

Schulte Roth & Zabel

# The New Form ADV — Strategy and Preparation

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# Initial Considerations

# Timing

- Amended Form ADV effective October 1, 2017
- Standard amendment triggers still apply
  - Effectiveness of amended Form ADV does not, by itself, trigger an amendment
  - Many US RIAs will not be required to complete New Form ADV until Q1 2018 (annual updating amendment)
- **But other-than-annual amendments from October 1, 2017, must be on the new Form**
  - New Items and Schedule D Sections cannot be left blank, the entire Form ADV must be filled out in order to pass a completeness check

# Other-Than-Annual Update Requirements

SECTION OF FORM ADV	UPDATE REQUIREMENT
Part 1A Item 1	Amend if item becomes inaccurate in any way
Part 1A Item 3	Amend if item becomes inaccurate in any way
Part 1A Item 4	Amend if item becomes materially inaccurate
Part 1A Item 8	Amend if item becomes materially inaccurate
Part 1A Item 9 (except 9.A.(2), 9.B.(2), 9.E., 9.F.)	Amend if item becomes inaccurate in any way
Part 1A Item 10	Amend if item becomes materially inaccurate
Part 1A Item 11	Amend if item becomes inaccurate in any way
Part 2A (Brochure)	Amend if item becomes materially inaccurate
Part 2B (Brochure Supplement)	Amend if item becomes materially inaccurate or there is a new or materially changed disciplinary disclosure

# Major Changes

- **Separately Managed Account Disclosures (Item 5)**
- **Umbrella Registration (Schedule R)**
- **Item 5 and Schedule R disclosures may differ for**
  - ERAs (vs. RIAs)
  - Non-US RIAs (vs. RIAs with a US principal place of business)
  - State-registered investment advisers (vs. ERAs), which are required to complete the entire Form ADV

# **Separately Managed Account Disclosure Obligations**

# Item 5 Disclosures Now Required

- **Types of clients and RAUM by client type (Item 5.D)**
- **SMA Portfolio Breakdown (Section 5.K.(1))**
- **SMA Borrowings and Derivatives (Section 5.K.(2))**
- **SMA Custodian information (Section 5.K.(3))**



# Definition of Managed Account

- **Advisory accounts that are not pooled investment vehicles**
- **Depending on the facts and circumstances, “funds of one” could be considered SMAs**
- **Form ADV FAQ 5.D – Individualized investment advice**
- **Public vs. private disclosures**

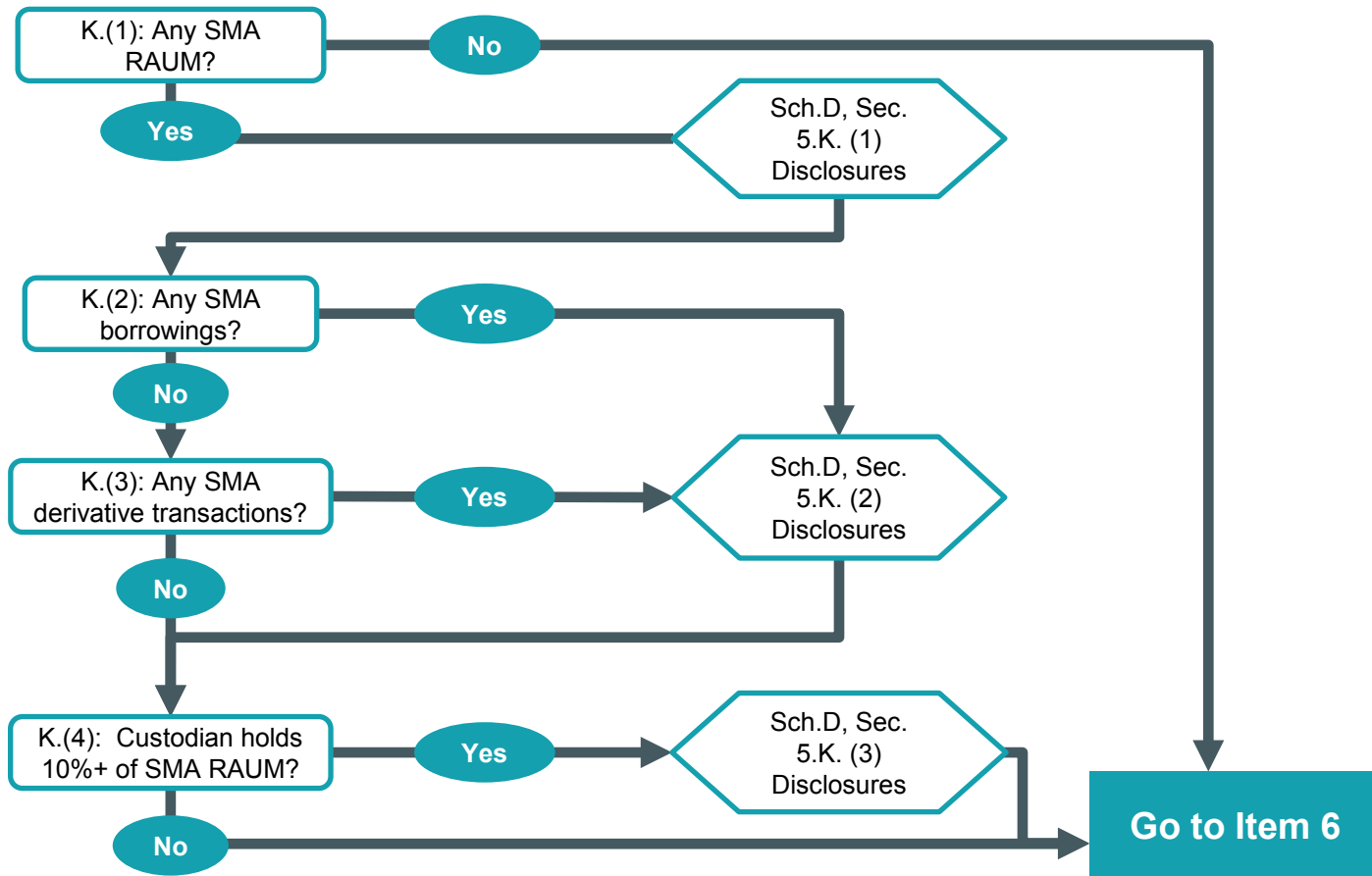
# Managed Account Disclosure Obligations

- **Item 5.D. (RIAs, not ERAs)**
  - Old
    - Disclosures of clients by client type and RAUM by client type in percentage bands
  - New
    - Number of clients by type (with a “fewer than 5” option)
    - Total regulatory assets under management by client type

# Separately Managed Account Disclosure Obligations

- (a) Individuals (other than-high-net worth individuals)
- (b) High-net-worth individuals
- (c) Banking or thrift institutions
- (d) Investment companies [*no “fewer than 5” option*]
- (e) Business development companies [*no “fewer than 5” option*]
- (f) Pooled investment vehicles (other than ICs and BDCs) [*no “fewer than 5” option*]
- (g) Pension and profit-sharing plans
- (h) Charitable organizations
- (i) State or municipal government entities (including government pension plans)
- (j) Other investment advisers
- (k) Insurance companies
- (l) Sovereign wealth funds and foreign official institutions
- (m) Corporations or other businesses not listed above
- (n) Other: \_\_\_\_\_

# New SMA Disclosures (Item 5.K.)



# Section 5.K.(1) — SMA Portfolio Breakdown

- **New**
  - RIAs with SMA RAUM need to disclose allocation of SMA RAUM by asset class (aggregate, across all SMAs)
    - RIAs with at least \$10 billion in SMA RAUM provide mid-year and end-of-year percentages
    - RIAs with less than \$10 billion in SMA RAUM provide end-of-year percentages only

# Section 5.K.(1) — SMA Portfolio Breakdown - Asset Classes

## Reporting as a percentage of SMA RAUM:

- |       |                                       |        |  |
|-------|---------------------------------------|--------|--|
| (i)   | Exchange-Traded Equity Securities     | (viii) | Derivatives  |
| (ii)  | Non-Exchange-Traded Equity Securities | (ix)   | Securities Issued by RICs or BDC                                   |
| (iii) | U.S. Government/Agency Bonds          | (x)    | Securities Issued by Pooled Investment Vehicles (excl. RICs, BDCs) |
| (iv)  | U.S. State and Local Bonds            | (xi)   | Cash and Cash Equivalents  |
| (v)   | Sovereign Bonds                       | (xii)  | Other  |
| (vi)  | Investment-Grade Corporate Bonds      |        |  |
| (vii) | Non-Investment-Grade Corporate Bonds  |        |  |

# **Section 5.K.(2) — SMA Borrowings & Derivatives**

- **No Section 5.K.(2) disclosures for advisers with SMA RAUM of \$500 million or less**

# Section 5.K.(2) — SMA Borrowings & Derivatives

Gross Notional Exposure	1 Regulatory AUM	2 Borrowing
Less than 10%	<i>[Dollar value]</i>	<i>[Dollar value]</i>
10-149%	<i>[Dollar value]</i>	<i>[Dollar value]</i>
150% or more	<i>[Dollar value]</i>	<i>[Dollar value]</i>

- **New: Question (b)**
  - For advisers with SMA RAUM of at least \$500 million, but less than \$10 billion
  - Data only provided for end-of-year





# **Section 5.K.(2) — SMA Borrowings and Derivatives**

- **Borrowings and derivatives information is consistent with Form PF reporting**
- **Section 5.K.(2) allows RIAs the option to insert a narrative description in order to provide clarification regarding the RIA's responses**

# Section 5.K.(3) — SMA Custodian Information

- **New**
  - Complete a separate Schedule D Section 5.K.(3) for each custodian that holds ten percent or more of your separately managed account RAUM across all SMAs

# Section 5.K.(3) — SMA Custodian Information

- (a) Legal name of custodian
- (b) Primary business name of custodian
- (c) The location(s) of the custodian's office(s) responsible for custody of the assets (city, state and country)
- (d) Is the custodian a related person of your firm?
- (e) If the custodian is a broker-dealer, provide its SEC registration number
- (f) If the custodian is not a broker-dealer, or is a broker-dealer but does not have an SEC registration number, provide its legal entity identifier
- (g) What amount of your regulatory assets under management attributable to separately managed accounts is held at the custodian?

# **Umbrella Registration**

# Background on Umbrella Registration

- **Umbrella registration allows multiple investment advisers to register on a single Form ADV**
- **2012 ABA No-Action Letter established the conditions that RIAs have to meet to utilize umbrella registration and how to list relying advisers on Form ADV**
- **New Form ADV codifies the 2012 ABA No-Action Letter and requires Schedule R for each relying adviser (replacing the filing instructions in the 2012 ABA No-Action Letter)**

# Fund General Partner Entities

- **Schedule R is not required for “special purpose entities” (“SPEs”) as referenced in the 2005 ABA No-Action Letter (which defined SPEs as entities that were formed for local legal or tax reasons, and which do not have their own employees)**
- **In general, fund general partner entities are considered SPEs instead of relying advisers and, therefore, Schedule R will generally not be required for fund general partners**
- **If a fund general partner has many of the characteristics of an investment adviser, however, it is possible that it will be considered a relying adviser (e.g., it has employees, it was not formed solely for legal or tax reasons)**

# Conditions for Umbrella Registration

1. The filing adviser and each relying adviser advise only private funds and clients in SMAs that are qualified clients
2. The filing adviser has its principal office and place of business in the United States
3. Each relying adviser, its employees and the persons acting on its behalf are subject to the filing adviser's supervision and control
4. The advisory activities of each relying adviser are subject to the Advisers Act and the rules thereunder, and each relying adviser is subject to examination by the SEC
5. The filing adviser and each relying adviser operate under a single code of ethics, a single set of written policies and procedures, both of which are administered by a single chief compliance officer



# Umbrella Registration in Non-US Context

- **RIAs commonly register non-US investment adviser affiliates as relying advisers**
  - The SEC and the SEC's staff have stated that the non-US advisory activities of a non-US RIA are outside of the scope of the Advisers Act – except this principle **does not apply** if a non-US RIA is a relying adviser
  - **Non-US relying advisers are subject to the Advisers Act with respect to all of their advisory activities, including with respect to non-US clients.** If a non-US adviser wants to avoid the application of the Advisers Act on its non-US advisory activities, it must separately register with the SEC

# Schedule R

- **Schedule R requires each relying adviser to answer slightly modified versions of these sections of Part 1A**
  - Item 1 – Identifying Information
  - Item 2 – SEC Registration (Basis for Registration)
  - Item 3 – Form of Organization
  - Item 10 – Control Persons (included in Item 4 on Schedule R)
  - Schedule A – Direct Owners (included in Item 4 of Schedule R)
  - Schedule B – Indirect Owners (included in Item 4 of Schedule R)

# Impact of Schedule R

- Old Requirement

- Name each relying adviser in Section 1.B of Schedule D
- Note in Schedule D "Miscellaneous" that the filing adviser and the relying adviser are relying on the same registration
- Only advise private funds and qualifying SMAs
- US principal place of business
- No mechanism to prevent any group of advisers from filing a single Form ADV

# Impact of Schedule R (cont.)

- New Form

- Relying advisers must be listed on Schedule R
- Advisers unable to utilize umbrella registration will be required to submit separate Form ADV filings for each investment adviser required to be registered with the SEC (instead of being listed as relying advisers)
- Only advise private funds and qualifying SMAs
- US principal place of business

# Exempt Reporting Advisers

- **SEC staff guidance permits ERAs to include SPEs on the same Form ADV as the filing adviser. As noted above, a fund general partner is a common example of an SPE**
- **ERAs are not permitted to submit a single Form ADV with respect to non-SPE advisory entities (e.g., entities that have employees and are not formed solely for local legal or tax reasons), and must instead submit separate Form ADV filings**

# **Additional Significant Changes**

# Additional Offices

- **Item 1.F**

- New

- Number of offices required to be listed has been increased to the largest 25 offices (previously the requirements was the largest 5 offices) and the total number of offices where investment advisory services are provided
- With respect to each office, advisers must disclose
  - The number of employees providing investment-related services
  - Whether certain other business activities are conducted
  - Whether any additional investment-related activities are conducted

# Social Media Accounts

- **Item 1.I**
  - New
    - Do you have one or more websites or accounts on publicly available social media platforms (including, but not limited to, Twitter, Facebook and LinkedIn)?
      - Yes    No
- **Form ADV FAQ 1.I – Guidance on social media account disclosure**



# Non-Employee CCOs

- **Item 1.J.(2)**

- If your Chief Compliance Officer is compensated or employed by any *person* other than you, a *related person* or an investment company registered under the Investment Company Act of 1940 that you advise for providing chief compliance officer services to you, provide the *person's* name and IRS Employer Identification Number (if any): \_\_\_\_\_

# 120-Day Registration

- **Item 2.A.(9)**

- Old: In order to utilize Item 2.A.(9) as a basis for registration, advisers had to be newly formed and expect to be eligible for SEC registration within 120 days
- New: Advisers may now utilize Item 2.A.(9) as a basis for registration if they expect to be eligible for SEC registration within 120 days (i.e., such advisers no longer need to be “newly formed”)

# Non-US Client Disclosures

- **Item 5.F.(3)**
  - New
    - What is the approximate amount of your total regulatory assets under management (reported in Item 5.F.(2)(c) above) attributable to clients who are non-United States persons?
- **Note: this disclosure includes non-US clients whose portfolios are counted in RAUM**

# RAUM vs. “Real” AUM Disclosures

- **Item 5.J.(2)**
  - New
    - Do you report client assets in Item 4.E. of Part 2A that are computed using a different method than the method used to compute your regulatory assets under management?
      - Yes     No

# Qualified Client Status Disclosure

- **Schedule D, Section 7.B.(1)(A)(15)(b)**
  - New
    - If the private fund qualifies for the exclusion from the definition of investment company under section 3(c)(1) of the Investment Company Act of 1940, are sales of the fund limited to *qualified clients*?  
Yes No

# **Books and Records Rule Update**

# Books and Records

- **Performance Calculation Records Retention**
  - RIAs are now required to maintain support for **all** calculations of performance contained in communications to any person
  - Prior version of the rule only required retention of supporting materials when the communication was distributed to ten or more persons
- **Communications Relating to Performance Information**
  - RIAs are now required to maintain **all** communications relating to the performance or rate of return or performance of any or all managed accounts or securities recommendations
  - Books and Records Rule previously limited this to certain categories of communications



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Brian T. Daly advises hedge, private equity and real estate fund managers on regulatory, compliance and operational matters. He has extensive experience designing and improving compliance processes and organizational systems and helps clients navigate their initial and ongoing regulatory compliance obligations under the rules and regulations of the Securities and Exchange Commission, the Commodity Futures Trading Commission, and the National Futures Association. Brian also regularly represents clients in enforcement actions, regulatory examinations, trading inquiries, and in seeking no-action or similar relief. Having spent nearly a decade in-house as general counsel and chief compliance officer of several prominent investment management firms, Brian is well-versed in the wide range of legal and business challenges facing investment advisers, commodity pool operators and commodity trading advisers.

Brian is a recognized leader in advising alternative investment fund managers on regulatory and compliance matters and is well-known for his thought leadership in this area. He also regularly represents managers in examinations, investigations, and enforcement actions in both the securities and the commodity futures sectors. *Chambers Global* and *Chambers USA* list Brian as a “leading individual” in investment funds, noting that he is “especially skilled at assisting clients with the development of strategic compliance programs.” Interviewees also praise him for knowing “what it’s like on the ground” and for providing “practical and meaningful advice.” In addition, Brian sits on the New York City Bar Association’s Private Investment Funds Committee, and he is a chair of the Steering Committee for the Managed Funds Association’s CTA/CPO Forum and a member of the CFTC Working Group for the Alternative Investment Management Association. He formerly served as co-chair of the MFA’s General Counsel Forum, its CTA, CPO & Futures Committee, and as a steering committee member of its Investment Advisory Committee. In addition to his legal practice, Brian taught legal ethics at Yale Law School. Brian received his J.D., with distinction, from Stanford Law School.





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Marc E. Elovitz is chair of the firm's Investment Management Regulatory & Compliance Group. He advises hedge funds, private equity funds and real estate funds on compliance with the Investment Advisers Act of 1940 and other federal, state and self-regulatory organization requirements, including establishing compliance programs, registering with the SEC and handling SEC examinations. Marc provides guidance to clients on securities trading matters and represents them in regulatory investigations and enforcement actions, arbitrations and civil litigation. He also regularly leads training sessions for portfolio managers and analysts on complying with insider trading and market manipulation laws.

A member of the American Bar Association's Business and Litigation Sections and the Hedge Funds Subcommittee of the Committee on Federal Securities Regulation, Marc is a frequent speaker at hedge fund industry conferences and seminars. In addition, he co-authors the "Market Manipulation" chapter in the leading treatise, *Federal Securities Exchange Act of 1934* (Matthew Bender) and wrote the chapter on "The Legal Basis of Investment Management in the U.S." for the Oxford University Press book, *The Law of Investment Management*. After graduating with honors from Wesleyan University in 1986, Marc attended New York University School of Law, from which he was awarded his J.D. degree in 1990.