

# Editorial Advisors Corner: Jacko Law Group Legal Risk Management Tip Private — Equity Reporting on New Form ADV

By Robert Conca, Esq.



**Robert Conca** has over 18 years of experience advising businesses and financial professionals. He has acted both in legal counsel and senior executive capacities for companies spanning all stages of development. From start-ups to established entities, his diverse experience provides a unique background allowing him to understand a client's practical business issues when delivering legal advice. He has extensive experience counseling corporate clients, including SEC and state registered investment advisers and private investment funds, regarding regulatory compliance, regulatory examinations, fund management issues, investment transactions, corporate governance and Board of Directors matters, human resources, and legal and operational strategy.

Over the past few years, private equity compliance has been a focus of the Securities and Exchange Commission's ("SEC") Office of Compliance Inspections and Examination ("OCIE"), and has been the topic of a variety of public speeches and comments from senior SEC personnel.<sup>1</sup> Not surprisingly, private equity advisers have remained a top SEC Examination Priority during that time period.<sup>2</sup>

Private equity advisers today are in a new regulatory era of increased scrutiny and transparency. One need look no further than the SEC's recently published update to the quarterly private fund statistics (with data as of the third quarter of 2016), which has been collected through Form PF and through Form ADV filings made by private fund advisers.<sup>3</sup>

Suffice to say, the SEC is paying close attention to private equity advisers' regulatory filings, and will be eagerly awaiting the next wave of new, material information that private fund advisers will be required to deliver, starting this fall. Beginning in October 2017, SEC registered investment advisers, including those advisers to private funds, will be required to report using an amended Form ADV, which significantly expands certain areas of disclosure for fund managers.

This Legal Tip highlights the continuing importance of regulatory compliance considerations for private equity fund advisers,<sup>4</sup> with a look ahead to the important upcoming changes to Form ADV,<sup>5</sup> which are expected to increase the amount and type of information private fund advisers will be delivering to the SEC through Form ADV filings.

## Regulatory Compliance Challenges for Private Equity Fund Advisers

In keeping with the theme of private equity compliance, below are brief summaries of issues that should be on every private equity fund adviser's compliance radar and that have recently made the headlines or are expected to receive regulatory attention:

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## 1. Pay to Play Issues

In January 2017, the SEC announced settlements with ten investment advisory firms relating to charges that they violated the pay-to-play rule by receiving compensation from public pension funds within two years after campaign contributions made by the firms' associates. Eight of the settling parties were private equity funds or venture funds (the other two were a hedge fund and a merchant banking fund).<sup>6</sup>

## 2. Public Pension Investors

As noted in the SEC's 2017 Examination Priorities, public pension advisers can expect increased attention from the SEC's examination staff. The focus in this area is expected to be management of conflicts of interest, whether an adviser has satisfied its fiduciary duty, selection of public pension advisers through the RFP/ RFI process, entertainment and gift practices (see also "Pay to Play Issues" above) and adviser internal controls.

In addition, as of January 1, 2017, California public pension and retirement systems are subject to new disclosure requirements regarding vehicles in which the system has entered alternative investments, which includes private equity. Per California Assembly Bill Number 2833, which augments the California Government Code, contracts (such as a subscription agreement) entered after January 1, 2017 and existing contracts under which new capital commitments are made after that date will be subject to the new disclosure standard, which will require annual disclosure of, among other things, details and a breakdown of fees and expenses (including management fees and carried interest) paid to the fund, fund manager and related parties and both gross and net rates of return.<sup>7</sup>

## 3. Cybersecurity

Cybersecurity continues to receive heavy attention from the SEC, based in large part on recurring, high profile cyber attacks, such as the recent WannaCry ransomware event that reached across the globe. This particular cyber event prompted the SEC to publish a National Exam Program Risk Alert dedicated to cybersecurity, which contained yet more information about cybersecurity and the importance of policies and procedures relating to cyber controls.<sup>8</sup> Needless to say, all advisers, including those to private equity and other private funds, should have smartly designed and well-implemented cybersecurity policies in their compliance manuals, and include cybersecurity as part of annual compliance training sessions.

## Looking Ahead to Changes in Form ADV

### 1. Umbrella Registration for Private Fund Advisers

Private fund advisers who are controlled by or under common control with a primary filing adviser may qualify for a streamlined reporting process referred to as "umbrella registration." This approach (which has been embraced by some private fund advisers already<sup>9</sup>) entails one registration filing required for a private fund adviser's advisory business if certain criteria are satisfied based on the adviser's operations and corporate structure. In order to utilize "umbrella registration" using the amended Form ADV, the following conditions must be met:

1. The filing adviser and each relying adviser must only advise private funds and clients in separately managed accounts ("SMAs") that are qualified clients;<sup>10</sup>
2. The filing adviser must have its principal office in the United States, and thereby, be subject to the provisions of the Investment Advisers Act of 1940;
3. The relying adviser(s) must be associated with and supervised by the filing adviser;
4. The relying adviser is subject to SEC examinations; and
5. The filing adviser and each relying adviser(s) operates under a single code of ethics<sup>11</sup> and written policies and procedures manual.

In addition, definitions within Form ADV instructions have been revised to track the "umbrella registration" changes, and each relying adviser will be required to complete a new Schedule R on which it will report details about how it satisfies the relying adviser criteria.

Notably, the "umbrella registration" option is not available in the same fashion to United States based exempt reporting advisers, or at all to investment advisers located outside of the United States.

### 2. Additional Information Relating to the Adviser

Using the new Form ADV, advisers will be required to report additional details relating to the following aspects of the private fund adviser's business (select items are listed below):

1. Social media sites controlled by the adviser (e.g., Twitter, LinkedIn) and the address for each of the adviser's social media pages;
2. Whether a private fund limits sales of the fund to qualified clients;

3. The total number of offices of the adviser where advisory services are provided and details regarding the number of employees providing such services;
4. Whether an adviser's Chief Compliance Officer receives compensation from a party other than the adviser, and details relating to such compensating parties; and
5. The amount of assets under management attributable to non-U.S. clients.

Please note that there are many new information requests to consider. You are strongly encouraged to review the SEC's Adopting Release in its entirety (available at <https://www.sec.gov/rules/final/2016/ia-4509.pdf>).

#### ENDNOTES

This article is for information purposes and does not contain or convey legal advice. The information herein should not be relied upon in regard to any particular facts or circumstances without first consulting with a lawyer.

- <sup>1</sup> See, e.g., Andrew J. Bowden, Director, OCIE, "Spreading Sunshine in Private Equity," May 6, 2014, available at <https://www.sec.gov/news/speech/2014--spch05062014ab.html>; Marc Wyatt, Director, OCIE, "Private Equity: A Look Back and a Glimpse Ahead," May 13, 2015, available at <https://www.sec.gov/news/speech/private-equity-look-back-and-glimpse-ahead.html>.
- <sup>2</sup> See, e.g., SEC 2015 Examination Priorities, available at <https://www.sec.gov/about/offices/ocie/national-examination-program-priorities-2015.pdf>; SEC 2016 Examination Priorities, available at <https://www.sec.gov/about/offices/ocie/national-examination-program-priorities-2016.pdf>; SEC 2017 Examination Priorities, available at <https://www.sec.gov/about/offices/ocie/national-examination-program-priorities-2017.pdf>.
- <sup>3</sup> See Private Fund Statistics available at <https://www.sec.gov/divisions/investment/private-funds-statistics/private-funds-statistics-2016-q3-accessible.pdf>.
- <sup>4</sup> Previous Legal Tips have focused on this topic include, "Back to Basics – Private Equity Compliance Beyond Fee and Expense Practices" (Oct. 2016) available at <http://www.jackolg.com/Legal-Tip-October-2016-Back-to-Basics-Private-Equity-Compliance-Beyond-Fee-and-Expense-Practices.pdf> and "How the Proposed Amendments to Form ADV and Advisers Act Will Impact Investment Advisers" available at <http://www.jackolg.com/JLG-Legal-Tip-How-the-Proposed-Amendments-to-Form-ADV-and-Advisers-Act-will-Impact-Investment-Advisers-05-2015.pdf>.

com/Legal-Tip-October-2016-Back-to-Basics-Private-Equity-Compliance-Beyond-Fee-and-Expense-Practices.pdf and "How the Proposed Amendments to Form ADV and Advisers Act Will Impact Investment Advisers" available at <http://www.jackolg.com/JLG-Legal-Tip-How-the-Proposed-Amendments-to-Form-ADV-and-Advisers-Act-will-Impact-Investment-Advisers-05-2015.pdf>.

- <sup>5</sup> These changes were announced in May 2015, and finalized in August 2016; see SEC Adopting Release No. IA-4509 (Aug. 25, 2016), available at <https://www.sec.gov/rules/final/2016/ia-4509.pdf>.
- <sup>6</sup> See SEC Press Release of Jan. 17, 2017 containing links to all ten settlement orders, available at <https://www.sec.gov/news/pressrelease/2017-15.html>.
- <sup>7</sup> See AB No. 2833 at [http://leginfo.ca.gov/faces/billNavClient.xhtml?bill\\_id=201520160AB2833](http://leginfo.ca.gov/faces/billNavClient.xhtml?bill_id=201520160AB2833).
- <sup>8</sup> See SEC National Exam Program Risk Alert, Cybersecurity: Ransomware Alert (May 17, 2017), available at <https://www.sec.gov/files/risk-alert-cybersecurity-ransomware-alert.pdf>.
- <sup>9</sup> The "umbrella registration" amendments to Form ADV are based on the American Bar Association No-Action Letter (Jan. 18, 2012) available at <https://www.sec.gov/divisions/investment/noaction/2012/aba011812.htm>.
- <sup>10</sup> 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.

- <sup>11</sup> For more information, see rule 204A-1.

## Conclusion

Commentators have observed that the information required from private fund advisers in new Form ADV is similar to data that is currently reported in a non-public manner on Form PF. Although OCIE and other divisions of the SEC have access to Form PF data and use the same for a variety of purposes, this new data will be publicly available on new Form ADV for the first time in October 2017.

Private fund advisers should be considering how the next frontier of Form ADV reporting will differ from prior years, and begin taking steps to ensure that the significant additional information required by the new Form ADV will be available for both Other than Annual ADV Amendments in October 2017 and for subsequent Form ADV filings.

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