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Alert

New Form ADV: The Impact on Private Fund Advisers

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On Aug. 25, 2016, the U.S. Securities and Exchange Commission adopted a final rule that amends Form ADV — the filing that investment advisers registered with the SEC use to apply for and maintain their registration and that exempt reporting advisers utilize to claim and maintain their registration exemption. The SEC also amended its books and records rule to require more documentation with respect to performance reporting records.[1]

While these amendments will go into technical effect in this calendar year, the SEC has delayed the substantive effectiveness of the amended ADV and the new books and records requirements until October 2017. This means that many advisers will not implement these new requirements until their first quarter 2018 annual updating amendment.

ADV Amendments

The proposed rule[2] generated a good amount of concern and consideration; the SEC received nearly 50 comment letters on the proposal from U.S. and non-U.S. industry participants, trade groups and law firms. Industry commenters focused on one large conceptual point (the new requirement to publicly disclose Form PF-style information for an adviser's managed accounts) and several practical points (including the need to preserve, clarify and expand the ability of a family of advisers to file a single "umbrella registration").

The final rule, however, is substantially similar to the proposed one, which means that managers will need to prepare to make more disclosures in their Form ADV, and many managers (especially non-U.S. managers) will need to file multiple Form ADVs to cover their family of affiliated managers.

In particular, the final rule contains the following provisions and requirements:

- *Separately Managed Accounts*. Form ADV currently requires registered and reporting investment advisers publicly to schedule a good deal of information with respect to each private fund advised by them. The amended Form ADV will require new disclosures with respect to the portfolio investments of separately managed accounts, including — for certain advisers — with respect to asset categories and borrowings. These disclosures will be publicly available. This contrasts with the confidential treatment afforded by Form PF, which is currently required of

[1] Form ADV and Investment Advisers Act Rules, IA-4509 (Aug. 25, 2016). The Commission also made certain clarifying, technical and other amendments to Form ADV.

[2] Amendments to Form ADV and Investment Advisers Act Rules, Release No. IA-4091 (May 20, 2015) (the "Proposing Release").

certain registered investment advisers and which requires detailed disclosures of information with respect to the portfolio investments of private funds.

  - The SEC declined to formally adopt a definition of the term "separately managed account," but, instead, provided in the Form ADV itself and the instructions that the new disclosures with respect to separately managed accounts exclude assets of clients that are investment companies, business development companies or other pooled investment vehicles.
  - All advisers with separately managed accounts will be required to provide a breakdown (by percentage) of the asset classes in which those accounts are invested (e.g., ETFs, non-exchange traded securities, bonds of various types, derivatives, securities issued by registered investment companies and other pooled investment vehicles, and cash and cash equivalents).
  - Advisers with $500 million or more of regulatory assets under management (which is gross assets, not net) in separately managed accounts must update the new portfolio investment reporting in Form ADV annually.
  - Advisers with $10 billion or more of regulatory assets under management in separately managed accounts must update this portfolio investment reporting on an annual basis, with information reported as of mid-year and end of year.
  - Information with respect to all separately managed accounts must be aggregated and disclosed, even those of non-U.S. clients. This requirement will apply to non-U.S. advisers, as well as advisers located in the United States.
  - Advisers must further identify all custodians that account for at least 10 percent of the adviser's regulatory assets under management attributable to separately managed accounts.
  - There is also a new requirement that the amount of assets managed for clients that are non-U.S. persons be specifically disclosed.

- *Umbrella Registration*. The amended Form ADV incorporates the "umbrella registration" concept from the SEC Staff's no-action letter to the American Bar Association on Jan. 18, 2012. The adopting release states the Commission's view that the final rule is codifying the SEC Staff's umbrella registration regime.
  - The new form includes a "Schedule R" that will need to be completed for each relying adviser and will require disclosures specific to that adviser (irrespective of whether the adviser has been treated as a single, undifferentiated business unit). This will include entity-specific disclosures of eligibility for registration, large owner information, identification of control persons and any disciplinary history.
  - Notwithstanding numerous comments that urged the Commission to provide the benefits of umbrella registration to the ADV filings of registered investment advisers with a principal office outside the United States, the Commission declined to do so.
  - Similarly, the SEC declined to provide the benefits of umbrella registration to the ADV filings of exempt reporting advisers on the same terms as U.S.-based registered investment advisers. The Commission did indicate that the SEC Staff views expressed in

Frequently Asked Questions permitting certain exempt reporting advisers to file a single Form ADV in certain circumstances are not withdrawn as a result of the ADV amendments.

- *Social Media Disclosures*. The proposed rule would have required expanded disclosure of social media sites and portals. The final rule largely gives effect to the proposal.
    - Any social media sites controlled by the filing adviser must be listed on the new Form ADV and promptly updated following any change.
    - The SEC specifically acknowledged that the use of new social media outlets would trigger multiple amendments, but did not feel that this obligation was unduly burdensome.
- *Other Offices*. The amended Form ADV will continue to require disclosures of other offices.
    - More other offices will be required to be disclosed (25).
    - Advisers will be required to specify the business activities occurring in each office other than the firm's principal place of business.
- *Employee Compensation*. If an adviser compensates an employee for finding "clients," the amount of the compensation paid will need to be disclosed in the new Form ADV.
- *Use of Third-Party Compliance Auditors*. The SEC did not include in the amended Form ADV a requirement that RIAs disclose third-party compliance auditors. (But note that the SEC Staff had previously indicated that they are working on a proposal that would involve mandatory annual audits of the private fund management business.)

Performance Recordkeeping

The Commission has adopted several final rules requiring registered advisers to retain a broader set of books and records related to performance advertising. First, advisers will be required to retain copies of all written communications sent by any such investment adviser relating to "the performance or rate of return of any or all managed accounts or securities recommendations." Second, advisers will now be required to retain records that demonstrate the calculation of the performance or rate of return in any communication to *any person* (as opposed to the prior rule, which was limited to communications circulated to 10 or more persons). Accordingly, registered advisers should review their approval and retention procedures for both broadly distributed and narrowly tailored performance presentations.

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If you have any questions concerning this *Alert*, please contact your attorney at Schulte Roth & Zabel or one of the authors.

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