

Client Update

Proposed Form ADV Amendments: The New SEC Focus on Data . . . and Other Matters

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On May 20, the Securities and Exchange Commission (the “SEC”) proposed rules, forms, and amendments to modernize and enhance data reporting requirements for investment advisers and investment companies.¹ The proposals are primarily designed to provide the SEC with the data that it believes that it needs to oversee the asset management industry, including monitoring systemic risks.

The proposals have significant implications for private fund sponsors. Among other things, the SEC proposed amendments would (i) codify the “umbrella registration” approach that many private fund sponsors use to register multiple affiliates on Form ADV under the Investment Advisers Act of 1940 (the “Advisers Act”); (ii) require significant new information concerning separately managed accounts to be reported on Form ADV; and (iii) impose new books and records requirements on advisers relating to performance information. The proposed amendments would also require a registrant to report if it outsources its chief compliance officer (“CCO”) function.

Private fund sponsors should review these amendments to prepare for future revisions to Part 1A of Form ADV as well as changes to their recordkeeping policies relating to performance information and investor communications. Comments on these proposals will be due 60 days after publication in the Federal Register, which at this writing has not yet occurred.

¹ See Amendments to Form ADV and Investment Advisers Act Rules, Advisers Act Release No. IA-4091 (May 20, 2015), available at <http://www.sec.gov/rules/proposed.shtml> (the “Proposing Release”); Investment Company Reporting Modernization, Securities Act Release No. 33-9776, Exchange Act Release No. 34-75002, Investment Company Act Release No. IC-31610 (May 20, 2015), available at <http://www.sec.gov/rules/proposed.shtml> (the “Investment Company Proposing Release”). The Investment Company Proposing Release would, among other things, require registered investment companies to provide the SEC with monthly portfolio reporting. We do not address the Investment Company Proposing Release in this Client Update.

UMBRELLA REGISTRATION FOR RELYING ADVISERS

In its current form, Form ADV is designed for the registration of investment advisers who conduct their business through a single legal entity. Most private fund sponsors provide their investment advisory services through several legal entities (including affiliated general partners and management companies) for a range of tax, legal, and regulatory reasons. In recognition of the fact that multiple filings by private fund sponsors would not serve any regulatory purpose, the SEC staff has permitted private fund sponsors to file a single Form ADV that covers the “filing adviser” (generally, the primary U.S.-based investment adviser) as well as certain affiliated advisers (“relying advisers”).²

The SEC is proposing to codify the umbrella registration approach. Umbrella registration would be subject to the following conditions (which largely reflect the SEC staff’s no-action guidance):

- Single Advisory Business – The filing adviser and the relying advisers must conduct a single advisory business;
- Clients Are Private Funds and Related Separately Managed Accounts – The filing adviser and relying advisers must advise only (i) private funds or (ii) separately managed accounts (A) whose investors are qualified clients that are otherwise eligible to invest in the advisers’ private funds and (B) that pursue investment objectives and strategies that are substantially similar or otherwise related to the advisers’ private funds;
- U.S. Principal Place of Business – The filing adviser must have its principal office and place of business in the U.S. (and, therefore, all of the substantive provisions of the Advisers Act would apply to all of the filing adviser’s and relying advisers’ investment advisory activities);
- Subject to Filing Adviser’s Supervision and Control – Each of the relying advisers and its employees and other persons acting on its behalf must be subject to the supervision and control of the filing adviser;
- Single Code of Ethics and Compliance Program and Single CCO – The advisers must operate under a single code of ethics and single set of written compliance policies and procedures administered by a single CCO; and

² See American Bar Association, Business Law Section, SEC Staff No-Action Letter (Jan. 18, 2012), available at <http://www.sec.gov/divisions/investment/noaction/2012/aba011812.htm> at Question 4.

- Basis for Registration with SEC – Each of the relying advisers must have a basis for registration with the SEC (e.g., either because it has more than \$100 million in assets under management, because it is under common control and has the same principal place of business as the filing adviser, or because its principal place of business is outside of the United States).

A filing adviser relying on umbrella registration would generally complete each question on Form ADV as if it and the relying advisers are a single entity.

As part of the amendments, the SEC is proposing to add a new Schedule R to Form ADV that would provide information with respect to the relying advisers. A separate Schedule R would be completed for each relying adviser that would provide identifying information with respect to the relying adviser (e.g., name and form of organization) as well as identifying information about the relying adviser's owners and control persons (substantially the same as existing Schedules A and B). Schedule R is designed to address the fact that the current umbrella filings have resulted in information regarding relying advisers being submitted in ways that are not consistent.

In addition, the SEC is proposing to add a new question to Schedule D that would require advisers to identify the filing advisers and relying advisers that manage or sponsor private funds reported on Form ADV. This information would allow the SEC to identify the specific adviser managing the private fund reported on Form ADV.

Of particular note, the umbrella filing approach is not available to exempt reporting advisers, including private fund sponsors that are exempt from registration under Section 203(m) (the so-called private fund adviser exemption). To the extent that such exempt reporting advisers have affiliated entities that might also be entitled to rely on this exemption, each adviser will have to file a separate Form ADV.

SEPARATE ACCOUNT DISCLOSURE

The SEC is also proposing a number of other changes that would impact advisers to separately managed accounts—that is, any client that is not a pooled investment vehicle (i.e., registered investment companies, business development companies, and pooled investment vehicles that are not investment companies (i.e., private funds)). In particular, investment advisers with at least \$150 million in regulatory assets under management attributable to separately managed accounts would be required to report aggregate data on the types of assets held by, and the use of derivatives and borrowings in, such accounts. Further detailed information about derivatives exposures would be required from investment

advisers with at least \$10 billion in regulatory assets under management attributable to separately managed accounts. In most circumstances, the SEC is seeking to collect information that is comparable to information provided with respect to private funds on Form PF. The proposed charts that would have to be completed are attached to this Client Update. Advisers with less than \$10 billion in regulatory assets under management attributable to separately managed accounts would be required to provide year-end data, and advisers with more than \$10 billion in regulatory assets under management attributable to separately managed accounts would be required to provide mid-year and year-end data. Notably, unlike the information provided on Form PF, this information would be public.

Finally, the proposals would require investment advisers to identify any custodians that account for at least 10 percent of regulatory assets under management attributable to separately managed accounts. This information would be required to be reported whether or not the adviser or the adviser's related person has custody of assets in separately managed accounts.

OTHER FORM ADV AMENDMENTS; OUTSOURCED CCOS

The SEC has proposed a number of additional amendments to Form ADV that could impact private fund sponsors. Among other things, the amendments would require the investment adviser to: provide (i) disclosure of the adviser's presence on social media platforms (e.g., Twitter, Facebook and LinkedIn), (ii) additional information about the adviser's 25 largest offices, and (iii) ranges of the adviser's own assets on its balance sheet. There are also clarifying and technical amendments that include, among other things, several changes to the private fund disclosure in Section 7.B.(1) of Schedule D of Part 1A of Form ADV.

One of these amendments appears to reflect SEC skepticism concerning the outsourcing of the CCO function. An adviser would be required to report whether its CCO is compensated or employed by any person other than the adviser for providing CCO services and identify the service provider. The Proposing Release notes that the SEC's examination staff "has observed a wide spectrum of both quality and effectiveness of outsourced chief compliance officers and firms" and that the required information would allow the SEC "to identify all advisers relying on a particular service provider and could be used to improve [its] ability to assess potential risks."

PERFORMANCE INFORMATION

Reflecting the SEC's focus on the calculation of performance information (which has been highlighted as a priority by the SEC's Office of Compliance

Inspections and Examinations), the SEC also proposed amendments to Rule 204-2 under the Advisers Act relating to books and records concerning performance information. Specifically, the proposed amendments would require investment advisers to retain (i) materials supporting performance claims that are distributed to any person (removing the current 10 or more persons condition) and (ii) originals of all written communications received and sent relating to the performance of managed accounts or securities recommendations. These proposed amendments would place greater emphasis on the need to ensure that all communications by an adviser and its employees are captured on the adviser's recordkeeping system and that any e-mails or other communications by employees that use performance information have appropriate books and records back-up.

* * *

We will continue to monitor these proposed amendments during the comment period. Please contact us with any questions you may have.

Appendix 1

SECTION 5.K.(1) Separately Managed Accounts

After subtracting the amounts reported in Item 5.D.(2)(d)-(f) from your total regulatory assets under management, indicate the approximate percentage of this remaining amount attributable to each of the following categories of assets. If the remaining amount is at least \$10 billion in regulatory assets under management, complete Question (a). If the remaining amount is less than \$10 billion in regulatory assets under management, complete Question (b). 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. Each column should add up to 100%.

(a)

Asset Type	Mid-year	End of year
(i) Exchange-Traded Equity Securities	___%	
(ii) U.S. Government / Agency Bonds		
(iii) U.S. State and Local Bonds		
(iv) <i>Sovereign Bonds</i>		
(v) Corporate Bonds – <i>Investment Grade</i>		
(vi) Corporate Bonds – <i>Non-Investment Grade</i>		
(vii) Derivatives		
(viii) Securities Issued by Registered Investment Companies or Business Development Companies		
(ix) Securities Issued by Pooled Investment Vehicles (other than Registered Investment Companies)		
(x) Other		

Generally describe any assets included in "Other": _____

(b)

Asset Type	End of year
(i) Exchange-Traded Equity Securities	___%
(ii) U.S. Government / Agency Bonds	
(iii) U.S. State and Local Bonds	
(iv) <i>Sovereign Bonds</i>	
(v) Corporate Bonds – <i>Investment Grade</i>	
(vi) Corporate Bonds – <i>Non-Investment Grade</i>	
(vii) Derivatives	
(viii) Securities Issued by Registered Investment Companies or Business Development Companies	
(ix) Securities Issued by Pooled Investment Vehicles (other than Registered Investment Companies)	
(x) Other	

Generally describe any assets included in "Other": _____

Section 5.K.(2). Separately Managed Accounts – Use of *Borrowings* and Derivatives. If your regulatory assets under management attributable to separately managed accounts are at least \$10 billion, you should complete Question (a). If your regulatory assets under management attributable to separately managed accounts are at least \$150 million but less than \$10 billion, you should complete Question (b).

(a)

In the table below, provide the following information regarding the separately managed accounts you advise. If you are a subadvisor to a separately managed account, you should only provide information with respect to the portion of the account that you subadvise. 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.

In column 1, indicate the number of separately managed accounts you advise according to *net asset value* and gross notional exposure. For this purpose, the 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 *net asset value* of the account.

In column 2, provide the weighted average amount of *borrowings* (as a percentage of net assets) for the accounts included in column 1.

In column 3, provide the weighted average *gross notional value* of derivatives (aggregate *gross notional value* of derivatives divided by the aggregate *net asset value* of the accounts included in column 1) with respect to each category of derivatives specified in 3(a) through (f).

You do not need to complete the table with respect to any separately managed accounts with a *net asset value* of less than \$10,000,000.

(i) Mid-Year

Net asset value of account	Gross notional exposure	1 Number of accounts	2 Average borrowings	3 Average Derivative Exposures					
				(a) Interest Rate Derivative	(b) Foreign Exchange Derivative	(c) Credit Derivative	(d) Equity Derivative	(e) Commodity Derivative	(f) Other Derivative
\$10,000,000-249,999,999	Less than 10%								
	10-99%								
	100-199%								
	200% or more								
\$250,000,000-999,999,999	Less than 10%								
	10-99%								
	100-199%								
	200% or more								
\$1,000,000,000 or greater	Less than 10%								
	10-99%								
	100-199%								
	200% or more								

Optional: Use the space below to provide a narrative description of the strategies and/or manner in which *borrowings* and derivatives are used in the management of the separately managed accounts that you advise.

(ii) End of Year

Net asset value of account	Gross notional exposure	1 Number of accounts	2 Average borrowings	3 Average Derivative Exposures					
				(a) Interest Rate Derivative	(b) Foreign Exchange Derivative	(c) Credit Derivative	(d) Equity Derivative	(e) Commodity Derivative	(f) Other Derivative
\$10,000,000-249,999,999	Less than 10%								
	10-99%								
	100-199%								
	200% or more								
\$250,000,000-999,999,999	Less than 10%								
	10-99%								
	100-199%								
	200% or more								
\$1,000,000,000 or greater	Less than 10%								
	10-99%								
	100-199%								
	200% or more								

Optional: Use the space below to provide a narrative description of the strategies and/or manner in which *borrowings* and derivatives are used in the management of the separately managed accounts that you advise.

(b)

In the table below, provide the following information regarding the separately managed accounts you advise as of the date used to calculate your regulatory assets under management for purposes of your *annual updating amendment*. If you are a subadvisor to a separately managed account, you should only provide information with respect to the portion of the account that you subadvise.

In column 1, indicate the number of separately managed accounts you advise according to *net asset value* and gross notional exposure. For purposes of this item, the 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 *net asset value* of the account.

In column 2, provide the weighted average amount of *borrowings* (as a percentage of *net asset value*) for the accounts included in column 1.

You do not need to complete the table with respect to any separately managed accounts with a *net asset value* of less than \$10,000,000.

<i>Net asset value of account</i>	<i>Gross notional exposure</i>	1 <i>Number of accounts</i>	2 <i>Average borrowings</i>
\$10,000,000-249,999,999	Less than 10%		
	10-99%		
	100-199%		
	200% or more		
\$250,000,000-999,999,999	Less than 10%		
	10-99%		
	100-199%		
	200% or more		
\$1,000,000,000-or greater	Less than 10%		
	10-99%		
	100-199%		
	200% or more		

Optional: Use the space below to provide a narrative description of the strategies and/or manner in which *borrowings* and derivatives are used in the management of the separately managed accounts that you advise.
