ALERT MEMORANDUM

SEC Adopts Form ADV Amendments for Affiliated Advisers and Separately Managed Accounts

August 30, 2016

On August 25, 2016, the Securities and Exchange Commission (the "SEC") adopted amendments to Form ADV to modernize and enhance information reported by investment advisers (the "Amendments" or the "Form ADV Amendments").[1] Among other changes, advisers will be required to use a new Schedule R for each relying adviser when using umbrella registration for multiple entities in a single advisory business and will be required to provide additional information about separately managed accounts. The adopting release also amends Rule 204-2 (the "Books and Records Rule") under the Investment Advisers Act of 1940, as amended (the "Advisers Act") to require additional documentation supporting any performance calculations or rates or return in written communications from the adviser.

While the SEC adopted the amendments largely as they were proposed,[2] there are some changes from the Proposal intended to address concerns raised in comment letters the SEC received regarding the Proposal.

The compliance date for the Form ADV Amendments is October 1, 2017 for initial and other-than-annual amendments. However, current registrants who do not need to file an amendment before their annual update will not complete the new sections until their 2018 annual update.[3]

If you have any questions concerning this memorandum, please reach out to your regular firm contact or the following authors:

WASHINGTON DC

Robin M. Bergen
T: +1 202 974 1514
rbergen@cgsh.com

Meghan A. Irmler
T: +1 202 974 1808
mirmler@cgsh.com

2000 Pennsylvania Avenue, NW
Washington, DC 20006-1801
T: +1 202 974 1500
F: +1 202 974 1999

NEW YORK

Richard S. Lincer
T: +1 212 225 2560
rlincer@cgsh.com

One Liberty Plaza
New York, NY 10006-1470
T: +1 212 225 2000
F: +1 212 225 3999

[1] Form ADV and Investment Advisers Act Rules, Rel. No. IA-4509 (Aug. 25, 2016), available at https://www.sec.gov/rules/final/2016/ia-4509.pdf.

[2] Amendments to Form ADV and Investment Advisers Act Rules, Rel. No. IA-4091 (May 20, 2015), available at https://www.sec.gov/rules/proposed/2015/ia-4091.pdf (the "Proposal").

[3] Advisers are required to file an annual ADV update 90 days after the end of their fiscal year; for advisers on a calendar fiscal year this is March 31, 2018. See Form ADV, General Instruction 4.

Form ADV – Umbrella Registration

— The Form ADV Amendments formalize and harmonize a single method of group registration for multiple advisers who conduct a single private fund advisory business. Currently, advisory complexes have taken different approaches to registering affiliated advisers.

- The SEC staff originally permitted group registration in a 2012 no-action letter to the American Bar Association Business Law Section (the "2012 ABA Letter") despite the fact that Form ADV was designed for registration of a single adviser. The amendments to the Form accommodate multiple advisers in a clearer format while incorporating the same criteria for umbrella registration as the 2012 ABA Letter:[4]
  - The "filing adviser" and one or more "relying advisers" must conduct a single private fund advisory business and each relying adviser must be controlled by or under common control with the filing adviser.
  - All of the advisers in the group must advise only private funds and "qualified clients" (as defined under Rule 205-3 under the Advisers Act) that are eligible to invest in private funds and pursue investment objectives substantially similar to the private funds.
  - The filing adviser must have its principal office and place of business in the United States. All relying advisers must be subject to examination by the SEC and have their advisory activities with each client (regardless of whether the relying adviser or client is a U.S. person) be subject to the Advisers Act.
  - The relying advisers and their employees must also be "person[s] associated with" (as defined in Section 202(a)(17) of the Advisers Act) the filing adviser, and each adviser in the group must operate under a single code of ethics and compliance program administered by the same chief compliance officer.[5]
- The Form ADV Amendments confirm that umbrella registration is an accepted practice but is not mandatory.
- Notably, the SEC declined to expand the "umbrella" concept as requested by some commenters to filing advisers with their principal place of business outside the United States or to exempt reporting advisers ("ERAs") who file Form ADV pursuant to registration exemptions for certain venture capital and private fund advisers. Related ERAs that conduct a single private fund advisory business must each file their own Form ADV.
- The Form ADV Amendments add a new Schedule R to Part 1A that the filing adviser must complete for each relying adviser registered on its Form. Schedule R requires,[6] for each relying adviser:
  - Identifying information including their address, CRD, and unique identifier numbers;
  - Basis for SEC registration; and
  - Ownership information about each relying adviser, including the form of organization

[4] See 2012 ABA Letter, available at http://www.sec.gov/divisions/investment/noaction/2012/aba011812.htm.

[5] The 2012 ABA Letter also included a requirement that relying advisers be listed on Section 1.B., Schedule D with a notation of "relying adviser", but this requirement is superseded by new Schedule R. All references to "Section", "Part", "Item", and "Schedule" refer to Form ADV unless otherwise noted.

[6] The information the SEC will require for relying advisers on Schedule R is a subset of the information to be required by filing advisers on Form ADV.

of each relying adviser and a list of control persons, if any.

- Schedule R will allow for more transparency regarding the ownership and advisory business of each relying adviser and how it qualifies for SEC registration.[7]
- The Amendments add a question to Section 7.B.(1) of Schedule D that will require the filing adviser to identify which adviser(s) registered on the Form manage or sponsor each private fund reported in Section 7.B.(1). Currently, Form ADV requires advisers to identify and provide information on each private fund client but because the Form was designed for one adviser, it does not match each fund to its respective adviser(s). This newly requested information will allow the SEC to better understand the structure of the advisory business as a whole.

Form ADV – Information on Separately Managed Accounts

— The Form ADV Amendments to Item 5 and Schedule D of Form ADV are designed to collect more information on separately managed accounts,[8] on which very little information is currently collected. Generally, the Amendments require information on separately managed accounts that is analogous to the information currently collected with respect to private funds on Form PF. Currently, in Item 5 of Part 1A, advisers provide information about their advisory business including percentages of types of clients and assets managed for those clients. Under the Amendments, advisers that have any regulatory assets under management ("R-AUM") attributable to separately managed accounts must answer one to three new subsections in Section 5 of Schedule D (Sections 5.K.(1), 5.K.(2) and 5.K.(3)) regarding those accounts, including types of assets held and use of derivatives and borrowings in the accounts. Subadvisers to separately managed accounts must provide the requested information even if the main adviser also does but only with respect to the portions of the accounts they subadvise.

- Asset Categories: The Amendments require advisers to report annually the approximate percentage of separately managed account R-AUM invested in twelve broad asset categories (rather than ten as in the Proposal).[9] For advisers with at least $10 billion R-AUM held in separately managed accounts, the Amendments require reporting this information annually with mid-year and year-end data; advisers with less than $10 billion R-AUM in separately managed accounts must report only year-end data. Advisers need not look through

[7] Although implicit in the 2012 ABA Letter criteria, the requirement on Schedule R to affirmatively assert a basis for SEC registration for each relying adviser will force advisers to more carefully time the registration of newly formed relying advisers until they are within 120 days of having assets under management of at least $100 million. However, as was the case before umbrella registration, would-be relying advisers that control, are controlled by, or are under common control with, an SEC-registered adviser, and who share the same principal office and place of business with that adviser will be eligible for SEC registration under Rule 203A-2(b) even if their assets are below the SEC threshold.

[8] For purposes of reporting on Form ADV, the SEC considers separately managed accounts to be advisory accounts other than those that are pooled investment vehicles (including, but not limited to, private funds).

[9] The full list of twelve categories includes: Exchange-Traded Equity Securities, Non-Exchange-Traded Equity Securities, U.S. Government/Agency Bonds, U.S. State and Local Bonds, Sovereign Bonds, Corporate Bonds - Investment Grade, Corporate Bonds - Non-Investment Grade, Derivatives, Securities Issued by Registered Investment Companies or Business Development Companies, Securities Issued by Pooled Investment Vehicles (other than Registered Investment Companies), Cash and Cash Equivalents, and Other. See Form ADV Amendments; Amendments to Form ADV and Investment Advisers Act Rules, 80 Fed. Reg. 33,718 app. D at 33,808 (June 12, 2015). The Form ADV Amendments instruct advisers to use their own methodologies—as long as they are applied consistently—to determine whether an asset falls into a category and not to double count assets that may fit more than one category.

investments in funds or ETFs to report the types of underlying assets.

- Reporting on borrowings and derivatives:[10] The Amendments include a tiered reporting scheme with $500 million and $10 billion thresholds, rather than $150 million and $10 billion thresholds as in the Proposal.
  - **All advisers** to separately managed accounts must report in new Section 5.K.(1) the percentage of separately managed account R-AUM that is held in derivatives.[11]
  - **Advisers with at least $500 million but less than $10 billion** R-AUM in separately managed accounts must report the dollar amount of borrowings attributable to assets corresponding to three levels of gross notional exposure[12] (rather than four levels, as proposed) in those accounts. The adviser may (but is not required to) exclude any separately managed account representing less than $10 million in R-AUM in compiling the borrowings data. In addition, the SEC declined to adopt as proposed a requirement to report the number of separately managed accounts represented in each category of gross notional exposure in order to help preserve confidentiality.
  - **Advisers with $10 billion** or more in separately managed account R-AUM must report the information requested for advisers over the $500 million threshold as described above, as well as derivative exposures in these accounts for each of six different categories of derivatives.[13] As part of their annual Form ADV amendment filing, these advisers will be required to report both mid-year and year-end data.
- Custodians Accounting for 10 percent: The Amendments require advisers to identify any custodian that holds at least ten percent of separately managed account R-AUM, and the amount of the adviser's R-AUM attributable to separately managed accounts held at the custodian. This information is in line with information that is already required to be reported on custodians holding private fund assets in Section 7.B. of Schedule D.

Form ADV – Other Key Changes

— The SEC made a number of amendments to existing questions on Form ADV including the following key changes:

- Adviser Identifying Information (Item 1):
  - All websites and all accounts on social media platforms that are publicly available and on which the adviser controls the content (a more narrowly tailored set of social media accounts than in the Proposal).
  - Whether the adviser's chief compliance officer is employed or compensated by any other person (i.e., outsourced) and the identity of the other person employing or compensating the chief compliance officer (unless the other person is a related person of the adviser or a registered investment company advised by the adviser).
  - Total number of offices at which the adviser conducts its investment advisory business and, with regard to each of the largest 25 offices of the adviser, the number of employees who perform advisory functions, the activities conducted (from a list of

[10] As in the Proposal, advisers need not report on securities lending or repurchase agreements in separately managed accounts.

[11] See the list of asset categories above, which includes derivatives.

[12] The three categories are (i) less than 10%, (ii) 10-149%, and (iii) 150% or more. In this Item, "gross notional exposure" is defined as 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 R-AUM of the account.

[13] As with Form PF, the new Form ADV will not define "derivative".

securities-related activities), and a description of any other investment-related business conduct. Unlike other Item 1 information, which must be updated promptly if it becomes inaccurate, this information need only be updated annually.

- Range, if over $1 billion, of the adviser's balance sheet assets (not R-AUM) that corresponds with ranges in a current proposal regarding incentive-based compensation arrangements. Currently, advisers check a box (Item 1.O.) to report if assets exceed $1 billion. [14]

- Client Information (Item 5):
  - Number (rather than a range) of advisory clients in certain categories (though, in contrast to the Proposal, the adviser can check a fewer-than-five box for all categories other than investment companies, business development companies, and other pooled investment vehicles in which the adviser has under five clients, to help preserve confidentiality) and R-AUM attributable to each client type.
  - Number of advisory clients for whom no R-AUM are attributable.
  - Approximate amount of R-AUM attributable to non-U.S. clients.
  - Whether ownership of private fund clients that are 3(c)(1) funds is limited to qualified clients, as defined in Rule 205-3 under the Advisers Act. The Proposal would have required approximate *percentages* of ownership of private funds by qualified clients for all private fund clients of the adviser (*i.e.*, including 3(c)(7) funds, but these funds are already limited by their terms to qualified purchasers).
  - Wrap fee programs: Additions to Item 5.I. of Form ADV require an adviser to report the total amount of R-AUM attributable to acting as a sponsor or portfolio manager of a wrap fee program.

Performance Advertising Recordkeeping Amendments

— The SEC also made two amendments under the Books and Records Rule relating to communications or advertisements including performance or rates of return.

- An amendment to Rule 204-2(a)(7) requires an adviser to retain any written communication sent or received related to the performance or rate of return of any managed accounts or securities recommendation. Currently, Rule 204-2(a)(7) requires retention of only the following written communications sent or received: (i) recommendations or advice, (ii) receipt, disbursement or delivery of funds or securities, and (iii) placing or execution of purchase and sell orders.
- An amendment to Rule 204-2(a)(16) requires advisers to make and keep supporting documentation for performance calculations or rates of return used in any communication that advisers circulate or distribute, directly or indirectly to *any* person. Currently the rule requires that advisers maintain records supporting performance claims in communications that are distributed or circulated *to ten or more persons*.

— The stated goal of the amendments to Rule 204-2 is to facilitate the examination and evaluation of performance claims to detect fraudulent or misleading performance claims.

…

CLEARY GOTTLIEB

[14] See Incentive Based Compensation Arrangements, Release No. 34-77776; IA-4383 (May 6, 2016), available at https://www.sec.gov/rules/proposed/2016/34-77776.pdf.