

Client Update

The SEC Adopts Form ADV and Recordkeeping Rule Amendments

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On August 25th, the Securities and Exchange Commission (the “SEC”) adopted final rules, forms, and amendments to modernize and enhance data reporting requirements for investment advisers.¹ The amendments 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 and assisting the SEC staff in examination and enforcement efforts. Among other things, the amendments (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 amendments 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.² The compliance date for the amendments is October 1, 2017. Therefore, any initial

¹ See Form ADV and Investment Advisers Act Rules, Advisers Act Release No. IA-4509 (Aug. 25, 2016), available at <https://www.sec.gov/rules/final.shtml> (the “Adopting Release”). The amendments were originally proposed in May 2015 and discussed in an earlier Client Alert. 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>. Debevoise & Plimpton Client Update: Proposed Form ADV Amendments: The New SEC Focus on Data . . . and Other Matters (Jun. 9, 2015), available at <http://www.debevoise.com/insights/publications/2015/06/proposed-form-adv-amendments>.

² The Adopting Release notes that securities authorities also intend to consider similar changes that affect advisers registered with the states, who are also required to complete Part 1B of Form ADV as part of their state registrations.

registrations or amendments filed on Form ADV on or after that date will be required to comply with the amended Form.

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. Many 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 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”).³

The amendments codify the umbrella registration approach for private fund advisers that consist of multiple entities that operate a single advisory business, subject to the following conditions (which largely reflect the SEC staff’s no-action guidance):

- 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 United States (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;
- Subject to the Advisers Act. The filing adviser and each relying adviser must be subject to the Advisers Act and examination by the SEC; and

³ 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.

- 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.

In addition, each of the relying advisers must be eligible to register 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).

Revised Form ADV includes general instructions for umbrella registration and changes in format to accommodate multiple legal entities. The revised instructions specify those questions that should be answered solely with respect to the filing adviser and those that require the filing adviser to answer on behalf of itself and its relying advisers. In addition, a new Schedule R must be filed with respect to each relying adviser. Schedule R requires specified information for each relying adviser, including its eligibility for SEC registration, form of organization, and ownership information with respect to the relying adviser (substantially the same as the reporting for direct and indirect ownership on existing Schedules A and B). In addition, Schedule D requires advisers to identify the filing advisers and relying advisers that manage or sponsor private funds reported on Form ADV. This information will 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 being made available to non-U.S. investment advisers or exempt reporting advisers. The Adopting Release states that the SEC was concerned that a group of related registered investment advisers based inside and outside the United States could designate a non-U.S. adviser as the filing adviser and assert that the Advisers Act's substantive provisions would not apply to the U.S.-based relying advisers' dealings with their non-U.S. clients. In the case of registered investment advisers that do not have any offices in the United States, the SEC concluded that umbrella registration is intended to apply only where its staff "has access to and can readily examine the filing and relying advisers and where the Advisers Act and rules thereunder fully apply to all advisers (and clients) under the umbrella registration." This would not be the case for a related group of non-U.S. advisers.

In the case of exempt reporting advisers, the SEC concluded that it would need to develop different conditions to determine whether a group of exempt reporting advisers is operating a single advisory business. To the extent that exempt reporting advisers, including private fund sponsors that are exempt from registration under Section 203(m) (the so-called private fund adviser exemption),

have affiliated entities that might also be entitled to rely on this exemption, each adviser will have to file a separate Form ADV.

Existing SEC staff positions permit certain exempt reporting advisers to file a single Form ADV on behalf of multiple special purpose entities (“SPEs”). The Adopting Release states that these positions are not being withdrawn.⁴

Separate Account Disclosure

Several of the amendments to Form ADV are designed to collect more specific information about advisers’ 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)). The charts that will have to be completed are attached as Appendix 1 and have been modified from the proposed versions in certain respects. In most circumstances, the SEC is seeking to collect information that is comparable to information provided with respect to private funds on Form PF, but unlike the information provided on Form PF, this information will be public.

Investment advisers will be required to report the approximate percentage of separately managed account regulatory assets under management that are invested in 12 broad asset categories (an expansion from the 10 originally proposed).⁵ Advisers will be required to include end of year information as part of their annual filing, and advisers with more than \$10 billion in regulatory assets under management attributable to separately managed accounts will also

⁴ 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>. The FAQ states that the exempt reporting adviser may include an SPE on its Form ADV rather than filing a separate Form ADV for the SPE where, among other things, the SPE (*i.e.*, a private fund’s general partner or managing member) does not exercise discretionary authority over the fund’s assets other than the hiring or firing of the adviser to the fund and acts as the SPE only for private funds or other pooled investment vehicles advised by the exempt reporting adviser. In addition, the FAQ does not require a separate Form ADV for an SPE that has no employees or other persons acting on its behalf other than officers, directors, partners or employees of the exempt reporting adviser even if the SPE retains and exercises discretionary authority over the private fund’s assets. In these circumstance, (i) the SPE may act as the SPE only for private funds or other pooled investment vehicles advised by the exempt reporting adviser, (ii) the exempt reporting adviser must control the SPE, (iii) the investment advisory activities of the SPE must be subject to the Advisers Act, and (iv) the SPE, its officers, directors, partners, employees and persons acting on its behalf must be subject to the exempt reporting adviser’s supervision and control.

⁵ In response to suggestions, the SEC added new categories for “Cash and Cash Equivalents” and “Non-Exchange-Traded Equity Securities.”

be required to include mid-year information as part of their annual filing. Advisers will be permitted to use their own consistently applied methodologies in determining how to categorize assets that may be classified into multiple categories.

Investment advisers with at least \$500 million in regulatory assets under management attributable to separately managed accounts will be required to report information regarding the use of borrowings and derivatives in those accounts (an increase from the originally proposed minimum threshold of \$150 million). Further detailed information about derivatives exposures will be required from investment advisers with at least \$10 billion in regulatory assets under management attributable to separately managed accounts.

A number of commenters had expressed concerns about the public disclosure of the information contained in the charts. While the SEC did not adopt suggestions that this information be provided to the SEC on a confidential basis, it believes that certain of the changes from the proposal will mitigate these concerns.

Finally, the proposals require investment advisers to identify any custodians that account for at least 10 percent of separately managed account regulatory assets under management. This information must 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 amendments require investment advisers to report additional information on Form ADV. Set forth below is a summary of the amendments that may be particularly relevant for private fund sponsors:

- Social Media Presence. An investment adviser will be required to disclose the adviser's accounts on social media platforms (e.g., Twitter, Facebook and LinkedIn) where the adviser controls the content.
- Office Information. An investment adviser will be required to provide the total number of offices at which it conducts investment advisory business and additional information about its 25 largest offices, including the number of employees who perform advisory functions and the nature of business activities conducted from each office.
- Assets on the Adviser's Balance Sheet. An investment adviser with assets of \$1 billion or more will be required to report its assets within three ranges:

(1) \$1 billion to less than \$10 billion; (2) \$10 billion to less than \$50 billion; and (3) \$50 billion or more.

- Additional Information about Advisory Business. There are certain amendments to the information currently required from an investment adviser regarding the number of advisory clients, the types of advisory clients, and regulatory assets under management attributable to client types.
- Additional Private Fund Reporting. The amendments includes several changes to the private fund disclosure in Section 7.B.(1) of Schedule D of Part 1A of Form ADV, including requiring 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.

In addition, an investment adviser will be required to report whether its CCO is compensated or employed by any person other than the adviser or a related person of the adviser for providing CCO services and identify the service provider. This amendment reflects SEC skepticism concerning the outsourcing of the CCO function. The Adopting Release reiterates that the SEC's examination staff "has observed a wide spectrum of both quality and effectiveness of outsourced [CCOs] and firms" and that the disclosure will 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 adopted amendments to Rule 204-2 under the Advisers Act relating to books and records concerning performance information. Specifically, the amendments require investment advisers to retain (i) materials supporting performance claims (*i.e.*, materials that demonstrate the calculation of the performance or rate of return) in communications 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 amendments 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 performance information contained in any e-mails or other communications by employees (including one-on-one client communications) is substantiated in the adviser's books and records (and thus subject to SEC examination).

* * *

As a practical matter, the amendments to Form ADV will not impact current registrants until they update their Form ADVs in the first quarter of 2018. However, private fund sponsors should begin the process of identifying the type of information that they will have to include in their updating amendments. Investment advisers filing an initial Form ADV on or after October 1, 2017 will be required to provide responses to the form revisions

Private fund sponsors should also prepare for changes to their recordkeeping policies relating to performance information and investor communications. Investment advisers that circulate or distribute communications after October 1, 2017 that include performance information (including performance information that predates that date) will be required to maintain the materials that demonstrate the calculation of the performance in accordance with the amendments.

* * *

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.(3)(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).

Any regulatory assets under management reported in Item 5.D.(3)(d), (e), and (f) should not be reported below.

If you are a subadviser 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. Each column should add up to 100% and numbers should be rounded to the nearest percent.

Investments in derivatives, registered investment companies, business development companies, and pooled investment vehicles should be reported in those categories. Do not report those investments based on related or underlying portfolio assets. Cash equivalents include bank deposits, certificates of deposit, bankers' acceptances and similar bank instruments.

Some assets could be classified into more than one category or require discretion about which category applies. You may use your own internal methodologies and the conventions of your service providers in determining how to categorize assets, so long as the methodologies or conventions are consistently applied and consistent with information you report internally and to current and prospective clients. However, you should not double count assets, and your responses must be consistent with any instructions or other guidance relating to this Section.

(a)

Asset Type	Mid-year	End of year
(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) <i>Sovereign Bonds</i>		
(vi) Investment Grade Corporate Bonds		
(vii) Non-Investment 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		
(xii) Other		

Generally describe any assets included in “Other” _____

(b)

Asset Type	End of year
(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) <i>Sovereign Bonds</i>	
(vi) Investment Grade Corporate Bonds	
(vii) Non-Investment 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	
(xii) 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 \$500 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 subadviser 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 regulatory assets under management attributable to separately managed accounts associated with each level of gross notional exposure. For purposes of this table, 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 regulatory assets under management of the account.

In column 2, provide the dollar amount of *borrowings* for the accounts included in column 1.

In column 3, provide aggregate *gross notional value* of derivatives divided by the aggregate regulatory assets under management of the accounts included in column 1 with respect to each category of derivatives specified in 3(a) through (f).

You may, but are not required to, complete the table with respect to any separately managed account with regulatory assets under management of less than \$10,000,000.

Any regulatory assets under management reported in Item 5.D.(3)(d), (e), and (f) should not be reported below.

(i) Mid-Year

Gross Notional Exposure	1 Regulatory Assets Under Management	2 Borrowings	3 Derivative Exposures					
			(a) Interest Rate Derivative	(b) Foreign Exchange Derivative	(c) Credit Derivative	(d) Equity Derivative	(e) Commodity Derivative	(f) Other Derivative
Less than 10%								
10-149%								
150% 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

Gross Notional Exposure	1 Regulatory Assets Under Management	2 Borrowings	3 Derivative Exposures					
			(a) Interest Rate Derivative	(b) Foreign Exchange Derivative	(c) Credit Derivative	(d) Equity Derivative	(e) Commodity Derivative	(f) Other Derivative
Less than 10%								
10-149%								
150% 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 subadviser 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 regulatory assets under management attributable to separately managed accounts associated with each level of gross notional exposure. For purposes of this table, 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 regulatory assets under management of the account.

In column 2, provide the dollar amount of *borrowings* for the accounts included in column 1.

You may, but are not required to, complete the table with respect to any separately managed accounts with regulatory assets under management of less than \$10,000,000.

Any regulatory assets under management reported in Item 5.D.(3)(d), (e), and (f) should not be reported below.

Gross Notional Exposure	1 Regulatory Assets Under Management	2 Borrowings
Less than 10%		
10-149%		
150% 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.
