

## Risk Management Update September 2016

### SEC RELEASES AMENDMENTS TO FORM ADV AND OTHER INVESTMENT ADVISER ACT RULES

In a press release dated August 25, 2016,<sup>1</sup> the Securities and Exchange Commission (“SEC”) announced their issuance of a final rule, which amends Form ADV (Uniform Application for Investment Adviser Registration), along with five other rules under the Investment Advisers Act of 1940, as amended (“Advisers Act”).<sup>2</sup>

Specifically, in addition to the required changes to Form ADV, the SEC made amendments to the following rules:

- Rule 202(a)(11)(G)-1 (Family Offices)
- Rule 203-1 (Application for Registration)
- Rule 204-1 (Amendments to Form ADV)
- Rule 204-2 (Books and Records)
- Rule 204-3 (Delivery of Form ADV)

With the exception of Rule 204-2, the amendments made to the above listed rules were only to remove transition provisions within each rule where the time periods have passed. In addition, the SEC rescinded Rule 203A-5 for the same reason.

While the amendments made to Form ADV and other Adviser Act rules currently only effect SEC registered investment advisers, the SEC noted the following in their rule release:

*“In general, this Release discusses the Commission’s rule and form amendments that will affect advisers registered with the Commission. We understand that the state securities authorities intend to consider similar changes that affect advisers registered with the states, who are also required to complete Part 1B of Form ADV as part of their state registrations.”*

The compliance date for the amendments isn’t until October 1, 2017, which gives investment advisory firms time to prepare. This Risk Management Update (“RMU”) provides an outline of changes to Form ADV, discusses new record-keeping requirements under Rule 204-2, and provides guidance on important preparation steps firm should consider.

### **Changes to Form ADV**

Form ADV (the Uniform Application for Investment Adviser Registration) is used by investment advisers to register with the SEC and applicable states as appropriate. The information collected on Form ADV serves to provide the SEC and the public with critical

---

<sup>1</sup> See <https://www.sec.gov/news/pressrelease/2016-168.html>.

<sup>2</sup> See <https://www.sec.gov/rules/final/2016/ia-4509.pdf>.

disclosure information concerning the advisory firm. For example, Form ADV currently includes the following among other information:

- The types of investment services offered by the firm;
- The fees the firm charges and how they are assessed;
- The types of clients the firm works with;
- The firm's investment strategies and methods of research;
- Any disciplinary disclosures applicable to the firm, and
- Applicable conflicts of interest and how these conflicts are addressed by the firm.

The recent amendments to Form ADV mandated by the SEC are designed to provide additional information about advisers, focusing mostly on their separately managed account business. Additionally, the revised Form ADV will provide a simplified method for private fund adviser entities operating a single advisory business to register using a single Form ADV ("Umbrella Registration").

Below is a summary of the additional information required to be included in the revised Form ADV for filings made on or after October 1, 2017.

*Separately Managed Accounts:* In its release, the SEC generally defines separately managed accounts as "advisory accounts other than those that are pooled investment vehicles (i.e., registered investment companies, business development companies and pooled investment vehicles that are not registered (including, but not limited to, private funds))." No formal definition was provided.

The revised Form ADV Part 1 will contain a new question, Item 5.K(1), which will ask whether the adviser has regulatory assets under management ("RAUM") that are attributed to separately managed accounts. If answered yes, then the adviser will be required to complete Section 5.K(1) of Schedule D. This new schedule will list twelve asset categories and the adviser will be required to fill in percentage amounts under each category relating to the firm's separately managed accounts. An example of some of the categories include:

- Cash and Cash Equivalents
- Exchange Traded Equity Securities
- Non-Exchange Trade Equity Securities
- Corporate Bonds – Investment Grade
- Corporate Bonds – Non-Investment Grade

Advisers that have separately managed accounts with account assets of \$10 million or more that invest in derivatives or utilize borrowing will be required to report on Section 5.K(2) of Schedule D information about the gross notional exposure and corresponding total dollar amount pertaining to borrowing and the gross notional value of derivatives. The information is to be based on the firm's RAUM in such separately managed accounts. This Schedule D will be sectioned into two parts, Section 5.K(2)(a) and 5.K(2)(b), and require advisers with higher RAUM levels to report additional information.

Investment advisers also will be required to report custodian information on new Section 5.K(3) Schedule D for any custodians that hold at least 10% of the firm's separately managed accounts based on RAUM.

*Social Media Disclosure:* Currently, advisers are required to disclose whether the firm has one or more websites, along with the address for each website they maintain. The revised Form ADV Part 1 will require investment advisers to report on whether they maintain public social media accounts, including Twitter, Facebook and/or LinkedIn, and if so, they will need to provide the address for each.

*Additional Information:* The revised Form ADV Part 1A also will include a number of new questions pertaining to the identity of the adviser, its business and affiliations. This includes: (i) requiring CIK numbers; (ii) total number of office locations and information on 25 largest offices; (iii) information on whether the firm's Chief Compliance Officer is employed or compensated by someone other than the adviser (*e.g.*, using third party consultants); (iv) additional reporting of asset ranges for advisers with firm assets of \$1 billion or more; (v) reporting the number of clients by category, along with the amount of RAUM for each category; (vi) the number of clients managed that are not included in RAUM calculation (*e.g.*, one time financial plan); (vii) checking a box if reporting AUM on Form ADV Part 2A that is different than RAUM in Form ADV Part 1; (viii) the approximate amount of RAUM that belong to non U.S. clients; (ix) RAUM of parallel accounts related to registered investment company and business development company clients; (x) additional information regarding adviser's participation in wrap fee programs, including the CRD and SEC file number of each sponsor; (xi) PCAOB numbers for financial auditors used; (xii) information on whether advisers to private funds relying on an exemption from registration under Section 3(c)1 under the Investment Company Act of 1940 will be limiting sales to qualified clients; and (xiii) the ability for umbrella registration by certain private fund advisers operating as a single entity.

The SEC also made certain technical and clarifying changes to Form ADV, stating in their release "we believe these amendments to Form ADV will make the filing process clearer and more efficient for advisers and increase the reliability and the consistency of information provided by investment advisers." These include changes to Item 2, 4, 7, 8, Section 9.C of Schedule D, and disclosure reporting pages in response to yes answers in Item 11. The Form ADV Instructions and Glossary of Terms also have been amended.

### **Additional Recordkeeping Requirements**

The SEC also adopted amendments to Rule 204-2 under the Advisers Act, more specifically Rule 204-2(a)(7) and Rule 204-2(a)(16). Under amended Rule 204-2(a)(7), investment advisers will be required to keep "originals of all written communications received and copies of written communications sent by an investment adviser relating to the performance or rate of return of any or all managed accounts or securities recommendations."

Under revised Rule 204-2(a)(16), investment advisers will be required to maintain backup documentation regarding performance calculations for performance or rates of return that is

shown directly or indirectly by the adviser to “any person.” Currently, these records only need to be maintained when showing to 10 or more persons.

### **Plan Now for Implementation**

The above is only a summary of the more material amendments the SEC made to Advisers Act rules and is not intended to include all changes. It’s important that compliance personnel carefully review the SEC final rule release to determine the specific impacts the amendments will have on their firm’s current reporting and record-keeping processes. To that end, below are some compliance steps to consider during implementation:

- Meet with senior management to discuss the new requirements and what action needs to be taken;
- Meet with operations personnel and area managers to determine adequate methods for accessing and retaining required information;
- Perform testing once processes are in place to help ensure accuracy of information and the adequacy of internal controls surrounding the data collection;
- Review and update and/or implement applicable written policies and procedures;
- Provide training to employees on the new requirements and changes to policies and procedures.

### **Conclusion**

There is a large amount of additional data that will be required for inclusion in Form ADV beginning October 1, 2017, and advisory firms should begin their preparation now to help ensure they have robust processes in place by the deadline.

For more information, or to learn about how CCLS may be of assistance, please contact us at (619) 278-0020, [info@corecls.com](mailto:info@corecls.com) or visit [www.corecls.com](http://www.corecls.com).

**Author: Kurt Nuñez, Compliance Consultant; Editor: Tina Mitchell, Lead Sr. Compliance Consultant, Core Compliance & Legal Services (“CCLS”). CCLS works extensively with investment advisers, broker-dealers, investment companies, hedge funds, private equity firms and banks on regulatory compliance issues.**

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