

January 3, 2017



Authors



Peter J. Bilfield
(212) 376-3010 or
(203) 324-8151
pbilfield@goodwin.com



Michael T. Cummings
(203) 324-8173
mcummings@goodwin.com

SEC Amends Form ADV for Separately Managed Account Reporting and Codifies “Umbrella Registration”

On August 25, 2016, the Securities and Exchange Commission (“SEC”) amended Form ADV (the “ADV Amendments”) to collect from registered investment advisers certain information about separately managed accounts (“SMAs”) that they manage, including the types of assets held and the use of derivatives and borrowings.¹ The ADV Amendments are designed to assist the SEC with making risk based assessments about SMAs managed by investment advisers. In addition, the ADV Amendments (along with amendments to Rule 204-2 of the Investment Advisers Act of 1940 (the “Advisers Act”)):

- Incorporate the “umbrella registration”² concept from the SEC staff’s January 18, 2012 no-action letter to the American Bar Association (the “ABA Letter”);
- Update the books and records rule under Rule 204-2 of the Advisers Act, as amended, regarding the calculation and distribution of performance information to better protect investors and clients from fraud; and
- Provide disclosure in Form ADV on social media and outsourced compliance officers and firms utilized by registered advisers.

Although the ADV Amendments and the new books and records requirements under Rule 204-2 went into effect in 2016, the SEC has delayed the compliance date until October 1, 2017. Most advisers will address the revised Form ADV requirements in connection with their annual updating amendment in 2018. Advisers that provide performance information after October 1 (relating to performance generated prior to such date), will be obligated to maintain the materials listed in amended Rule 204-2 demonstrating the calculation of the prior performance.

Enhanced Information Disclosed for Separately Managed Accounts

The final rule provides for the following requirements:

- New disclosures (which will be publicly available) with respect to portfolio investments of SMAs of certain advisers based on regulatory assets under management (“RAUM”) thresholds.
 - Advisers with SMAs will be required to provide a breakdown by percentage of the asset classes in which the SMAs invest (e.g., ETFs, non-exchange traded

¹ SMAs do not include pooled investment vehicles, investment companies or business development companies.

² Registration on one Form ADV of multiple private fund adviser entities operating a single advisory business.

securities, bonds, derivatives, cash, cash equivalents, etc.). With respect to assets that may be classified in multiple categories, the SEC has added an instruction allowing advisers to use their own internal methodologies and the conventions of their service providers in determining how to categorize assets, provided that such methodologies are consistently applied and that assets are not double counted.

- o Advisers with at least \$500 million in SMA RAUM are required to provide additional information, on an aggregate basis, on the use of borrowing and derivatives in individual SMA accounts with at least \$10.0 million in RAUM. In addition, such advisers must update this portfolio information reporting annually.
- o Advisers with at least \$500 million but less than \$10.0 billion in SMA RAUM are required to report the RAUM and the dollar amount of borrowings attributable to those assets that correspond to three levels of gross notional exposure.³ The three levels of gross notional exposure are: less than 10%, 10%-149% and 150% or more.
- o Advisers with at least \$10.0 billion in SMA RAUM are required to report the gross notional exposure and borrowing information described above, as well as their derivatives exposure across six different categories of derivatives. In addition, these advisers must update this portfolio information reporting annually, with information reported as of mid-year and end of year.
- o SMA information must be aggregated and disclosed, including non-U.S. clients (even if managed by a non-U.S. adviser whose principal office and place of business is outside the U.S.).
- o Non-U.S. client information must be specifically disclosed.
- o Custodians that account for 10 percent or more of SMA RAUM must be identified, including the amount of RAUM attributable to SMAs held at the custodian. This information will allow the staff to identify advisers whose clients use the same custodian.

“Umbrella Registration”

The ADV Amendments codify the “umbrella registration” of relying advisers set forth in the ABA Letter.

- The new Form ADV includes a Schedule R which will require relying advisers to provide disclosure specific to that adviser, including entity level disclosures on eligibility to register, large owner information, identification of control persons and any disciplinary history.
- With respect to foreign SEC registered advisers (with a principal place of business located outside the United States), the SEC declined to extend the umbrella registration to such foreign adviser’s affiliates (thus necessitating such adviser affiliates to file a separate Form ADV).
- Similar to foreign registered advisers, the SEC declined to extend umbrella registration to exempt reporting advisers (although the current staff interpretations set forth in Frequently Asked Questions permitting certain exempt reporting advisers and their

3 Gross notional exposure of an account is “the percentage obtained by dividing (i) the sum of (a) the dollar amount of any borrowings and (b) the Gross Notional Value of all derivatives, by (ii) the RAUM of the account.” See *Amended Form ADV, Part 1A, Schedule D, Item 5.K.(2)*. “Gross Notional Value” is defined in the Glossary to Form ADV as “The 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.”



affiliates to file a single Form ADV have not been withdrawn).

- Foreign “relying” advisers to a U.S. registered adviser will be subject to the full panoply of the Advisers Act whereas foreign advisers registering separately will be able to continue to rely on “adviser lite” registration.

Social Media and Additional Information Regarding Investment Advisers

The SEC added other new requirements, in addition to amending certain existing items, regarding advisers and their businesses (including exempt reporting advisers for certain additions), including, but not limited to:

- Providing information on the adviser’s social media platforms.
- Reporting the total number of offices at which the adviser conducts investment advisory business.
- Providing information regarding outsourced chief compliance officers, including whether they are compensated or employed by a third party (and if employed, the name of the third party). The final rule notes the SEC has observed uneven quality and effectiveness of outsourced chief compliance officers and/or firms. The SEC further notes that identifying advisers who use these outsourced chief compliance officers or firms could be helpful in assessing potential risks.

Books and Records Rule: Performance Information

Several rules have been adopted requiring registered investment advisers to retain a broad array of books and records related to performance advertising. The SEC has adopted two amendments to the books and records rule in order to provide the SEC examination staff with additional information to assess compliance with Rule 206(4)-1 of the Advisers Act (i.e., the advertising rule) and the SEC’s enforcement of the rule in connection with fraudulent advertising.

First, the SEC removed the 10 person threshold for requiring the preservation of records containing performance information necessary to support performance claims. Advisers will now be required to maintain and preserve all records that demonstrate the calculation of performance or rate of return in any communication to *any* person.

Second, the SEC amended its rules to require the retention of all written communications related to the performance or rate of return of any SMA or securities recommendations.

Questions or Assistance:

If you would like to discuss the foregoing in further detail, please contact Peter Bilfield at (212) 376-3010 or (203) 324-8151 or pbilfield@goodwin.com, or Michael Cummings at (203) 324-8173 or mcummings@goodwin.com.

This communication is being circulated to Shipman & Goodwin LLP clients and friends and does not constitute an attorney client relationship. The contents are intended for informational purposes only and are not intended and should not be construed as legal advice. This may be deemed advertising under certain state laws. © 2017 Shipman & Goodwin LLP.

289 Greenwich Avenue
Greenwich, CT 06830-6595
203-869-5600

One Constitution Plaza
Hartford, CT 06103-1919
860-251-5000

265 Church Street - Suite 1207
New Haven, CT 06510-7013
203-836-2801

400 Park Avenue - Fifth Floor
New York, NY 10022-4406
212-376-3010

300 Atlantic Street
Stamford, CT 06901-3522
203-324-8100

1875 K St., NW - Suite 600
Washington, DC 20006-1251
202-469-7750

www.shipmangoodwin.com