SEC Adopts Rules to Enhance Adviser Reporting

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Recently enacted SEC rules have imposed several amendments to Form ADV that advisers should be aware of, and which will apply to all Form ADVs filed after September 31, 2017 (for most advisers with a December 31-year end, the enhanced reporting will first apply to their annual amendment due March 2018). The revised Form ADV will require substantial additional disclosures with regard to separately managed accounts ("SMAs"), provide for a method of umbrella registration for private fund entities operating a single advisory business, and implement other technical amendments to current items and instructions. In addition, the update imposes new requirements under Rule 204-2, commonly known as the "books and records rule."

A full copy of the release may be found here. A summary of the changes is set forth below. However, advisers are encouraged to consult with counsel to determine the impact of these changes on their reporting and recordkeeping requirements.

Requests for Additional Information, Including Information about Separately Managed Account Business, on Form ADV

Much of the focus of the new rules addresses disclosures related to SMAs, which advisers previously provided little information about and which the SEC believes will assist them in better monitoring the industry and to help to identify advisers to particular asset classes. The SEC considers SMAs to be "advisory accounts other than those that are pooled investment vehicles." Advisers who report regulatory assets under management ("RAUM") attributable to SMAs in response to new Item 5.K.(1) of Part 1A will now be required to report, on the aggregate level, information in the new Section 5.K.(1) of Schedule D to Form ADV, and may additionally be required to complete new Sections 5.K.(2) and 5.K.(3) of Schedule D to disclose additional information about the use of borrowings and derivatives by SMAs and certain custodian information. It should be noted that the SEC will require reporting of information regarding **all** of a registered adviser's SMAs, including accounts held by non-U.S. persons (even when the adviser itself has a principal place of business outside of the U.S.).

The additional information to be reported in the new sections of Form ADV related to SMAs is set forth in the below table.

Who	What to Complete	What to Include	Frequency
Advisers who report AUM attributable to SMAs	Complete new Sections 5.K.(1) of Part 1A and of Schedule D	Advisers will be required to report the approximate percentage of SMA RAUM in 12 categories: 1. Cash and Cash Equivalents 2. Non-Exchange-Traded Equity Securities 3. Exchange-Traded Equity Securities 4. Corporate Bonds - Investment Grade 5. Corporate Bonds - Non-Investment Grade 6. U.S. government bonds 7. U.S. state and local bonds 8. Sovereign bonds 9. Derivatives	Advisers with $10 billion or more in RAUM will report annually, but required to provide both mid- and year-end percentages of RAUM attributable to SMAs. Advisers with $10 billion or less in RAUM will report year-end percentages of RAUM attributable to SMAs.

		10. Securities issued by registered investment companies and business development companies 11. Securities issued by other pooled investment vehicles 12. Other. Advisers may use their other internal methodologies and conventions of their service providers to determine how to categorize assets so long as they are consistently applied and assets are counted only once. The SEC has deliberately excluded definitions of these categories.
Advisers who report RAUM attributable to SMAs that engage in borrowings and derivatives.	May need to complete new Section 5.K.(2) of Schedule D	Advisers to SMAs will need to report information regarding the use of borrowings and derivatives in those accounts, including the gross notional value and gross notional exposure. Advisers may limit their reporting to individual accounts with at least $10 million in Sections (a) and (b). Advisers with at least $500 million but less than $10 billion in RAUM will be required to report the amount of SMA RAUM and the dollar amount of borrowings attributable to those assets that correspond to three levels of gross notional exposures: less than 10%, 10-149%, and 150% or more. Advisers with at least $10 billion in RAUM will be required to additionally report derivative exposures across six derivative categories.
Advisers who use custodians that account for 10% or more of the RAUM attributable to SMAs.	May need to complete new Section 5.K.(3) of Schedule D.	Advisers must identify any custodians that account for 10% or more of SMA RAUM and the amount of the adviser's RAUM attributable to SMA held with the custodian.

The SEC is also requiring additional information to be reported about the adviser itself:

- Advisers are now instead required to provide all assigned Central Index Key ("CIK") numbers; previously this only applied if the adviser was a public reporting company under Sections 12 or 15(d) of the Securities and Exchange Act of 1934.
- Advisers are required to include the addresses of all accounts/pages on social media platforms it uses in which it controls the content of the information posted, including Twitter, Facebook, and LinkedIn.
- Advisers will now be required to disclose information about their 25 largest offices (by number of employees), each office's CRD branch number, the number of employees who perform advisory functions at each office, the business activities conducted from each office, and a description of any other investment-related business conducted at each office. Previously an adviser was required to disclose information only about its principal place of business and five largest offices.
- Item I.J. has been amended to require disclosure of whether an adviser's chief compliance officer is compensated or employed by any person other than the adviser (or a related person of the adviser or registered investment company managed by the adviser), and if so, to report the name and IRS Employer Identification Number of such other person.

- Item 1.O. has been amended to require advisers proprietary assets (not RAUM) of $1 billion or more to report their assets within three ranges: $1 billion to less than $10 billion; $10 billion to less than $50 billion, and $50 billion or more.

Lastly, the SEC is requiring additional information about the adviser's advisory business:

- Advisers will now need to report in Item 5 the number of clients attributable to each category of clients (noting that advisers may report that they have fewer than five clients in a category rather than the number, if fewer than five). In addition, the amendments have added new client categories for sovereign wealth funds and foreign official institutions, and have clarified that government pension plans should be reported as government entities rather than pension and profit sharing plans. Where clients may fall into more than one category, advisers are instructed to report the client in the category that most accurately represents the client in order to report such client only once. Previously advisers were required to disclose only the total number of advisory clients, the types of advisory clients, and RAUM attributable to those client types.
- Item 5 will now require disclosure of the number of clients for whom advisers provide advisory services but for whom the adviser does not have any RAUM (noting that advisers to fewer than five clients in this category may indicate that fact rather than reporting an actual number).
- Advisers that report client assets differently than RAUM in their Part 2A brochure must now check a box indicating that election.
- Advisers will be required to report the approximate amount of RAUM attributable to clients who are non-U.S. persons (defined as a person that is not a United States person within the meaning of Advisers Act Rule 203(m)-1.
- Section 5.G.(3) now requires advisers that advise registered investment companies ("RICs") or business development companies ("BDC") to report the RAUM of all parallel managed accounts related to those RICs or BDCs.
- Item 5 has been updated to solicit additional information in regard to wrap fee programs, including whether the adviser participates in any such program, the total amount of RAUM attributable to acting as both a sponsor to and portfolio manager of such program. Advisers must also include any SEC file number and CRD number for the sponsors to those programs.
- Advisers must provide additional identifying numbers for their financial industry affiliates and private funds they manage, as well as certain service providers, in Sections 7.A. and 7.B.(1), including numbers issued by the Public Company Accounting Oversight Board ("PCAOB") and CIK numbers.
- Private fund advisers that qualify for the exclusion of the definition of "investment company" in Section 3(c)(1) of the Investment Company Act of 1940 (the "Advisers Act") will now be required to report whether they limit sales of the fund to "qualified clients," as defined in Rule 205-3 of the Advisers Act (noting that "qualified client" status will be determined as of the date that it entered into the advisory contract; advisers will not be required to re-certify the qualified client status of their clients). Exempt reporting advisers ("ERAs") who are not required to determine whether the fund's investors are qualified clients may answer "no" to this question.

Umbrella Form ADV Registration for Private Fund Adviser Entities Operating a Single Advisory Business

The SEC has codified umbrella registration for multiple advisor entities that operate a single advisory business in order to simplify the registration process and to provide a less fragmented overview of an advisory business operated through groups of private funds. Though umbrella registration is not mandatory and most investment advisers already implement some form of it based on guidance previously issued by the SEC[1], the instructions to Form ADV have been updated to include the conditions pursuant to which an adviser may submit an umbrella registration.

The conditions include:

- All of the advisers (including the filing adviser and the advisers relying on such registration) advise only private funds and qualified clients in SMAs whose accounts pursue substantially similar investment strategies and objectives;
- The filing adviser has a principal office and place of business in the U.S.;
- Each relying adviser's employees and agents are acting under the supervision and control of the filing adviser;
- The advisory activities of each relying adviser are subject to the Advisers Act and examination by the SEC; and
- Each filing adviser and relying adviser operate under a single code of ethics administered by a single chief compliance officer.

The filing adviser will be required to file (and update) Parts 1 and 2 to Form ADV for itself and each relying adviser with the same information contained in any other reports or filings required under the Advisers Act, such as Form PF. In addition, Part 1A now includes Schedule R, which requires separate reporting of indirect and direct ownership for each relying adviser (similar to Schedules A and B of Form ADV), and Schedule D asks advisers to identify the filing advisers and relying advisers that manage or sponsor private funds reported on Form ADV. The SEC noted that umbrella registration will not be extended to include umbrella reporting by exempt reporting advisers at this time, however this will not limit ERAs relying on previous guidance regarding reporting of multiple special purpose entities (typically general partner entities) on a single Form ADV.

Clarifying and Technical Amendments to Form ADV

The SEC adopted several amendments to clarify its position on questions it is frequently asked. "Newly formed adviser" has been deleted from Item 2.A.(9) and Section 2.A.(9) of Schedule D as it created confusion as to whether Rule 203A-2(c) under the Advisers Act is applicable only to entities that have been "newly formed" (it does not). Clarifying text has been added, confusing text has been deleted, and formatting has been updated in order to address questions in a number of sections. In particular, Item 4 of Part 1A has been updated to reflect that succeeding to the business of a registered investment adviser includes a change in legal structure or status. Item 7.A. of Part 1A has been modified to prevent duplicate disclosure of information in this section that is already reported in Items 5.B.(1) and 5.B.(2) related to information about an adviser's employees, as well as some clarifying text and formatting in Section 7.B.(1) of Schedule D and Question 8.(a). Question 25.(g) has been added to solicit the legal entity identifier for any private fund custodian that is not a broker-dealer or that is a broker-dealer but that does not have an SEC registered identification number, and clarifying updates have been added to Item 8.H of Part 1A, which asks about compensation for client referrals. Lastly, the Disclosure Reporting Page ("DRP") has been modified to explain that both registered investment advisers and exempt reporting advisers may remove a DRP from their Form ADV record if a criminal, regulatory, or civil judicial action was decided in their favor.

Changes to Investment Advisers Act Rule 204-2

The SEC has also updated Rule 204-2 (the "books and records rule") in two ways. First, the books and records rule will now require that advisers required to be registered with the SEC to maintain records related to performance claims in communications distributed to any person (as opposed to those circulated to ten or more persons under the prior version of the rule). Further, Rule 204-2(a)(7) has been amended to require advisers, in addition to other communications required to be maintained by such section, to maintain originals of all written communications received, and copies of all written communications sent, by the adviser that relate to performance or rates of return of any managed account or securities recommendation.

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1. See American Bar Association, Business Law Section, SEC Staff Letter (Jan. 18, 2012), available here.

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- Professional Services

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