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ALERTS

Securities And Capital Markets Law Alert - SEC Makes Substantial Changes To Investment Adviser Reporting Requirements

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Recently, the Securities and Exchange Commission (SEC) adopted substantial changes to the reporting requirements for registered investment advisers, which will require investment advisers to enhance their disclosures in their Form ADVs. These increased reporting requirements go into effect on Oct. 1, which means for most advisers with a Dec. 31 fiscal year-end, the first disclosures under the revised Form ADV will be the annual updating amendment due in March 2018.

The changes to Form ADV will require advisers to gather more information, expend more time preparing their Form ADVs, and require additional critical decision-making in crafting their Form ADV disclosures. Advisers should consider preparing for these enhanced reporting requirements now and instituting proper policies and procedures, including amendments to written policies and procedures manuals, in order to prepare for the next Form ADV filing.

Following is a summary of the enhanced Form ADV reporting requirements and key considerations.

New Disclosures Regarding Separately Managed Accounts

The revised Form ADV requires advisers to provide more information regarding the separately managed accounts (SMAs) they manage. In this regard, the Form ADV will now require disclosure of:

- The amount of regulatory assets under management attributable to all SMAs managed by the adviser, including SMAs held by non-U.S. persons.
- Additional information about the use of borrowings and derivatives by the SMAs.
- Any custodians that account for at least 10 percent of the SMA's regulatory assets under management, and the amount of the adviser's regulatory assets under management attributable to separately managed accounts held at the custodian.

Advisers with regulatory assets under management of $10 billion or more will be required to report the SMA assets under management (AUM) annually, and provide mid-year and year-end percentages of AUM attributable to the SMAs. Advisers with less than $10 billion of AUM will only be required to report their year-end percentages of AUM attributable

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to the SMAs.

Additional Information About the Adviser

The revised Form ADV also will require a substantial amount of new disclosures regarding the investment adviser itself, including the following:

- Advisers will be required to provide all assigned Central Index Key (CIK) numbers.
- The addresses and handles of all social media accounts the adviser uses in connection with its business (such as Twitter, Facebook, and LinkedIn).
- Additional information about the adviser's 25 largest offices, the employees at each office, and the business conducted at each office.
- Advisers will be required to disclose whether they use "out-sourced" chief compliance officers (i.e., CCOs who are compensated or employed by third-party vendors and who are not solely employed by the adviser on a day-to-day basis). Advisers will be required to disclose the name and taxpayer ID number of the out-sourced CCO. The practice of advisers using out-sourced CCOs has come under increased scrutiny by the SEC in recent years, and now the SEC appears to be increasing its vigilance even further.
- Advisers will be required to report their proprietary assets if they hold more than $1 billion of proprietary assets. This does not cover the adviser's AUM.

Additional Information About the Adviser's Business

The revised Form ADV will require the following additional information about the adviser's business activities:

- The number of clients attributable to each category of clients (rather than the previous disclosure, which merely required the total number of advisory clients, the types of clients, and the AUM attributable to the client types).
- The number of clients for whom the adviser has no AUM (essentially financial planning-only clients).
- A disclosure whether the adviser reports client assets differently in the Form ADV Part 1 than they report AUM in the Part 2A brochure.
- The approximate amount of AUM attributable to clients who are non-U.S. persons.
- Certain information regarding parallel managed accounts related to registered investment companies and business development companies.
- Additional information about wrap fee programs.

- Additional information for private funds managed by the adviser and financial industry affiliates, including additional identifying numbers, service providers, CIK numbers, and numbers issued by the PCAOB.

- Private fund advisers that manage Section 3(c)(1) funds (i.e., investment funds with 100 or fewer beneficial owners) will now be required to report whether they limit sales of the funds to "qualified clients" as defined in Rule 205-3 of the Investment Advisers Act of 1940.

- The SEC is now permitting umbrella Form ADV registration filings for multiple affiliated fund adviser entities which, in reality, operate a single advisory business. This is intended to simplify the registration process and provide a more understandable disclosure regime for affiliated advisers that essentially operate a single advisory business.

Books and Record Rule Changes

Finally, the SEC has revised Investment Advisers Act Rule 204-2 to now require the following:

- SEC-registered advisers must now maintain records of performance-related communications that are distributed to any person (under the prior rule, this only applied to performance material distributed to 10 or more persons).

- Advisers will be required to maintain originals of all performance-related written communications received and sent by the adviser, including those of SMAs, as well as communications regarding securities recommendations.

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