

# Client Alert

---

September 6, 2016

## The SEC Adopts Amendments to Form ADV and Recordkeeping Rule: Advisers Now Required to Disclose Information About Separately Managed Accounts

By Kelley A. Howes, Jay G. Baris and Eric Requenez

### OVERVIEW

The Securities and Exchange Commission (SEC) recently amended Form ADV to require investment advisers to disclose more information about their separately managed account business, aggregate data related to the use of borrowings and derivatives, and disclose information about other aspects of their advisory business, including branch office operations and the use of social media. The amendments also streamline registration and reporting for “umbrella registrations” made by groups of private fund advisers operating a single advisory business.

The SEC also adopted amendments to the books and records requirements under the Investment Advisers Act of 1940 (the “Advisers Act”) to require advisers to maintain additional records related to the calculation and distribution of performance information.

The SEC said that the new information required in Form ADV and in the new books and records rules will “improve the depth and quality of information that [it collects] on investment advisers, facilitate [its] risk monitoring initiatives and assist [its] staff in its risk-based examination program.” The SEC also believes the enhanced records regarding calculation of performance information could reduce the incidence of misleading or fraudulent advertising and communications by advisers.

### SEPARATELY MANAGED ACCOUNTS

The amendments to Form ADV will require advisers to report more information about their separately managed accounts. The SEC did not define “separately managed accounts” but noted that it considers such accounts to be advisory accounts other than those that are pooled investment vehicles, including (i) investment companies; (ii) business development companies; and (iii) other pooled investments vehicles that are not registered (such as private funds). Among other things, advisers will be required to provide information on an aggregate basis regarding their separately managed accounts, including the types of assets held and the use of derivatives and borrowings in such accounts. Sub-advisers to separately managed accounts are required to provide information only about the portion of the account that they sub-advise.

### Disclosure of Asset Classes

The amended Form ADV will require advisers to report, on an annual basis, the aggregate separate account investments in 12 identified categories of investments:

1. exchange traded equity securities;
2. non-exchange traded equity securities;

# Client Alert

---

3. U.S. government/agency bonds;
4. U.S. state and local bonds;
5. sovereign bonds;
6. investment grade corporate bonds;
7. non-investment grade corporate bonds;
8. derivatives;
9. securities issued by registered investment companies or business development companies;
10. securities issued by pooled investment vehicles (other than registered investment companies or business development companies);
11. cash and cash equivalents; and
12. other.

Advisers will be permitted to use internal methodologies and conventions of their service providers to determine how to categorize assets within the 12 identified categories, as long as such methodologies are consistently applied and consistent with information the advisers report internally and to current and prospective clients. The SEC acknowledged that permitting advisers such flexibility could result in different advisers categorizing the same or similar assets differently as a result of different methodologies.

Advisers with at least \$10 billion in regulatory assets under management (RAUM) held in separately managed accounts will provide information as of two dates—mid-year and year end. Advisers with less than \$10 billion of RAUM will report information only as of year end.

## **Disclosure of Derivatives and Borrowing**

The revised Form ADV requires advisers to report derivative transactions and borrowings using “gross notional value” and “gross notional exposure.” Gross notional exposure includes borrowings and the gross notional value of derivatives. The definition of “gross notional value” specifies how derivatives are measured when determining an account’s gross notional exposure.

Advisers with at least \$500 million but less than \$10 billion in separately managed account RAUM will be required to report the amount of such RAUM and the dollar amount of borrowings attributable to those assets that correspond to three levels of gross notional exposures ((i) less than 10%; (ii) 10–149%; and (iii) 150% or more).

Advisers with at least \$10 billion in separately managed account RAUM will be required to report this information and also report on derivative exposures across six categories of derivatives in individual accounts of at least \$10 million:

1. interest rate;
2. foreign exchange;
3. credit;

# Client Alert

4. equity;
5. commodity; and
6. other.

The SEC acknowledged that it received many comments regarding the use of gross notional metrics because it “may not always reflect the way in which derivatives are used in a separately managed account and are not a risk measure.” The SEC noted, however, that if advisers believe that gross notional metrics are misleading, they can provide additional narrative related to how they use derivatives in separately managed accounts. In crafting any such disclosure related to the use of derivatives, advisers should consider that Section 207 of the Advisers Act prohibits omission of material facts in a Form ADV filed with the SEC.

## **Disclosure Regarding Custodians Holding Ten Percent (10%) or More of an Adviser’s Separately Managed Account RAUM.**

The revised Form ADV requires advisers to identify custodians that hold at least ten percent of an adviser’s separately managed account RAUM. Advisers are required to disclose the amount of such RAUM held with each such custodian. The SEC said that it intends to use this information in case “a concern is raised about a particular custodian.”

The SEC noted that, since it does not directly regulate all custodians that may hold the assets of separately managed accounts, this disclosure requirement will allow its staff to appropriately monitor the risk that certain custodians may present.

## **ADDITIONAL INFORMATION ABOUT INVESTMENT ADVISERS**

The SEC also amended other sections of Form ADV to require advisers to disclose additional information, including:

- All of its Central Index Key (CIK) numbers, regardless of whether the adviser is a public reporting company or not;
- Its social media presence in addition to its website, including accounts on Twitter, Facebook or LinkedIn, and the address of each of the adviser’s social media pages where the adviser controls the content of the page;
- Expanded information regarding the adviser’s offices other than its principal office and place of business, including the total number of offices from which the adviser conducts its investment advisory business and data regarding the particular business activities conducted at each of its largest 25 offices in terms of the number of employees; such information includes:
  - each office’s CRD branch number (if applicable);
  - the number of employees who perform advisory functions from each office;
  - the business activities conducted from each office (based on a list of securities-related activities); and
  - a description of any other investment-related business conducted from each office;
- Whether the adviser’s chief compliance officer is paid by or employed by a person other than the adviser or a related person of the adviser, including the name and IRS Employer Identification Number of such person;

# Client Alert

- If it has more than \$1 billion in RAUM, the adviser must report such assets in ranges: (i) \$1 billion to less than \$10 billion; (ii) \$10 billion to less than \$50 billion; and (iii) \$50 billion or more;
- The number of the adviser's clients and the amount of RAUM attributable to particular categories of clients;
- The number of clients for whom an adviser provides advisory services but whose assets do not count as RAUM;
- The approximate amount of an adviser's RAUM attributable to clients that are non-U.S. persons;
- The RAUM of parallel managed accounts related to any registered investment company (or series thereof) or business development company managed by the adviser;
- Whether the adviser participates in a wrap fee program, and if so, the total amount of RAUM attributable to the adviser acting as a sponsor or portfolio manager for a wrap fee program and the SEC File Number and CRD Number for sponsors to those wrap fee programs; and
- If the adviser manages private funds that qualify for the Section 3(c)(1) exclusion from the definition of investment company under the Investment Company Act of 1940, it is required to report on whether it limits sales of each such fund to qualified clients as defined in Rule 205-3 under the Advisers Act.

## UMBRELLA REGISTRATION

The amended Form ADV codifies no-action relief that the staff has granted addressing "umbrella registration" of advisers. Under the staff guidance, private fund advisers consisting of a group of related advisers that are "separate legal entities but effectively operate as - and appear to investors and regulators to be - a single advisory business" may file a single umbrella registration for all the legal entities. The conditions for umbrella registration are the same as the conditions set forth in the staff's prior guidance and will be reflected in the instructions to the amended Form ADV. The revised Form ADV includes a new schedule - Schedule R - that requires disclosure for each relying adviser.

Umbrella registration is not mandatory, and private fund advisers can continue to file separate Forms ADV if they choose to do so.

## AMENDMENTS TO THE BOOKS AND RECORDS RULE

Rule 204-2 under the Advisers Act currently requires advisers to maintain records that support performance information included in any communications distributed to 10 or more persons. As amended, the Rule will require advisers to:

- maintain records demonstrating the calculation of performance or rate of return information included in communications distributed, directly or indirectly, to *any* person; and
- maintain originals of all written communications received and copies of written communications sent by an adviser relating to the performance or rate of return of any or all managed accounts or securities recommendations.

The SEC declined to exclude from the new recordkeeping requirements one-on-one communications that are "customized responses" to investors or communications with sophisticated clients.

The new recordkeeping requirements will apply to communications distributed after the compliance date of the new rules. Importantly, the new recordkeeping requirements also apply to communications that include performance even if the performance predates the effective date of the amendments.

# Client Alert

---

## COMPLIANCE DATES

The amendments take effect 60 days after publication in the *Federal Register*, and advisers must comply with the amendments on Oct. 1, 2017. These compliance dates assume that the SEC and FINRA can update the IARD and CRD systems prior to that date.

### Contact:

**Jay G. Baris**

(212) 468-8053

[jbaris@mofo.com](mailto:jbaris@mofo.com)

**Kelley A. Howes**

(303) 592-2237

[khowes@mofo.com](mailto:khowes@mofo.com)

**Eric Requenez**

(212) 336-4138

[erequenez@mofo.com](mailto:erequenez@mofo.com)

**Stephanie C. Thomas**

(415) 268-7586

[stthomas@mofo.com](mailto:stthomas@mofo.com)

**Matthew J. Kutner**

(212) 336-4061

[mkutner@mofo.com](mailto:mkutner@mofo.com)

### About Morrison & Foerster:

We are Morrison & Foerster—a global firm of exceptional credentials. Our clients include some of the largest financial institutions, investment banks, Fortune 100, technology and life science companies. We've been included on *The American Lawyer's* A-List for 13 straight years, and *Fortune* named us one of the "100 Best Companies to Work For." Our lawyers are committed to achieving innovative and business-minded results for our clients, while preserving the differences that make us stronger. This is MoFo. Visit us at [www.mofo.com](http://www.mofo.com).

*Because of the generality of this update, the information provided herein may not be applicable in all situations and should not be acted upon without specific legal advice based on particular situations. Prior results do not guarantee a similar outcome.*