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Insights: Alerts

SEC Proposes Changes to Form ADV

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On May 20, 2015, the Securities and Exchange Commission (the "SEC") issued a rulemaking proposal that will likely lead to significant changes in the Form ADV reporting requirements for registered investment advisers ("RIAs"). The rulemaking proposal builds on recent changes to the reporting requirements for advisers to privately offered pooled investment vehicles ("Private Funds"), including those within the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). The current proposal both substantively adds to those requirements and stylistically amends them. The SEC has described the proposal as having the following three broad objectives:

(1) filling data gaps to enhance the current Form ADV reporting requirements;

(2) amending the filing requirements to allow for "umbrella registration" of advisers to Private Funds; and

(3) clarifying Form ADV's instructions and the accompanying disclosures.

Data Collection

The components of the proposal with perhaps the most significant practical implications for RIAs are those intended to fill data gaps and enhance Form ADV's current reporting requirements . While the SEC currently gathers extensive data from investment advisers related to Private Funds, the agency collects far less detailed information about separately managed accounts. This rulemaking proposal would alter that dynamic in three ways. First, it would require RIAs to report approximate percentages of separately managed accounts invested in ten broad asset categories. Second, it would require RIAs with at least $150 million in regulatory assets under management attributable to separately managed accounts to report information on the use of borrowing and derivatives in those accounts. Third, it would require RIAs to identify any custodians that account for at least 10% of their separately managed account assets under management and the amount of such assets held at the custodian. The SEC believes that this additional information about separately managed accounts will allow it to better assess risk and increase the effectiveness of its examinations.

Umbrella Registration

The components of the proposal related to umbrella registrations could have a positive impact on RIAs. In 2010, the Dodd-Frank Act repealed the exemption from investment adviser registration that was most commonly used by advisers to Private Funds.[1] As a result, there are now more than 4,300 RIAs managing more than 28,000

Private Funds. Many Private Fund advisers are organized as groups of related entities for a variety of tax and legal reasons, but the current Form ADV is designed for single entities. The proposed change would allow a single RIA's registration to include the registration of one or more "relying adviser" entities controlled by, or under common control with, the filing RIA.[2] The SEC believes this will save investment adviser organizations substantial time and money, while providing the SEC with a clearer picture of the industry.

Amending Existing Items

In addition to the proposals for substantive changes to Form ADV, the SEC has proposed a number of stylistic amendments. The SEC believes these amendments will make the filing process clearer and more efficient. Below are several examples drawn from the rulemaking proposal that reflect the SEC's desire to eliminate duplicative filings and inconsistent responses:

- Item 7.B. of Part 1A of Form ADV asks whether the RIA serves as an adviser to any Private Fund, which currently leads to multiple advisers reporting their affiliation to the same Private Fund. Under the proposed amendments, only one RIA would be required to report, thereby eliminating duplicative filings.
- Question 10 of Section 7.B.(1) of Schedule D asks RIAs advising Private Fund funds of funds to identify the Private Fund's category by referring to the underlying funds. The proposal would delete that instruction, which would reconcile differences with Form PF.[3]
- Question 19 of Section 7.B.(1) of Schedule D asks whether the RIA's clients are solicited to invest in the Private Fund. The proposal would add text to Question 19 to make it clear that the RIA should not consider feeder funds in answering the question.
- Question 21 of Section 7.B.(1) of Schedule D asks whether the Private Fund relies on an exemption from registration of its securities under Regulation D of the Securities Act of 1933. The proposed amendment would ask if the Private Fund has ever relied on a Regulation D exemption.
- Question 23(a)(2) of Section 7.B.(1) of Schedule D currently requires an investment adviser to check a box indicating whether the Private Fund's financial statements are prepared in accordance with U.S. generally accepted accounting principles ("GAAP"). The proposal would add text instructing RIAs to answer Question 23(a)(2) only if the Private Fund's financial statements are subject to an annual audit.
- Section 9.C. of Schedule D requests information about the form independent public accountants that perform surprise examinations for RIAs. The proposal would require the RIA to provide its accountant's PCAOB registration number and to report any qualified or problem opinions issued since the RIA's last annual updating amendment.
- Item 11 of Part 1A of Form ADV requires disciplinary history reports on a Disclosure Reporting Page ("DRP"). Under some circumstances, DRP's may be removed from a Form ADV. The proposal would amend certain instructions to clarify that a DRP may be removed if a criminal, regulatory or civil judicial action was resolved in the RIA's (or its affiliate's) favor.

Enhanced Disclosures

The proposal would also require RIAs to provide new information on Form ADV in a number of different areas. These areas include information related to any social media platforms (e.g., Facebook, Twitter, LinkedIn, etc.) that an RIA uses; enhanced information on branch offices of RIAs (e.g., disclosure of total number of offices and specifics regarding the largest 25 branches); disclosure of whether an RIA's chief compliance officer is outsourced or not; more precise information about an RIA's clients that would replace the current ranges for numbers and different types of clients required by Item 5 of Part 1A; and additional information on compensation, outside of regular salaries, received by employees for obtaining clients for an RIA.

Supporting Information for Performance Calculations

In addition to the amendments described above, the SEC has proposed a change to the books and records, which requires the maintenance of records supporting performance claims in communications that are distributed or circulated to 10 or more persons.[4] The proposal would modify the rule by requiring the maintenance of performance calculation support records for performance claims in communications that are distributed or circulated to any client.

Impact on RIAs

The rulemaking proposal issued by the SEC has wide-ranging implications for RIAs. Some components of the proposal simply streamline the registration process, which likely would lead to time and cost savings for investment advisers. Other components, however, would require investment advisers to disclose more information about their businesses and their clients' holdings. While we expect some of the proposals to generate much discussion and, perhaps, controversy, we believe it is probable that the changes and additions will be adopted largely as proposed by the SEC. Accordingly, RIAs should carefully review the proposal's new requirements to begin planning for its likely implementation.

A copy of the SEC's entire proposal is available here. For more information about these issues, please contact the author of this Legal Alert or your existing firm contact.

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[1] Prior to the Dodd-Frank Act, Section 203(b)(3) of the Advisers Act (the "private adviser exemption") exempted any investment adviser from registration if the adviser: (i) had fewer than 15 clients (with each Private Fund counting as a single client regardless of the number of its investors) in the preceding 12 months; (ii) did not hold itself out to the public as an investment adviser; and (iii) did not act as an investment adviser to a registered investment company or a company that elected to be a business development company.

[2] The umbrella registration concept would codify, clarify and expand upon the "relying adviser" concept that was included in the SEC staff's response in No-Action Letter, American Bar Association, Business Law Section (January 18, 2012).

[3] Form PF requests similar information, but permits an RIA to disregard the Private Fund's equity investments in other Private Funds when selecting its category.

[4] See Rule 204-2(a)(16) of the Investment Advisers Act of 1940, as amended.

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