

# SEC PROPOSES RULES FOR REPORTING SEPARATELY MANAGED ACCOUNTS ON FORM ADV AND REVISED RECORDKEEPING RULES

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## Investment Management Alert

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On May 20, 2015, the U.S. Securities and Exchange Commission ("SEC") proposed amendments to Part 1A of Form ADV in three areas: to collect information regarding separately managed accounts ("SMAs") and additional information regarding registered investment advisers; to incorporate "umbrella" registration for private fund advisers; and to make clarifying, technical and other amendments to existing instructions.<sup>[1]</sup> Additionally, the SEC proposed several amendments to Rule 204-2 under the U.S. Investment Advisers Act of 1940, as amended ("Advisers Act"), the books and records rule, as well as technical amendments to rules under the Advisers Act to remove transition provisions that are now irrelevant. The SEC is not proposing changes to Part 2 of Form ADV at this time. Simultaneous with the Proposing Release, the SEC proposed amendments to the U.S. Investment Company Act of 1940, as amended, intended to modernize the reporting and disclosure of information by registered investment companies, as found here: <https://www.sec.gov/rules/proposed/2015/33-9776.pdf>.

Comments to the SEC's proposed amendments are due 60 days after the Proposing Release is published in the Federal Register, which at this writing has not yet occurred.

## I. PROPOSED AMENDMENTS TO FORM ADV

### A. Information Regarding Separately Managed Accounts

The SEC's proposed amendments to Part 1A of Form ADV include items intended to collect more information about each adviser's SMAs.<sup>[2]</sup> The amendments are intended to help the SEC make risk assessments with respect to SMAs and their investment advisers. Under the proposal, a "separately managed account" is an advisory account that is not a pooled investment vehicle (i.e., a registered investment company, business development company or private fund<sup>[3]</sup>). Under the proposed amendments, a new Item 5.K.(1) would be added to Item 5 of Part 1A, asking advisers if they have regulatory assets under management ("RAUM") attributable to SMAs. If so, the adviser will be required to complete additional questions in Item 5.K. of Part 1A and accompanying disclosure in Schedule D. The information collected would be based on the amount of the adviser's RAUM attributable to SMAs and the value of those accounts, as follows:

- All advisers would be required to report annually the approximate percentage of RAUM attributable to SMAs invested in ten broad asset categories, such as exchange-traded equity securities and U.S. government/agency bonds. Definitions of asset categories included in the revised Glossary to Proposed Form ADV are consistent with those in Form PF.

- Advisers with at least \$10 billion in RAUM attributable to SMAs would provide annually both midyear and year-end data.<sup>[4]</sup>
- All advisers to SMAs would be required to report the percentage of SMA assets held in derivatives.
  - Advisers with at least \$150 million but less than \$10 billion in RAUM attributable to SMAs would be required to report the number of SMAs that correspond to certain categories of gross notional exposure and the weighted amount of borrowings, expressed as a percentage of net asset value, in those SMAs.<sup>[5]</sup>
  - In addition to the reporting described in the bullet point above, advisers with at least \$10 billion in RAUM attributable to SMAs would also be required to report the weighted average gross notional value of derivatives, expressed as a percentage of the net asset value, in each of six different categories of derivatives.<sup>[6]</sup>
  - The reporting in the two bullet points above is solely with respect to an SMA with a net asset value of at least \$10 million.
- Advisers would be required to identify any custodians that account for at least 10% of RAUM attributable to SMAs and the amount of RAUM attributable to SMAs held at such custodian.<sup>[7]</sup>

The SEC requests comment on a variety of topics with respect to the above items, including whether: (1) the \$10 million, \$150 million and \$10 billion thresholds are appropriate; (2) the investment strategies used in SMAs should be reported as opposed or in addition to asset types; (3) a definition of "derivatives" would be helpful and, if so, a proposed definition; (4) gross notional exposures and values are the appropriate measures of the use of derivatives; (5) the 10% threshold is appropriate with respect to custodians; and (6) the SEC should require advisers to report information about the use of securities lending and repurchase agreements in SMAs.

## **B. Information Regarding an Adviser's Business and Affiliations**

The SEC is proposing to add several new questions and amend existing questions on Form ADV regarding an adviser's identifying information, advisory business and affiliations. The changes are designed to enhance the SEC's understanding of investment advisers and aid the SEC in its risk-based examination program. They would:

- Require an adviser to provide all of its Central Index Key numbers ("CIK Numbers"), if applicable, rather than solely an adviser's CIK Number as a public reporting company under Sections 12 or 15(d) of the Securities Exchange Act of 1934.
- In addition to providing the adviser's website address in Schedule D, require an adviser to disclose its websites for social media platforms (e.g., Twitter, Facebook and LinkedIn), if applicable.
- Require that an adviser provide the total number of offices at which the adviser conducts investment advisory business and provide information in Schedule D about the 25 largest offices (measured by number of employees), including each office's CRD branch number, if applicable, the number of employees performing advisory functions from each office and a description of any other investment-related business activities conducted from each office.
- In addition to providing the name and contact information for the adviser's chief compliance officer ("CCO"), require an adviser to disclose whether the CCO is compensated or employed by any person

other than the adviser (or a related person of the adviser) for providing CCO services and, if so, report the name and Internal Revenue Service Employer Identification Number, if any, of that employer.

- Require an adviser to report its own assets within a range, rather than simply indicate if it has assets of \$1 billion or more as is required under Part 1A of the current Form ADV.<sup>[8]</sup>
- Require an adviser to report the number of clients and amount of RAUM attributable to each category of clients as of the date the adviser determines its RAUM.<sup>[9]</sup> ftn9
- Require an adviser to report on the number of clients for whom an adviser provided advisory services, although the assets of such clients do not count toward the adviser's RAUM because, for example, the adviser provides advice on a nondiscretionary basis.
- An adviser that elects to report client assets in Part 2A of Form ADV differently from the RAUM the adviser reports in Part 1A of Form ADV would be required to check a box noting that election.
- Require an adviser to report on the approximate amount of an adviser's RAUM attributable to non-U.S. clients<sup>[10]</sup> in addition to the current requirement that each adviser report the percentage of its clients that are non-U.S. persons.
- Require an adviser to report RAUM of all "parallel managed accounts" related to a registered investment company or business development company that is advised by the adviser.<sup>[11]</sup>
- Rather than simply identifying itself as a sponsor of or portfolio manager for a wrap fee program and listing the name and sponsor of each wrap fee program for which an adviser serves as portfolio manager, advisers would be required to report the total amount of RAUM attributable to acting as a sponsor and/or portfolio manager of a wrap fee program and provide any SEC File Number and CRD Number for sponsors to those wrap fee programs.<sup>[12]</sup>
- Require an adviser to provide identifying numbers (e.g., Public Company Accounting Oversight Board ("PCAOB") registration numbers and CIK Numbers) in several questions.
- Require an adviser to report the percentage of a private fund owned by qualified clients, as defined in rule 205-3 under the Advisers Act.

With respect to the proposed changes described in the bullet points above, the SEC is seeking comment with respect to a number of topics, including whether: (1) the SEC should ask an adviser if it permits employees to have social media accounts associated with the adviser's business and, if so, should the adviser be required to identify the number or percentage of employees that have such accounts; (2) there are concerns related to disclosure of information regarding outsourced CCOs and, if so, the nature of such concerns; (3) an adviser should be asked whether it uses third-party compliance auditors; and (4) there are concerns with providing information on the number of clients the assets of which do not contribute toward an adviser's RAUM, the RAUM attributable to non-U.S. clients or an adviser's parallel managed accounts.

### C. Umbrella Registration

In the Proposing Release, the SEC notes that the current Form ADV, designed for registration by a single legal entity, limits the current staff guidance for filing Form ADV on behalf of multiple entities.<sup>[13]</sup> The SEC is proposing

amendments to make umbrella registration available where a filing adviser and one or more relying advisers conduct a single private fund advisory business and each relying adviser is controlled by or under common control with the filing adviser, such that the private fund adviser is operating as a single business unit through multiple legal entities.<sup>[14]</sup> The conditions for an adviser to avail itself of umbrella registration are the same as those in the SEC staff's guidance.<sup>[15]</sup>

A filing adviser availing itself of umbrella registration would be required to file and update a single Form ADV (Parts 1 and 2) that takes into account all information about the filing adviser and each relying adviser. Additionally, the filing adviser must include this same information in any other reports required under the Advisers Act, such as Form PF. Instructions to proposed Form ADV would specify which questions should be answered by the filing adviser and those that also apply to its relying adviser(s).<sup>[16]</sup> Finally, definitions for "filing adviser," "relying adviser" and "umbrella" registration would be added to the Glossary.<sup>[17]</sup>

Additionally, a new proposed schedule -- Schedule R to Part 1A -- would have to be filed for each relying adviser.<sup>[18]</sup> Schedule R would require identifying information, basis for SEC registration, form of organization and ownership information about each relying adviser.<sup>[19]</sup> Finally, the filing adviser or relying adviser, as appropriate, would be identified as advising the private funds reported on in Section 7.B.(1) of Schedule D.

The SEC requests comments regarding its proposals with respect to umbrella registration, including whether: (1) umbrella registration should be required (the Proposing Release does not require it; it just permits it); (2) the categories of investment advisers eligible to take advantage of umbrella registration should be expanded (e.g., not only advisers primarily to private funds); and (3) the volume of information about a filing adviser and its relying adviser(s) is appropriate.

#### **D. Proposed Clarifying, Technical and Other Amendments to Form ADV**

The Proposing Release identifies a number of items in Part 1A of Form ADV that should be clarified, based on the questions the SEC staff receives on a regular basis. The proposed amendments are intended to make the filing process easier and more understandable. Among them are the following:

- The addition of text to Item 7.B. clarifying that Section 7.B.(1) of Schedule D should not be completed if another SEC-registered adviser or SEC exempt reporting adviser reports the information.
- The deletion of question 10 in Section 7.B.(1) of Schedule D that asks the adviser to identify the category of the private fund with reference to the underlying funds in the case of a fund of funds, in order to provide consistency with Form PF, which permits advisers to disregard any private fund's equity investment in other private funds.<sup>[20]</sup>
- The addition of text to Question 19 in Section 7.B.(1) of Schedule D to clarify that feeder funds should not be considered clients of the adviser when answering whether the adviser's clients are solicited to invest in the private fund.
- Clarification of Question 21 in Section 7.B.(1) of Schedule D to ask if the private fund has ever relied on an exemption from registration of its securities under Regulation D, so the SEC will receive the Form D file numbers.
- Revisions to Item 8.H. of Part 1A to break out compensation paid to nonemployees for client referrals versus compensation paid to employees for client referrals in addition to the employees' salaries.

- The addition of text to ask for the PCAOB registration number of the adviser's independent public accountant in Section 9.C. of Schedule D.

The SEC asks for comments regarding the clarifications described in the above bullet points, including whether: (1) the proposed amendments are necessary; (2) additional amendments should be considered; and (3) the proposed language is ambiguous.

## II. PROPOSED AMENDMENTS TO INVESTMENT ADVISERS ACT RULES

### Proposed Amendments to Books and Records Rule

The SEC is proposing two amendments to Rule 204-2 under the Advisers Act that would require investment advisers to maintain certain materials related to the calculation and distribution of performance information. The purpose of the amendments is to provide the SEC examination staff with additional information in reviewing advisers' compliance with Rule 206(4)-1 and the SEC's enforcement of such rule in cases of fraudulent advertising.

First, the proposed amendments would remove the 10-person threshold for the requirement that an adviser make and preserve records containing performance information necessary to support performance claims when a communication regarding such performance is made to 10 or more persons. Rather, advisers would be required to maintain the materials set forth in Rule 204-2(a)(16)<sup>[21]</sup> with respect to the calculation of performance or rate of return communicated to anyone.

Second, the SEC proposes to amend Rule 204-2(a)(7) to require advisers to maintain originals of all written communications received and copies of written communications sent by an investment adviser relating to the performance or rate of return of any or all managed accounts or securities recommendations.<sup>[22]</sup>

The SEC requests comments on whether: (1) advisers currently maintain these records or it would be difficult to maintain them; and (2) there are other means by which the SEC could collect similar information.

### Proposed Technical Amendments to Advisers Act Rules

The SEC is also proposing to make technical amendments that would eliminate certain transition periods that have expired.

Please contact the following attorneys or your regular K&L Gates attorney if you have questions about this Alert.

Please note that the SEC has proposed additional changes which would affect registered funds. To read our alert on these proposed changes, [click here](#).

#### Notes:

<sup>[1]</sup> Amendments to Form ADV and Investment Advisers Act Rules, Release No. IA-4091 (May 20, 2015), available at <http://www.sec.gov/rules/proposed/2015/ia-4091.pdf> (the "Proposing Release").

<sup>[2]</sup> It is not clear whether the SEC considers a "fund of one" a separately managed account.

[3] Part 1A of Form ADV defines a "private fund" as "[a]n issuer that would be an investment company as defined in section 3 of the Investment Company Act of 1940 but for section 3(c)(1) or 3(c)(7) of that Act." It is the same definition used in Form PF filed quarterly or annually by advisers to private funds.

[4] The SEC notes that it is not proposing that advisers file information semiannually. Rather, when filing its annual amendment, an adviser with \$10 billion in RAUM attributable to SMAs would be required to provide information as of each semiannual period. See the Proposing Release at page 12.

[5] "Gross notional value" is defined as "[t]he gross nominal or notional value of all transactions that have been entered into but not yet settled as of the reporting date. For contracts with variable nominal or notional principal amounts, the basis for reporting is the nominal or notional principal amounts as of the reporting date. For options, use delta adjusted notional value."

"Borrowings" is defined as "[s]ecured borrowings and unsecured borrowings, collectively. Secured borrowings are obligations for borrowed money in respect of which the borrower has posted collateral or other credit support and should include any reverse repos (i.e., any sale of securities coupled with an agreement to repurchase the same (or similar) securities at a later date at an agreed price). Unsecured borrowings are obligations for borrowed money in respect of which the borrower has not posted collateral or other credit support."

"[N]et asset value" is defined as, "[w]ith respect to any client, the gross assets of the client's accounts minus any outstanding indebtedness or other accrued but unpaid liabilities." See the Proposing Release at footnote 17.

These definitions are consistent with the definitions of "gross notional value," "borrowings" and "net asset value" in Form PF.

[6] The six categories of derivatives are: interest rate derivatives, foreign exchange derivatives, credit derivatives, equity derivatives, commodity derivatives and other derivatives. See the proposed Schedule D to Part 1A of Form ADV.

[7] The information provided would be with respect to all custodians, not solely qualified custodians. Accordingly, the information would not be duplicative of the information provided in Item 9.F. of Part 1A.

[8] Proposed Form ADV, Part 1A, Item 1.O. The SEC is also proposing to move the instruction for how to report assets in Item 1.O. from the Instructions for Part 1A to Item 1.O. in order to emphasize the instruction.

[9] Proposed Form ADV, Part 1A, Item 5.D.(1)-(2). The categories of clients are the same as those currently in Item 5.D. of Form ADV, except "sovereign wealth funds and foreign official institutions" would be added as a client category, state or municipal government entities would specifically include government pension plans, and pension and profit sharing plans would specifically exclude government pension plans.

[10] Proposed Form ADV, Part 1A, Item 5.F.(3). The Glossary to Form ADV provides that "United States person" has the same meaning as in rule 203(m)-1 under the Advisers Act.

[11] Proposed Form ADV, Part 1A, Section 5.G.(3) of Schedule D. The definition of "parallel managed account" in the Glossary to Proposed Form ADV is "[w]ith respect to any registered investment company or business development company, a parallel managed account is any managed account or other pool of assets that you advise and that pursues substantially the same investment objective and strategy and invests side by side in substantially the same positions as the identified investment company or business development company that you advise." It is the same definition of "parallel managed account" used in Form PF with respect to private funds.

[12] Proposed Form ADV, Part 1A, Item 5.I. and Section 5.I.(2) of Schedule D. The definition of "wrap fee program" is expected to stay the same as it is in the Glossary to the current Form ADV, "[a]ny advisory program under which a specified fee or fees not based directly upon transactions in a client's account is charged for investment advisory services (which may include portfolio management or advice concerning the selection of other investment advisers) and the execution of client transactions."

[13] Section 403 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010) (the "Dodd-Frank Act") repealed the private adviser exemption that used to be in section 203(b)(3) of the Advisers Act, which provided an exemption from registration for any investment adviser if the adviser (i) had fewer than 15 clients in the preceding 12 months; (ii) did not hold itself out to the public as an investment adviser and (iii) did not act as an investment adviser to a registered investment company or a company that elected to be a business development company.

In American Bar Association, Business Law Section, SEC Staff Letter (Jan. 19, 2012), *available at* <http://www.sec.gov/divisions/investment/noaction/2012/aba01182.htm> (the "2012 ABA Letter"), the SEC staff provided guidance to private fund advisers regarding umbrella registration within the confines of the current form. Currently, a filing adviser reports in its Form ADV (Miscellaneous Section of Schedule D) that it and its relying adviser(s) are together filing a single Form ADV in reliance on the 2012 ABA Letter and identifies each relying adviser in a separate Section 1.B., Schedule D, of Form ADV, by noting "relying adviser."

[14] The SEC notes that the filing of a single Form ADV for exempt reporting advisers in a manner similar to the filing of an umbrella registration for registered advisers would not be available because certain requirements applicable to registered investment advisers do not apply to exempt reporting advisers, such as the requirement for compliance policies and procedures and code of ethics under rules 206(4)-7 and 204A-1 of the Advisers Act, respectively. An exempt reporting adviser qualifies for exemption from registration as an investment adviser under section 203(l) of the Advisers Act because it is an adviser solely to one or more venture capital funds, or under rule 203(m)-1 of the Advisers Act because it is an adviser solely to private funds and has assets under management in the United States of less than \$150 million. See Form ADV Glossary.

[15] The conditions set forth in the 2012 ABA Letter are:

1. The filing adviser and each relying adviser only advise private funds and clients in SMAs that are parallel managed accounts to those private funds and such SMA clients are qualified clients (as defined in rule 205-3 under the Advisers Act) or otherwise eligible to invest in those private funds;
2. The filing adviser has its principal office and place of business in the United States;
3. Each relying adviser, its employees and the persons acting on its behalf are "persons associated with" the filing adviser (as defined in section 202(a)(17) of the Advisers Act);
4. The advisory activities of each relying adviser are subject to the Advisers Act and examination by the SEC; and
5. The filing adviser and each relying adviser operate under a single code of ethics and set of written policies and procedures, adopted in accordance with rules 204A-1 and 206(4)-7 of the Advisers Act, respectively, and administered by a single CCO.

[16] See, e.g., statements added to proposed Form ADV, Instructions and Part 1A, Items 1, 2, 3, 7, 10 and 11.

[17] "Filing Adviser" would mean: "[a]n investment adviser eligible to register with the SEC that files (and amends) a single umbrella registration on behalf of itself and each of its relying advisers."

"Relying Adviser" would mean: "[a]n investment adviser eligible to register with the SEC that relies on a filing

adviser to file (and amend) a single umbrella registration on its behalf."

"Umbrella Registration" would mean: "[a] single registration by a filing adviser and one or more relying advisers who collectively conduct a single advisory business and that meet the conditions set forth in General Instruction 5." See Proposed Form ADV Glossary.

[18] Proposed Form ADV, Part 1A, Item 1.B.(2).

[19] Categories that would make a relying adviser ineligible for umbrella registration, such as serving as an adviser to a registered investment company, would not be available as a basis for SEC registration on proposed Schedule R to Part 1A of Form ADV.

[20] Proposed Form ADV, Part 1A, Section 7.B.(1) of Schedule D, Question 10. See also General Instruction 7 to Form PF.

[21] Rule 204-2(a)(16) under the Advisers Act requires advisers to make and keep "[a]ll accounts, books, internal working papers, and any other records or documents that are necessary to form the basis for or demonstrate the calculation of the performance or rate of return of any or all managed accounts or securities recommendations in any notice, circular, advertisement, newspaper article, investment letter, bulletin or other communication that the investment adviser circulates or distributes, directly or indirectly, to 10 or more persons (other than persons connected with such investment adviser); provided, however, that, with respect to the performance of managed accounts, the retention of all account statements, if they reflect all debits, credits, and other transactions in a client's account for the period of the statement, and all worksheets necessary to demonstrate the calculation of the performance or rate of return of all managed accounts shall be deemed to satisfy the requirements of this paragraph."

[22] Rule 204-2(a)(7) currently requires advisers to make and keep: "Originals of all written communications received and copies of all written communications sent by such investment adviser relating to (i) any recommendation made or proposed to be made and any advice given or proposed to be given, (ii) any receipt, disbursement or delivery of funds or securities, or (iii) the placing or executing of any order to purchase or sell any security."

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