

Legal Risk Management Tip
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HOW THE PROPOSED AMENDMENTS TO FORM ADV AND ADVISERS ACT WILL IMPACT INVESTMENT ADVISERS

The Form ADV is one of the most important documents compiled by an investment adviser. Not only does it serve as the adviser's client disclosure brochure to unveil important information related to the firm's products and service offerings, fees, business practices and related conflicts of interest, but it also serves as a critical tool for the SEC's regulatory program for measuring and analyzing risk for its registrants.

On May 20, 2015, the Securities and Exchange Commission ("SEC" or the "Commission") issued [Release No. IA-4091](#) (the "Release"), which proposes certain amendments to Form ADV in order to obtain additional data related to an adviser's business practices in three broad areas: obtaining information related to separately managed accounts ("SMAs"); streamlining reporting obligations for related advisers to multiple private funds; and amendments clarifying the reporting obligations intended for Form ADV Part 1.¹

In addition, the Release also seeks to amend the Investment Advisers Act of 1940² to include new provisions relating to rule 204-2, the books and records rule,³ which would require registrants to maintain certain performance backup documentation for and written communications relating to performance information presented and circulated by the adviser. With these heightened requirements, it is the Commission's intent to help deter fraudulent performance claims, thereby offering better protections for investors.

This month's Legal Tip highlights some of the most important aspects of the proposed amendments and provides guidance on what comments the Commission seeks.

Proposed Amendments to Form ADV

In an effort to gather more meaningful data to help investors assess an investment adviser and the Commission to monitor industry trends and conduct risk analytics, the SEC is proposing amendments to the following areas.

A. New Information Requests for SMAs

Several of the proposed amendments relate directly to SMAs. For purposes of this amendment, the SEC defines an SMA as "advisory accounts other than those that are pooled investment vehicles."⁴ New information required to be reported would include:

¹ See <https://www.sec.gov/about/forms/formadv-part1a.pdf>.

² See <https://www.sec.gov/about/laws/iaa40.pdf>.

³ See <https://www.law.cornell.edu/cfr/text/17/275.204-2>.

⁴ A pooled investment vehicle would include registered investment companies, business development companies and pooled investment vehicles that are not investment companies, such as private funds.

- Types of SMA assets held;
- Data on SMA regulatory assets under management and the types of accounts⁵ that comprise those assets;
- Use of derivatives and borrowings in SMAs; and
- Information relating to those custodians who custody over 10% of the adviser’s SMA business.

Notably, dependent upon the response provided by the adviser, there could be differing reporting obligations based upon, for example, the regulatory assets under management reported.⁶ The SEC is seeking comments on reporting frequency (i.e., more than on an annual basis) and the thresholds proposed for such reporting.

B. Additional Information Relating to the Investment Adviser and Its Business

The SEC also is proposing to expand its reporting questions within Form ADV Part 1 to include questions related to an adviser’s identification, business and affiliations. This includes the following:

- Providing all Central Index Key (“CIK”) numbers if there is more than one;
- Reporting all social media platform websites⁷ currently in use by the adviser;
- Additional information relating to offices other than the adviser’s principal office;⁸
- Whether the Chief Compliance Officer is associated with or compensated by someone other than the adviser;⁹
- Reporting company assets within a range;
- Expanding Item 5 to include new client information relating to number of clients and amount of regulatory assets under management for each category of client;
- Reporting on the number of clients where the registrant performed an advisory activity but does not have regulatory assets under management;
- Notating if regulatory assets under management reported on Form ADV Part 1A differs from the client assets under management reported on Form ADV Part 2A;
- Reporting regulatory assets under management attributable to non-U.S. clients;
- Providing the regulatory assets under management for each managed account related to an investment company or business development company advised by the registrant; and

⁵ Among other things, collection of this data could help in better understanding whether an adviser specializes in particular asset classes.

⁶ For example, advisers with at least \$10 billion in regulatory assets under management reported for SMAs would have to update certain data on Form ADV Part 1A on both a mid-year and year-end basis. For more information, *see* page 10 of the Release.

⁷ Social media platforms include, for example, Twitter, Facebook and LinkedIn.

⁸ Information collected would include the total number of offices and information about the 25 largest offices based on number of employees. These largest offices would provide additional information on the office’s CRD branch number, number of employees performing advisory functions and business activities conducted from that office. For more information, *see* page 18 of the Release.

⁹ Among other things, this data could be useful in helping to identify outsourced chief compliance officers for purposes of assessing potential risks.

- Reporting the regulatory assets under management attributable to the adviser serving as a portfolio manager or sponsor to a wrap fee program.

Additional information also is being sought related to the identifying numbers of an adviser's financial industry affiliations and service providers, such as Public Company Accounting Oversight Board ("PCAOB") registration numbers and CIK numbers as well as the percentage of private fund clients who are qualified clients.¹⁰

The SEC is seeking comments on the usefulness of such data to investors and the concerns of and burden placed on advisers for providing this information.

C. Availability of Umbrella Registration for Certain Private Fund Advisers

Through amendment of the filing requirements for private fund advisers who are controlled by or under common control with a primary filing adviser, the SEC intends to streamline the reporting process by using an "umbrella registration" technique wherein there would be only one registration filing required for the advisory business. In order to qualify for the umbrella registration, a series of conditions must be met. This includes:

- The filing adviser and each relying adviser must only advise private funds and clients in SMAs that are qualified clients;
- The filing adviser must have its principal office in the U.S., thus subjecting the filing adviser and each relying adviser to the provisions of the Investment Advisers Act of 1940;
- The relying adviser must be associated with and supervised by the filing adviser;
- The relying adviser is subject to SEC examinations; and
- The filing adviser and each relying adviser operates under a single code of ethics¹¹ and written policies and procedures manual.¹²

In addition, as proposed, Form ADV Part 1A would include new identifying information related to the relying adviser, including the relying adviser's address, CRD and other unique identifier numbers, basis for SEC registration and ownership information.

¹⁰ A "qualified client" is defined in rule 205-3 as a natural person who or a company that (1) immediately after entering into the contract, has at least \$1,000,000 under the management of the investment adviser; (2) the investment adviser entering into the contract (and any person acting on his behalf) reasonably believes, immediately prior to entering into the contract, either: (a) has a net worth (together, in the case of a natural person, with assets held jointly with a spouse) of more than \$2,000,000 at the time the contract is entered into; or (b) is a qualified purchaser as defined in section 2(a)(51)(A) of the Investment Company Act of 1940 at the time the contract is entered into; or (3) a natural person who immediately prior to entering into the contract is: (a) an executive officer, director, trustee, general partner, or person serving in a similar capacity, of the investment adviser; or (b) an employee of the investment adviser (other than an employee performing solely clerical, secretarial or administrative functions with regard to the investment adviser) who, in connection with his or her regular functions or duties, participates in the investment activities of such investment adviser, provided that such employee has been performing such functions and duties for or on behalf of the investment adviser, or substantially similar functions or duties for or on behalf of another company for at least 12 months.

¹¹ For more information, see rule 204A-1.

¹² For more information, see rule 206(4)-7.

The SEC is seeking comments on the usefulness of umbrella registration and whether the Commission should amend Form ADV to accommodate for such umbrella registration.

D. Clarifying Amendments to Form ADV Part 1A

Finally, there are a number of proposed amendments to Form ADV Part 1A that are designed to clarify the type of data sought by the Commission for advisory filings. This includes:

- Item 2 – specifying SEC registration eligibility for “newly formed advisers”;
- Item 4 – succession by amendment filings;
- Item 7 – information about financial industry affiliations and advisement to private funds;
- Item 8 – clarifying the types of participation and interest the adviser expects to engage in during the year;
- Section 9.C. of Schedule D – information about independent public accountants that perform surprise examinations in connection with the custody rule; and
- Disclosure Reporting Pages – relating to disciplinary reporting for both registered and exempt reporting advisers.

For more information, including proposed changes to the instructions and glossary related to these areas, please refer to pages 35-44 of the Release.

Proposed Amendments to the Books and Records Rules – Maintenance of Performance Information

Many investment advisers have enacted internal controls whereby the firm routinely maintains backup records to support performance numbers presented within their marketing collateral. The Commission is now proposing amendments to rule 204-2 requiring mandatory maintenance of all materials “that demonstrate the calculation of the performance or rate of return in any communication that the adviser circulates or distributes, directly or indirectly, to any person.”¹³ This means that supporting materials to performance claims communicated to just one person would need to be maintained.

Moreover, under the proposal, advisers also would be required to maintain originals of all written communications sent or received by the adviser relating to performance or rate of return of any or all managed accounts or securities recommendations.¹⁴ Given the fact that performance advertising continues to be an area where the Commission continues to find deficiencies during its examinations, it appears to be the staff’s hope that requiring this additional information will help to mitigate against misleading advertising claims.

Conclusion

Based on our clients’ business models, many of these proposals will have a material impact on their compliance programs. Consequently, investment advisers are strongly encouraged to

¹³ See page 45 of the Release.

¹⁴ *Id.*

review the Release and consider submitting comments related to these proposed changes, taking into consideration the types and amount of information that will be required to be reported. Comments to the proposed rules can be submitted via [form](#), by sending an email to rule-comments@sec.gov or by accessing the [Federal eRulemaking Portal online](#). Comments must be submitted no later than 60 days after publication in the *Federal Register*. For more information on submitted comments to the proposed rules, see <https://www.sec.gov/rules/proposed/2015/ia-4091.pdf>.

For more information on the proposed rule changes and to evaluate how they may impact your advisory firm, please contact us at (619) 298-2880 or at info@jackolg.com.

Author: Michelle L. Jacko, Esq., Managing Partner, Jacko Law Group, PC. JLG works extensively with investment advisers, broker-dealers, investment companies, hedge funds, banks and corporate clients on securities and corporate counsel matters.

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