

## SEC Proposes Amendments to Form ADV and Investment Advisers Act Rules

On May 20, 2015, the Securities and Exchange Commission (“SEC”) issued a release proposing amendments to Form ADV and to certain rules under the Investment Advisers Act of 1940 (the “Advisers Act”).<sup>1</sup> The proposed amendments are relevant to all investment advisers, including investment advisers to hedge funds and private funds and those not currently managing private funds. In a companion release, the SEC also proposed new rules and forms and amendments to existing rules and forms for registered investment companies.<sup>2</sup> The proposals set forth in these releases are intended to modernize and enhance disclosures for the investment management industry. Additionally, the proposals would further the SEC’s use of technology in its efforts to monitor risks as the primary regulator of registered investment advisers and registered investment companies.

The SEC also indicated that these proposals are a result of the growth of new and increasingly complex investment products and strategies. Additionally, the proposals seek to take advantage of technological advances in data collection and analysis.

The proposals seek, with respect to investment advisers, to amend Form ADV to (1) require investment advisers to provide information related to their separately managed account (“SMA”) business; (2) enable private fund investment advisers to file an “umbrella registration” for separate investment advisers that operate as a single investment advisory business; and (3) make certain clarifying, technical and other amendments. Additionally, the proposals seek to amend Rule 204-2 under the Advisers Act, the books and records rule, and to make various technical and clarifying amendments to other rules under the Advisers Act.

### Proposed Amendments to Form ADV

#### Information Regarding SMAs

Many of the proposed amendments to Form ADV are designed to assist the SEC in collecting information

specific to investment advisers’ SMAs, thereby enhancing the SEC staff’s ability to effectively carry out its risk-based examination program and other risk assessment and monitoring activities.<sup>3</sup> The data collection focuses on types of assets held and the use of derivatives and borrowings in SMAs. The proposed changes are as follows:

- Investment advisers would be obligated to indicate the percentage of SMA assets in 10 broad asset categories (*e.g.*, exchange-traded equities, U.S. Government and agency bonds, securities issued by investment companies and derivatives). This information would be provided annually. Investment advisers with SMA assets under management of \$10 billion or more would be required to include both annual and semi-annual data in the annual filing.
- All investment advisers with SMA assets under management would be required to report the percentage of SMA assets invested in derivatives.
- Investment advisers with \$150 million in SMA assets under management would be required to report information on the use of borrowings and derivatives in SMAs:
  - Investment advisers with \$150 million but less than \$10 billion in SMA assets under management would be required to report the number of accounts that correspond to certain categories of gross notional exposure and the weighted average amount of borrowings (as a percentage of net asset value) in those accounts; and
  - Investment advisers with \$10 billion or more in SMA assets under management would be required to report the gross notional exposure and weighted average amount of borrowings (as a percentage of net asset value) as well as the weighted average gross notional value of derivatives (as a percentage of net asset value) in each of six specific derivatives categories.<sup>4</sup>
- Investment advisers would be required to update their borrowing and derivatives information

<sup>1</sup> See *Amendments to Form ADV and Investment Advisers Act Rules*, Investment Advisers Act Release No. 4091 (May 20, 2015), <http://www.sec.gov/rules/proposed/2015/ia-4091.pdf>. This release pertains to proposed rules and form amendments that would affect investment advisers registered with the SEC. The SEC stated in the release that it understands that state securities authorities intend to consider similar changes that affect investment advisers registered with the states, who are also required to complete Form ADV Part 1B as part of their state registrations.

<sup>2</sup> See *Investment Company Reporting Modernization*, Securities Act Release No. 9776, Securities Exchange Act Release No. 75002 and Investment Company Act Release No. 31610 (May 20, 2015), <http://www.sec.gov/rules/proposed/2015/33-9776.pdf>.

<sup>3</sup> For the purposes of reporting on Form ADV, the SEC considers SMAs to be all advisory accounts other than registered investment companies, business development companies, and pooled investment vehicles that are not investment companies (*i.e.*, private funds).

<sup>4</sup> See the Glossary to Proposed Form ADV for the definition of “gross notional value,” “borrowings” and “net asset value.”

annually when filing their annual updating amendment to Form ADV, and those with at least \$10 billion in SMA assets under management would be required to report mid-year and annual borrowing and derivatives information as part of their annual filing.

- Investment advisers would be required to identify custodians that hold at least 10% of their SMA assets under management along with the amount of assets held at those custodians.

#### ***Additional Information Regarding Investment Adviser and Advisory Business***

The investment adviser proposals include additional amendments to Form ADV to elicit information regarding the investment adviser and its business operations and affiliations. These amendments are designed to enhance the SEC's understanding and oversight of investment advisers and to assist the SEC staff in its risk-based examination program. The additional information that the SEC would collect includes, but is not limited to, the following:

- The addresses of the investment adviser's website(s) and all social media accounts and marketing platforms, including Twitter, Facebook and LinkedIn;
- The total number of offices at which the investment adviser's advisory business is conducted, along with the locations of the investment adviser's 25 largest offices and their respective CRD branch numbers;
- The number of employees who performed advisory functions from the investment adviser's 25 largest offices, and an indication of each of the 25 largest offices' other investment-related business operations;
- Whether the investment adviser's Chief Compliance Officer ("CCO") is compensated or employed by any person other than the investment adviser or a related person of the investment adviser (*e.g.*, outsourced CCO services);
- An indication, within a range, of the investment adviser's own assets;
- Information related to the number of the investment adviser's clients and the amount of regulatory assets attributable to regulatory accounts (*e.g.*, registered investment companies, business development companies and all parallel managed accounts), assets under management in non-U.S. regulatory accounts, and the number of non-regulatory accounts;<sup>5</sup>
- Detailed information regarding the total amount of regulatory assets under management attributable to acting as a sponsor and/or portfolio manager of a wrap fee program, and the name, SEC file number

and CRD number of sponsors of wrap fee programs for which the investment adviser serves as portfolio manager;

- The percentage of each private fund owned by qualified clients, as defined in Rule 205-3 under the Advisers Act; and
- The identifying numbers of financial industry affiliates of the investment adviser (*e.g.*, Public Company Accounting Oversight Board ("PCAOB") registration numbers and CIK numbers).

#### ***Umbrella Registration***

The proposed amendments to Form ADV would also allow multiple private fund investment advisers that operate as a single investment advisory business to register with the SEC under "umbrella registration" on a single Form ADV. Currently, a number of private fund investment advisers rely on the guidance in the SEC no-action letter to the American Bar Association (the "ABA Letter"), which imposes a number of conditions on investment advisers wishing to rely on the registration of an affiliated investment adviser.<sup>6</sup> Many of the changes to Form ADV to accommodate umbrella registration codify the relief granted in the ABA Letter. The conditions for umbrella registration include the following:

- The filing investment adviser and one or more relying investment advisers conduct a single private fund advisory business and each relying adviser is controlled by or under common control with the filing investment adviser;
- The filing investment adviser and each relying investment adviser advise only private funds and clients in separately managed accounts that are qualified clients (as defined in Rule 205-3 under the Advisers Act) and are otherwise eligible to invest in the private funds advised by the filing investment adviser or a relying investment adviser and whose accounts pursue investment objectives and strategies that are substantially similar or otherwise related to those private funds;
- The filing investment adviser has its principal office and place of business in the United States;
- Any relying investment adviser and its employees are supervised and controlled by the filing investment adviser, such that the relying investment adviser and its employees are "persons associated with" the filing investment adviser as defined in the Advisers Act;
- The advisory activities of each relying investment adviser are subject to the Advisers Act and the rules thereunder, and each relying investment adviser is subject to examination by the SEC; and

<sup>5</sup> For the purpose of calculating regulatory accounts and regulatory assets under management, investment advisers should review the proposed Form ADV, Part 1A, Instruction 5.b., which is available at <http://www.sec.gov/rules/proposed/2015/ia-4091-appendix-b.pdf>.

<sup>6</sup> See American Bar Association, Business Law Section, SEC No-Action Letter (Jan. 18, 2012), available at <http://www.sec.gov/divisions/investment/noaction/2012/aba011812.htm>.

- The filing investment adviser and each relying investment adviser operate under a single code of ethics adopted in accordance with Rule 204A-1 under the Advisers Act and a single set of written policies and procedures adopted and implemented in accordance with Rule 206(4)-(7) under the Advisers Act and administered by a single CCO in accordance with that rule.

The SEC has also proposed a new Schedule R to Form ADV, which would include detailed information regarding the ownership structure of each relying investment adviser. Additional amendments to the instructions and Glossary of Form ADV would be made to reflect the umbrella registration amendment. Umbrella registration would not be available for exempt reporting investment advisers.

The proposal also includes clarifying and technical amendments to Form ADV and its instructions. The SEC believes that the proposed technical and clarifying amendments would make the filing process clearer and more efficient for investment advisers, thus increasing the reliability and consistency of information provided by investment advisers.

## Proposed Amendments to Advisers Act Rules

### *Proposed Amendments to Books and Records Rules*

The proposed amendments would tighten certain recordkeeping obligations under Advisers Act Rule 204-2. The proposed amendment to Rule 204-2(a)(16) would require an investment adviser to maintain records supporting performance claims in communications that are distributed or circulated to any person. Currently, an investment adviser is required to maintain such records of communications distributed or circulated to 10 or more persons.

Additionally, the proposed amendment to Rule 204-2(a)(7) would broaden the recordkeeping obligations of an investment adviser to maintain original records of all written communications received and copies of all written communications that are sent related to the performance or rate of return of any or all managed accounts or investment recommendations. Investment advisers are currently only required to maintain records of correspondence that fall into certain categories.

### *Proposed Technical Amendments to Advisers Act Rules*

The SEC has proposed additional technical amendments to several rules under the Advisers Act, removing transition provisions where the transition process is complete, as well as the withdrawal of transition Rule 203A-5 under the Advisers Act. Most of these transition provisions were added as part of the implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

## Submission of Comments

Interested persons may submit written comments on the proposed amendments and any other matters that might have an impact on the proposed amendments. Comments must be received on or before August 11, 2015.



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