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SEC Adopts Amendments to Investment Adviser Act Rules

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Background:
On August 25, 2016, the Securities and Exchange Commission (the "SEC" or the "Commission") adopted amendments to various rules under the Investment Advisers Act of 1940 (the "Act"). The amendments will be effective 60 days after the date of publication in the Federal Register, but investment advisers are expected to comply with the amendments after October 1, 2017. In general, the amendments will cause investment advisers to provide more specific and detailed information about their advisory business, which is expected to be more useful to clients as well as to assist the SEC in its risk-monitoring and examination programs.

Most of the amendments relate to providing more information about separately managed accounts (which previously has not been a focus under the Act). The final amendments are very similar to the proposed amendments issued by the SEC in May 2015, with certain improvements and changes made due to the Commission's consideration of comments submitted by various commenters.

This alert summarizes the key amendments to Form ADV and the Act. For further information, refer to the final amendments at https://www.sec.gov/rules/final/2016/ia-4509.pdf.

Separately managed accounts ("SMAs"):

The amendments will require the following from investment advisers for SMAs:

- Report on the percentage of assets under management ("AUM") invested in twelve categories described below. Investment advisers with less than $10 billion in regulatory AUM will report the end-of-year percentages, whereas those with over $10 billion in regulatory AUM must report both mid-year and end-of-year percentages on an *annual* basis. The final amendements notes that investment advisers can use either their own internal conventions or information provided by their service providers to categorize the regulatory AUM, as long as it is consistently applied and AUM is not double counted. Investment advisers also should note that they must not look through investments in funds or ETFs, because the Commission is looking to understand the extent of separately managed account AUM that are invested in both funds and other types of investments.

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The twelve asset categories are:
    - Cash and cash equivalents
    - Corporate bonds – investment grade
    - Corporate bonds – non-investment grade
    - Derivatives
    - Exchange traded equity securities
    - Non-exchange-traded equity securities
    - Securities issued by registered investment companies or business development companies
    - Securities issued by pooled investment companies (other than registered investment companies)
    - Sovereign bonds
    - U.S. Government/agency bonds
    - U.S. State and Local bonds
    - Other
- Report on the use of borrowings and derivatives in SMAs - As compared to the proposed amendments issued by the Commission in May 2015, the final amendments raise the minimum reporting threshold for borrowing and derivatives to investment advisers with at least $500 million in AUM. Investment advisers may report on the above for individual accounts of at least $10 million. Advisers with:
    - $500 million to less than $10 billion in SMA regulatory AUM will report the amount of borrowings attributable to those assets that correspond to the following three levels of gross notional exposures: less than 10%; 10% to 149%; and 150% or more.
    - $10 billion or more in SMA regulatory AUM will report (a) the amount of borrowings attributable to those assets that correspond to the following three levels of gross notional exposures: less than 10%; 10% to 149%; and 150% or more; (b) derivative exposures across six derivatives categories. The six derivative categories are: interest rate derivatives; foreign exchange derivatives; credit derivatives; equity derivatives; commodity derivatives; and other.

  If the investment adviser believes that the disclosure of gross notional metrics would mislead the reader, the adviser also may provide additional narrative regarding the strategy and the use of borrowings and derivatives in SMAs.
- Identify custodians who account for at least 10% of SMA regulatory AUM, as well as the aggregate amount of the investment adviser's SMA regulatory AUM held at the custodian.

Additional information about investment advisers:

The amendments also include the following additional identifying information regarding advisers:

- Central index key ("CIK") number, if an adviser has one or more such CIK numbers assigned.
- Publicly available social media platform addresses, which might be used in connection with the Commission's examination of investment advisers. The SEC clarified within the final amendments that the information requested is only for social media accounts whose content is controlled by the investment adviser.
- Total number of offices, the number of employees at the 25 largest offices (including the number of employees who perform advisory functions), and the securities-related and investment-related business conducted from each office. The information should be updated annually.
- Report whether the investment adviser's chief compliance officer ("CCO") is compensated or employed by any person other than the adviser or a related party for providing CCO services to the adviser. If the above circumstance does exist, the investment adviser must provide the name and tax ID number of the person who compensates the CCO. The SEC has noted in the final amendments that its "examination staff has observed a wide spectrum of both quality and effectiveness of outsourced chief compliance officers and firms. Identifying information for these third-party service providers, like others on Form ADV, will allow [the SEC] to identify all advisers relying on a particular service provider, and could be used to improve [the SEC's] ability to assess potential risks." The above information should exclude CCOs who are compensated/employed by a registered investment company advised by the investment adviser.
- Advisers with assets of $1 billion or more should report those assets within three ranges: $1 billion to less than $10 billion; $10 billion to less than $50 billion; and $50 billion or more.
- Report the number of clients and the amount of regulatory AUM attributable to each category of client. The final amendments will replace the approximate ranges (currently required) with more specific data. Advisers with fewer than five clients in a particular category can indicate that fact, rather than report the actual number of clients.
- Report the approximate amount of regulatory AUM that is attributable to non-U.S. persons.
- Report the regulatory AUM of all parallel managed accounts related to a registered investment company or business development company advised by the investment adviser. As noted by the SEC, the staff will focus on how the investment adviser manages conflicts of interest due to such relationships.

Umbrella registration:

The final amendments simplify registration for certain investment advisers to private funds that operate a single advisory business through multiple legal entities. The Commission also has clarified the factors that could indicate a single advisory business: "commonality of advisory services and clients; a consistent application of the [Act] and the rules thereunder to all advisers in the business; and a unified compliance program."

Amendments to the books and records rules in the Act:

- Advisers will be required to retain all accounts, books, internal working papers, etc. (as noted in Rule 204-2(a)(16)) that demonstrate the computation of the rate of return in any communication that is distributed by the adviser directly or indirectly, to any person. The current requirement under Rule 204-2(a)(16) is to maintain records that are sent to ten or more persons.
- In addition, Rule 204-2(a)(7) is amended to require investment advisers to retain originals of all written communications received and sent by the investment adviser relating to the rate of return of any or all managed accounts or securities recommendation.

In response to the SEC's proposed amendments in May 2015, various commenters had stated that the rule amendments should exclude custom one-on-one communications. However, the SEC clarified in the final

amendments that it "believe(s) the veracity of performance information is important regardless of whether it is a personalized client communication or in an advertisement sent to ten or more persons." Investment advisers should note that although the requirements would apply after October 1, 2017, if the communications (after the compliance date) include information prior to the effective date, the investment adviser must maintain this information as well.

WeiserMazars Can Help:

Please contact your WeiserMazars Engagement Partner or one of the following individuals to have an in-depth discussion regarding the impact of these changes on your business.

For more information contact:

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