedule D.

- Section 5.K.(1) requires a registrant to state the approximate percentage of SMA regulatory assets under management that are invested across 12 broad asset categories.^[4] Advisers with at least \$10 billion in

regulatory assets under management attributable to SMAs must report both mid-year and end-of-year percentages, while advisers with under \$10 billion in regulatory assets under management will only need to report end-of-year percentages.^[5]

- In total, the percentages listed under the 12 categories should add up to 100%.
- Advisers may use internal methodologies in determining how to categorize the assets. Although some assets may reasonably be included under multiple categories, advisers must not double count assets when reporting and will need to make a good-faith determination as to which of the categories is best.
- Investments in derivatives, registered investment companies, business development companies, or pooled investment vehicles should be reported in those specific categories; registrants should not "look through" these investments to report on exposures created by the underlying portfolio or reference assets.

Items 5.K.(2) and (3). — Borrowings and Derivatives. The next two questions of Item 5.K. relate to the use of borrowings and derivatives, respectively, in an adviser's SMAs. If an adviser answers "yes" to either question, the adviser must complete Section 5.K.(2) of Schedule D.

- Like Section 5.K.(1), Section 5.K.(2) has a threshold requirement for reporting — only advisers that have regulatory assets under management attributable to SMAs of at least \$500 million are required to complete this section.
- Advisers with \$10 billion or more in SMA regulatory assets under management must complete Section 5.K.(2)(a), which requires the information in Section 5.K.(2)(b), described below, as well as the derivative exposures across six derivative categories.
 - The six derivative categories, which are defined in the Glossary of Terms, are (1) Interest Rate Derivative; (2) Foreign Exchange Derivative; (3) Credit Derivative; (4) Equity Derivative; (5) Commodity Derivative; and (6) Other Derivative.^[6]
- An adviser with at least \$500 million but less than \$10 billion in SMA regulatory assets under management must complete 5.K.(2)(b), reporting the amount of SMA regulatory assets under management and the dollar amount of borrowings attributable to those assets that correspond to three levels of gross notional exposure created by such borrowings.
 - The three categories of gross notional exposure are (1) less than 10%; (2) 10%–149%; and (3) 150% or more.
 - If the disclosure of gross notional exposure is not fully representative of an adviser's investment strategy, Section 5.K.(2) provides the option to include a narrative description of the manner in which borrowings and derivatives are used in the SMA.^[7]
- Section 5.K.(2) does not require advisers to report the specific number of accounts that correspond to the accounts' regulatory assets under management and gross notional exposure.
- SMAs representing regulatory assets under management under \$10 million need not be included in the reporting, although it is permitted.

Item 5.K.(4). — Identification of Custodians. If a custodian holds at least 10% of an adviser's total SMA regulatory assets under management, the registrant must complete Section 5.K.(3) of Schedule D. For each such custodian, Section 5.K.(3) requires the registrant to identify the custodian, the amount of SMA assets managed by the registrant held by that custodian, and a few identifying questions about the custodian, including the location of the custodian's office responsible for the custody of the assets.

C. UMBRELLA REGISTRATION

I. Filing Advisers and Relying Advisers

On January 18, 2012, SEC staff published guidance (the "2012 Guidance") permitting a private fund adviser to file a single Form ADV on behalf of itself (the "filing adviser") and other private fund advisers that operate as a single advisory business (each, a "relying adviser"), subject to certain requirements. [

8

] Because the "old" Form ADV predated the 2012 Guidance and contemplated the registration of a single advisory entity and did not readily allow for umbrella registration, a filing adviser typically disclosed in the Miscellaneous Section of Schedule D that it and its relying advisers together filed a single Form ADV in reliance on the position expressed in the 2012 Guidance and identified each relying adviser in Section 1.B. of Schedule D of Form ADV for each relying adviser.

The revised Form ADV creates a new disclosure protocol for advisers relying on umbrella registration and codifies the registration requirements set forth in the 2012 Guidance. A new section in the General Instructions sets forth the conditions for umbrella registration,^[9] which do not reflect substantive changes from 2012 Guidance. The General Instructions direct a filing adviser to file a single Form ADV (Part 1 and Part 2) that relates to and includes all information concerning the filing adviser and each relying adviser, including disciplinary history and ownership information.^[10] However, the answers to Items 1, 2, 3, and 10 of Form ADV Part 1 (identifying information, SEC registration, form of organization, and control persons, respectively) should be answered with respect to the filing adviser only. For each relying adviser, the filing adviser should fill out a separate Schedule R, which is a new addition to the Form designed to consolidate identifying information about each relying adviser in a single place. In addition to the newly created Schedule R, the amendments also add a new question 3(b) to Section 7.B.(1) of Schedule D, which requires advisers to identify the filing and/or relying adviser(s) that manage or sponsor each private fund reported on Form ADV.

II. Treatment of General Partners

Advisers should note that the 2012 Guidance did not supersede prior guidance issued in 2005 relating to the registration requirements applicable to general partners or managing members of private funds, referred to by SEC staff as "special purpose vehicles."^[11] SEC staff has confirmed that new sections of the Form do not affect the registration requirements applicable to special purpose vehicles, which are not required to complete a Schedule R, as described below. ^[12]

D. ADDITIONAL IDENTIFYING INFORMATION

Item 1.I. Recognizing the increasing use of social media by advisers, the SEC has also amended Item 1.I. to request information regarding the registrant's accounts on publicly available social media platforms, such as Twitter, Facebook, and LinkedIn. Previously, Item 1.I. only asked for information about an adviser's websites. Now, the registrant must provide, in addition to its website addresses, the addresses of each of its social media pages in Section 1.I. of Schedule D. However, a registrant should not provide the addresses of websites or accounts on publicly available social media platforms where the registrant does not control the content, nor should it provide the website and social media addresses of its employees' accounts, regardless of whether the registrant controls the content of such accounts. [13]

Item 1.F. The amendments also modify Item 1.F. of Part 1A of Form ADV and Section 1.F. of Schedule D. In the old Form, Item 1.F. requested that the adviser provide contact and other generic information about its principal office and place of business and, if the adviser conducted advisory activities from more than one location, about its largest five offices in terms of number of employees. Now, advisers must disclose the total number of offices from which they conduct investment advisory business and provide information in Section 1.F. of Schedule D about their 25 largest offices in terms of number of employees. In Section 1.F. of Schedule D, the registrant must report each office's Central Registration Depository ("CRD") branch number (if applicable) and the number of employees who perform advisory functions from each office, identify from a list of securities-related activities the business activities conducted from each office, and describe any other investment-related business conducted from each office.

Item 1.J. Previously, Item 1.J. only required that each adviser provide the name and contact information for the adviser's chief compliance officer. Now, an adviser must also disclose whether the chief compliance officer is compensated or employed by any person other than the adviser (or a related person of the adviser) for providing chief compliance officer services to the adviser and, if so, report the name and IRS Employer Identification Number (if any) of that other person. However, if the other person is a registered investment company that the adviser advises, then the adviser need not report the identity of that person.

E. ADDITIONAL ADVISORY BUSINESS INFORMATION

Items 5.C. and 5.D. The revised Form ADV amends Items 5.C. and 5.D. such that an adviser must now report the exact number of clients and amount of regulatory assets under management attributable to each category of client as of the date the adviser determines its regulatory assets under management. [14] SEC staff have clarified that advisers who subadvise investment companies, business development companies, or pooled investment vehicles [15] should report these assets under the corresponding categories, rather than under the category, "Other investment advisers." [16]

Item 5.J.(2). Advisers that elect to report client assets in Part 2A of Form ADV differently from the regulatory assets under management reported in Part 1A of Form ADV must specifically note that difference.

Item 5.F.(3). Advisers must now report the approximate amount of total regulatory assets under management

attributable to clients who are non-United States persons. The amended Glossary explains that "United States person" has the same meaning as in Rule 203(m)-1 under the Advisers Act, which includes any natural person that is resident in the United States. The item does not distinguish between registrants that are U.S. advisers and registrants that are non-U.S. advisers. Although the Advisers Act obligations of non-U.S. advisers with respect to non-U.S. clients have been limited,^[17] accounts of clients who are not United States persons were, and continue to be, included for purposes of calculating regulatory assets under management.^[18]

Section 5.G.(3). Advisers must now report the regulatory assets under management of all parallel managed accounts related to a registered investment company (or series thereof) or business company that they advise.^[19]

Item 5.I. Advisers that participate in wrap fee programs must report certain new information, including the total regulatory assets under management attributable to each wrap fee program for which the registrant acts as a portfolio manager (Item 5.I(b)) and each wrap fee program for which the registrant acts as both sponsor and portfolio manager (Item 5.I(c)).

In addition, Section 5.I.(2) of Schedule D requires the SEC File Number and CRD Number for the sponsor of each wrap fee program for which the adviser acts as a portfolio manager.

F. FINANCIAL INDUSTRY AFFILIATIONS AND PRIVATE FUND REPORTING

Sections 7.A. and 7.B.(1) of Schedule D have been revised to require an adviser to provide certain identification information (specifically, Public Company Accounting Oversight Board-assigned numbers and Central Index Key Numbers) regarding related entities and service providers to private funds in an effort to allow the SEC to more easily compare information across data sets and understand the relationships of advisers to other financial service providers. Section 7.B.(1) also requires an adviser to a private fund that qualifies for the exclusion from the definition of investment company under Section 3(c)(1) of the Investment Company Act of 1940 to report whether it limits sales of the fund to "qualified clients," as defined in Rule 205-3 under the Advisers Act.

Notes:

[1] The amendments to the Form were adopted by the Securities and Exchange Commission ("SEC") on August 25, 2016. *Form ADV and Investment Advisers Act Rules ("Adopting Release")*, Release No. IA-4509, SEC, <https://www.sec.gov/rules/final/2016/ia-4509.pdf>.

[2] The Investment Adviser Registration Depository system will not allow the submission of filings with incomplete responses. *Information Update for Advisers Filing Certain Form ADV Amendments*, SEC, <https://www.sec.gov/divisions/investment/imannouncements/im-info-2017-06.pdf>.

[3] For example, Schedule 7.B. requires that a registrant provide identifying, organizational, and ownership information about its "private funds" (i.e., funds relying on the exclusions from the definition of "investment company" under Section 3(c)(1) or 3(c)(7) of the Investment Company Act of 1940. Schedule 7.B. also solicits the names and locations of a private fund's auditor, prime broker, custodian, administrator, and marketers.

[4] 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) Investment Grade Corporate Bonds; (vii) Noninvestment Grade Corporate Bonds; (viii) Derivatives; (ix) Securities Issued by Registered Investment Companies or Business Development Companies; (x) Securities Issued by Pooled Investment Vehicles (other than Registered Investment Companies or Business Development Companies); (xi) Cash and Cash Equivalents; and (xii) Other.

[5] End-of-year refers to the date used to calculate your regulatory assets under management for purposes of your annual updating amendment. Mid-year is the date six months before the end-of-year date.

[6] "Interest Rate Derivative" means "any derivative whose underlying asset is the obligation to pay or the right to receive a given amount of money accruing interest at a given rate." Reporting on Interest Rate Derivatives must be presented in terms of 10-year bond equivalents.

"Foreign Exchange Derivative" means "any derivative whose underlying asset is a currency other than U.S. dollars or is an exchange rate." Cross-currency interest rate swaps should be included in foreign exchange derivatives rather than interest rate derivatives.

"Credit Derivative" means a "single name credit default swap, including loan credit default swap, credit default swap referencing a standardized basket of credit entities, including credit default swap indices and indices referencing leveraged loans, and credit default swap referencing bespoke basket or tranche of collateralized debt obligations and collateralized loan obligations (including cash flow and synthetic) other than mortgage backed securities."

"Equity Derivative" includes "both listed equity derivative and derivative exposure to unlisted securities." This category includes all synthetic or derivative exposure to equities, including single stock futures, equity index futures, dividend swaps, total return swaps (contracts for difference), warrants and rights.

"Commodity Derivative" refers to "exposures to commodities that [an SMA does] not hold physically, whether held synthetically or through derivatives (whether cash or physically settled)."

"Other Derivatives" are derivatives other than the foregoing.

[7] Section 5.K.(2) of Schedule D clearly states that providing such a narrative description is optional rather than required.

[8] American Bar Association, SEC No-Action Letter (January 18, 2012).

[9] The General Instructions note that any references to "you" in the Form refer to both the filing and each relying adviser, unless otherwise specified.

[10] The Adopting Release also directs advisers relying on umbrella registration to complete other reports or filings required under the Investment Advisers Act of 1940 ("Advisers Act") or the rules thereunder (e.g., Form PF) on behalf of the filing adviser and all relying advisers.

[11] American Bar Association, SEC No-Action Letter (December 8, 2005) ("2005 Guidance"). The 2005 Guidance addressed registration requirements applicable to general partners or managing members of private funds, while the 2012 Guidance discussed registration requirements applicable to related advisers conducting a single advisory business.

[12] The SEC staff has noted that the 2005 Guidance continues to represent the staff's position and that the staff would not recommend enforcement action to the SEC against a special purpose vehicle that does not file a Schedule R but meets the fact patterns and conditions described in the 2005 Guidance. See *Frequently Asked Questions on Form ADV and IARD*, SEC, <https://www.sec.gov/divisions/investment/iard/iardfaq.shtml>.

[13] *Frequently Asked Questions on Form ADV and IARD*, SEC, <https://www.sec.gov/divisions/investment/iard/iardfaq.shtml>.

[14] The client categories are: (a) Individuals (other than high net worth individuals); (b) High net worth individuals; (c) Banking or thrift institutions; (d) Investment companies; (e) Business development companies; (f) Pooled investment vehicles other than investment companies and business development companies; (g) Pension and profit sharing plans (but not plan participants or government pension plans); (h) Charitable organizations; (i) State or municipal government entities (including government pension plans); (j) Other investment advisers; (k) Insurance companies; (l) Sovereign wealth funds and foreign official institutions; (m) Corporations or other businesses not listed above; and (n) Other.

[15] For purposes of Item 5.D., "pooled investment vehicles" include, but are not limited to, private funds. See *Frequently Asked Questions on Form ADV and IARD*, SEC, <https://www.sec.gov/divisions/investment/iard/iardfaq.shtml>.

[16] *Frequently Asked Questions on Form ADV and IARD*, SEC, <https://www.sec.gov/divisions/investment/iard/iardfaq.shtml>.

[17] See, e.g., Royal Bank of Canada, SEC No-Action Letter (June 3, 1998). See also Adopting Release, n.226, SEC, <https://www.sec.gov/rules/final/2016/ia-4509.pdf>.

[18] See Form ADV: Instructions for Part 1A, paragraph 5.b.(1).

[19] The Glossary to the new Form ADV states that "[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." This definition is consistent with the Form PF definition of "parallel managed account."

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