August 11, 2015

Via Electronic Mail (rule-comments@sec.gov)

Mr. Brent J. Fields, Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Amendments to Form ADV and Investment Advisers Act Rules, SEC Rel. IA-4091, File No. S7-09-15, RIN 3235-AL75

Dear Mr. Fields:

The Investment Adviser Association[1] appreciates the opportunity to comment on the Securities and Exchange Commission's proposed amendments to Form ADV, which would require advisers to report additional data about their business and their clients' investments, particularly in client accounts that are managed individually (referred to by the Commission as "separately managed accounts" or "SMAs").[2]

We fully support the Commission's goals in this important rulemaking, which marks the beginning of a series of proposed rulemakings designed to enhance the SEC's risk monitoring and regulatory safeguards for the asset management industry.[3] We concur that the collection and analysis of additional census-type data about SMAs will further strengthen the SEC's ability to oversee the asset management industry, including assessing industry trends and risks. Significantly, additional information will also help the SEC staff enhance its ability to conduct risk-based examinations of advisers, thus making the Commission more efficient and effective in overseeing the advisory industry. The IAA has long supported Commission efforts to better

[1] The IAA is a not-for-profit association that represents the interests of investment adviser firms registered with the U.S. Securities and Exchange Commission. The IAA's membership consists of more than 550 firms that collectively manage approximately $16 trillion for a wide variety of individual and institutional investors, including pension plans, trusts, investment companies, private funds, endowments, foundations, and corporations. For more information, please visit www.investmentadviser.org.

[2] *Amendments to Form ADV and Investment Advisers Act Rules,* SEC Rel. IA-4091 (May 20, 2015) ("Proposal"), available at http://www.sec.gov/rules/proposed/2015/ia-4091.pdf.

[3] With this Proposal, the SEC contemporaneously proposed amendments to the Investment Company Act of 1940 to increase reporting obligations of registered investment companies. *See Investment Company Reporting Modernization,* SEC Rel. IC-31610 (May 20, 2015) ("Investment Company Reporting Proposal"), available at http://www.sec.gov/rules/proposed/2015/33-9776.pdf. In addition to these data reporting proposals, the SEC is also developing recommendations on liquidity risks and standards for mutual funds and ETFs, reviewing options for specific requirements for the use of derivatives by funds, studying new requirements for stress testing by large investment advisers and large funds, and considering provisions for transition plans after a major disruption in an investment adviser's operations. *See* Chair Mary Jo White, Statement at an Open Meeting on Investment Company and Investment Adviser Reporting (May 20, 2015), available at http://www.sec.gov/news/statement/modernizing-investment-company-and-investment-adviser-reporting.html.

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leverage its resources and data to effectively and efficiently oversee and examine investment advisers.

We appreciate the Commission's efforts to design additional data reporting requirements "with a view towards minimizing as much as possible the burden on regulated entities and the investors they serve."[4] While the SEC should have access to appropriate data, it should always seek to collect that information in the most efficient and cost-effective way possible, with a particularly keen eye on the way costs disproportionately affect smaller advisers. We offer a number of comments along these lines, intended to help tailor the regulatory approach to be more targeted, while consistent with the Commission's goals. In particular, we suggest that:

- ***The threshold for reporting use of borrowings and derivatives should be adjusted.*** Increasing the basic $150 million reporting threshold for derivatives and borrowing use in SMAs to $500 million would alleviate reporting burdens and associated costs on approximately 3,000 small firms, while retaining more than 95 percent of the data sought by the Commission. We also recommend making the exclusion of small accounts optional, rather than mandatory—a change that would actually increase the amount of data reported to the SEC while simplifying the reporting process and reducing costs for advisers that choose to include those SMA assets in their reporting.

- ***Reporting clients' assets and derivatives exposures in SMAs should be confidential.*** While we understand the potential regulatory utility of additional SMA data, the Proposal may raise concerns about disclosure of client confidential information and advisers' proprietary information under certain circumstances. Moreover, the derivatives disclosure is likely to be difficult to interpret and place in the appropriate context, and as a result may potentially confuse or mislead investors. We strongly recommend that the SEC make responses to these particular sections of Form ADV non-public.

- ***If the Commission decides to require public disclosure of clients' assets and derivatives exposures in SMAs, then it should modify certain aspects of the disclosure.*** In particular, we recommend allowing advisers to use a generic response (such as "fewer than five") when only one or a few accounts fit a particular category and make adjustments to the information requested related to "gross notional" exposure and the value of derivatives.

- ***The Commission should take this opportunity to clarify Form ADV's questions on custody.*** While not necessarily related to the Commission's immediate goals of enhancing its data on SMAs, we strongly recommend that the Commission amend the questions on custody in Form ADV. These questions are a source of

[4] Commissioner Daniel M. Gallagher, Statement at Open Meeting on Modernizing and Enhancing Investment Company and Investment Adviser Reporting (May 20, 2015), available at http://www.sec.gov/news/statement/modernizing-ic-ia-reporting-commissioner-gallagher.html.

needless confusion for advisers. They could be easily amended in ways that would clarify Form ADV and generate more accurate, consistent responses from the industry.

In addition to these primary recommendations, we have several suggestions with respect to the disclosure on parallel managed accounts, custodians, the proposed amendments to the books and records rule, and responses to several of the SEC's specific request for comments. An Appendix attached to this letter provides specific and technical comments to proposed Items, terms, and the general instructions in Form ADV Part 1A.

Finally, we note that the proposed amendments to Form ADV Part 1A will affect all of the approximately 11,500 investment advisers registered with the SEC. They will need an appropriate amount of time to understand the new reporting requirements and ensure that their portfolio accounting and data management systems can capture the required data so that it can be reported on the revised Form ADV Part 1A. Accordingly, we respectfully request an implementation date of twelve months after the adoption of the final rules and form changes.

I. Reporting Thresholds

A significant part of the Proposal relates to reporting data on the net asset value ("NAV") of SMAs,[5] based on either adviser-level or account-level thresholds. Advisers with more than $150 million in SMA regulatory assets under management ("RAUM") would report data about derivatives and borrowings in those accounts. Advisers with more than $10 billion in SMA RAUM would report additional data, and report it as of year-end and mid-year dates. The Proposal would exclude reporting on SMAs with a NAV of less than $10 million. We have several comments on these adviser-level and account-level thresholds.

1. Adviser-Level Thresholds

As noted above, the Proposal has two adviser-level thresholds: $150 million in SMA RAUM and $10 billion in SMA RAUM. We support the $10 billion threshold, as we believe that it strikes the right balance between achieving the regulatory goal of obtaining additional information about the use of derivatives in separately managed accounts and the burdens that

[5] In general, a separate account is an individual client account advised by an adviser, established under an investment management or advisory agreement between the client and the adviser, whereby the agreement establishes the investment strategies, guidelines and/or restrictions that a particular client has directed the adviser to follow. SMAs are strictly separated from the adviser's own assets; they are not part of an adviser's own balance sheet and are generally held in a segregated account at an independent custodian. Separate accounts provide asset owners, rather than the adviser, with direct ownership and control of investment assets, without the rights and liabilities associated with the pooling of funds. We note that the term "separate account" has a different meaning in the insurance context. The Commission defines SMA to mean: "advisory accounts other than those that are pooled investment vehicles (i.e., registered investment companies [("RICs"], business development companies [("BDCs")], and pooled investment vehicles that are not investment companies (i.e., private funds))." Proposal at 8. We have further recommendations about the terms "SMA" and "NAV" in the Appendix under Item 5.K. and Section 5.K.(2).

will be imposed on larger advisers in tagging, sorting, and collecting the required data. We recommend, however, that the Commission increase the $150 million threshold to $500 million.

Advisers that cross this initial $150 million threshold would identify in new Item 5.K.(2) whether they engage in derivatives or "borrowing" transactions on behalf of any of their separately managed account clients.[6] We estimate, however, that if the regulatory threshold for collecting this data on derivatives and borrowings in SMAs were increased from $150 million to $500 million of SMA RAUM, the Commission would still obtain data on more than 95% of the SMA assets it proposes to collect, while alleviating the reporting burden and related costs on approximately 3,000 advisers.[7]

We do not believe that this marginal reduction in the data requested would frustrate the Commission's policy goals. By proposing the $150 million SMA and $10 million account thresholds, the Commission clearly recognizes that a complete data set is unnecessary to achieve its policy goals, and that the costs of collecting this information at the margin exceeds its benefit. We agree. Industry surveys have indicated that SMAs typically reflect a long-term investing mandate that utilize little leverage at the account level and few investments in derivatives.[8] We would expect that the SEC's more comprehensive data collection would confirm that this is true generally. Accordingly, it is not necessary to set a threshold that captures nearly all SEC-registered advisers managing SMAs for these purposes.[9]

In raising the threshold to $500 million, the Commission would alleviate the reporting burden on approximately 3,000 advisers. While we recognize that Section 5.K.(2)(b) requires less information than the similar disclosure for larger advisers, there is still a meaningful cost and resource burden associated with calculating these new reporting requirements. In particular, in order to make the required disclosure, every adviser subject to reporting will have to categorize

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[6] Comments on the term "borrowings" are in the Appendix.

[7] The use of maximum and minimum ranges makes this calculation imprecise. Using the maximum ranges from Form ADV data as of April 8, 2015 (the data set used in the IAA's *2015 Evolution Revolution* report), we estimate that the SEC would collect data on $37,813,740,821,411 in SMA RAUM from 7,257 advisers. Raising the threshold to $500 million would result in data on $36,839,399,090,198 from 3,703 advisers—97.4 percent of the data from 3,554 fewer advisers. Using minimum ranges from the same data set results in 95.7 percent of the data collected from 2,762 fewer advisers.

[8] A recent survey of separate accounts advised by large asset managers showed that nearly all (99%) of the separate accounts in the survey were long-only strategies, the majority (53%) of which were index strategies, and that very few used leverage. *See* Letter from Timothy Cameron, Head, SIFMA AMG, to Secretariat of the Financial Stability Board, Re: "Assessment Methodologies for Identifying Non-Bank Non-Insurer Global Systemically Important Financial Institutions" (Apr. 4, 2014), available at http://www.sifma.org/comment-letters/2014/sifma-amg-submits-comments-to-the-fsb-and-sec-in-response-to-ofr-study-and-in-regards-to-separate-accounts/.

[9] The Commission noted that it selected a $150 million threshold for SMAs because the Form PF threshold for advisers is $150 million or more in private fund assets. Proposal at 10, n. 16. Given the significant differences in the nature and extent of the data obtained through Form PF and that proposed for Form ADV for SMAs, as well as the differences in the Commission's policy goals underlying the two forms, we do not see any compelling reason to adopt the same reporting threshold.

and maintain SMA client information in the manner proposed—by calculating for each account its net asset value, dollar amount of borrowings, and gross notional exposure of derivatives. After excluding accounts with less than $10 million in SMA assets, the adviser would have to categorize accounts into three NAV ranges, then subcategorize them into four gross notional exposure ranges, then calculate the number and weighted average borrowings for each subcategory. For most advisers, all of this would require a modification of their current internal reporting systems.

These costs and burdens—while not insurmountable—outweigh the marginal benefit of collecting the data from smaller advisers. We therefore respectfully request the Commission increase the reporting threshold from $150 million in RAUM attributable to SMAs to $500 million in RAUM attributable to SMAs for Section 5.K.(2), which will still allow the Commission to fulfill its regulatory goals in generally tracking borrowing and derivatives use.

2. Account-Level Thresholds

The Commission proposes to exclude accounts with a net asset value of less than $10 million from the reporting requirements in Section 5.K.(2). We appreciate the Commission's intent to eliminate reporting on smaller accounts, recognizing that the burdens outweigh the benefits of gathering data at the margins. However, some firms may find that it is actually more difficult to exclude these accounts, as it would require them to further analyze, categorize, and report SMAs in ways not currently captured by advisers' systems. Thus, this approach may not alleviate burdens but rather inadvertently increase the reporting burden on some firms. Therefore, we request that advisers be provided the *option* to exclude accounts under $10 million. We note that this approach has the potential to benefit both industry and the SEC, given that an adviser choosing to include all of its SMA assets in Section 5.K.(2) would actually be reporting *more* data to the SEC.[10]

3. Treatment of Sub-Advisory Relationships

For all reporting of aggregate information on derivatives and borrowings in SMAs in Section 5.K.(2), the Commission states that "if an adviser is a subadviser to an SMA, the adviser should only provide information with respect to the portion of the account that the adviser subadvises."[11] We support this idea with one clarification.

We recommend that advisers with affiliated sub-advisers should be permitted to select and identify which entity (whether the adviser or sub-adviser) is reporting data on the accounts it advises in Section 5.K.(1) on asset types, as well as in Section 5.K.(2) for the derivatives and borrowings exposures of the SMAs. The Commission should include instructions stating that

[10] We asked participants on a recent IAA webinar whether they would include or exclude accounts smaller than $10 million if given that option. Out of 102 responses, 39 would exclude the accounts, 28 would include them (*i.e.*, would take advantage of the option we propose), and 35 were undecided.

[11] *See* Proposed Section 5.K.(2) of Schedule D.

either the adviser *or* the affiliated sub-adviser should complete and file Sections 5.K.(1) and 5.K.(2).[12]

II. Reporting SMA Asset Composition and Derivatives Exposures

The SEC seeks comment on whether the public disclosure of aggregate separately managed account information raises confidentiality concerns. More specifically, the SEC asks whether "disclosure of aggregate holdings, derivatives and borrowings in separately managed accounts raise concerns, in light of Section 210(c) of the [Investment] Advisers Act [of 1940 "(Advisers Act")], regarding the identity, investments, or affairs of any clients" and whether "disclosure [would] impact a client's selection of an investment adviser."[13]

1. Data on Aggregate Holdings, Borrowings, and Derivatives Should be Non-Public

Although we appreciate that the Commission proposed aggregate disclosure, we nevertheless have concerns that the data could be misused or misinterpreted. Section 5.K.(1) asks advisers to report the composition of SMA assets by asset type, and Section 5.K.(2) asks for aggregate data on derivatives and borrowing transactions. The nature of the data requested primarily serves a regulatory purpose, as it is intended to allow the SEC to more efficiently and effectively oversee the asset management industry. As explained in more detail below, however, it serves little public purpose and, in fact, could be potentially damaging to advisers and their clients. Accordingly, we strongly recommend that the SEC make responses to Sections 5.K.(1) and 5.K.(2) non-public.

We have two primary concerns with respect to this data. First, responses to Sections 5.K.(1) and (2) could indirectly disclose the identity of an adviser's clients and potentially proprietary information about their investments and the adviser's trading strategies. Section 5.K.(1) requires disclosure of asset types across all SMA client accounts. Advisers, both large and small, have concerns that this disclosure could unfairly reveal information about their asset allocation and quantitative model-driven strategies, which may be highly proprietary and customized. Section 5.K.(2) requires derivatives and borrowing data, broken down by three NAV ranges and four subcategories of gross notional exposure. There is a particular risk in this disclosure that an adviser could have one or a few accounts in a particular category, and that in those cases it might be inferred that a particular client has hired that adviser. For example, some public pension plans have to either publish or make available on request details of an award of business to an adviser under the plans' contracting rules. Assume that such a plan has a large mandate managed by an adviser that indicates a sole or a few clients in a particular category. It might be possible for an interested party to trace the adviser's reporting to attempt to determine the particular plan's portfolio profile and movements over time. While this is a concern for both

[12] We understand and seek confirmation that sub-advisers to mutual funds or pooled funds should not include these assets as SMA assets. We discuss this in the Appendix under Item 5.D., Client Type.

[13] Proposal at 14, 65-66. Section 210(c) prohibits the Commission from requiring an adviser to disclose the identity, investments, or affairs of any client of the adviser.

large and small advisers, the more detailed breakdown of derivatives exposures in Section 5.K.(2) makes it particularly troubling for larger advisers. We also share the concern highlighted in the SEC's request for comment that the public disclosure of responses to Section 5.K.(2) could harm an adviser's ability to attract clients, if clients choose to hire only advisers that already have enough existing clients in a particular NAV range to ensure that the prospective client's account would be part of truly aggregate disclosure.

Second, as discussed in more detail in the next section of this letter, we are concerned that the disclosure of exposures based on gross notional values for derivatives would be misleading in a public filing. While the information may serve regulatory purposes, such as for tracking overall industry trends on the volume of derivatives use, gross notional values are not a measure of leverage or risk. Regulators might be able to place the weighted average gross notional values required in Section 5.K.(2)(a) in the appropriate context; individual investors or others who might use Form ADV data are more likely to incorrectly assume the figures relate to some measure of risk. To the extent that an adviser employs derivatives or borrowings as part of an investment strategy, clients can better understand a plain English narrative explanation than the raw quantitative data that would be provided under the proposed items.[14]

The Commission can alleviate these concerns by making this data non-public. Under Section 210(a) of the Advisers Act, "the information contained in any registration application or report or amendment thereto filed with the Commission…shall be made available to the public, unless and except insofar as the Commission, by rules and regulations upon its own motion…finds that public disclosure is neither necessary nor appropriate in the public interest or for the protection of investors." Not all information in Form ADV is necessary or appropriate in the public interest. For example, certain information in Item 1, such as an adviser's CCO's email address or a sole proprietor's primary residential address, is suppressed from public release on the Investment Adviser Public Disclosure ("IAPD") website.[15] Given the nature of the proposed information about client holdings and derivatives exposure in proposed Sections 5.K.(1) and 5.K.(2), we urge the Commission to make a finding that public answers to these particular questions are neither necessary nor appropriate in the public interest or for the protection of investors.

If the Commission made this determination, the treatment of this particular data as non-public would be similar to the treatment of private fund information filed on Form PF. We recognize that under Section 204(b)(10) of the Advisers Act, as adopted by the Dodd-Frank Act, the Commission is expressly limited from disclosing publicly an adviser's "proprietary

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[14] Advisers are required to describe investment strategies in Item 8 of Part 2A of Form ADV, and for significant investment strategies, the material risks involved with the strategy.

[15] *See Fast Answers: Investment Adviser Public Disclosure (IAPD)* on the SEC's website at http://www.sec.gov/answers/iapd.htm. The Commission does not state what information on Form ADV Part 1A it suppresses.

information" in Form PF filings.[16] "Proprietary information" under Section 204(b)(10)(B) includes "sensitive, non-public information regarding" the investment or trading strategies of the adviser, analytical or research methodologies, trading data, computer hardware or software containing intellectual property, and any additional information the Commission considers proprietary.[17] In adopting Form PF, the Commission noted that it determined not to adopt certain questions on Form ADV in response to commenter concerns that "they would result in the public disclosure of competitively sensitive or proprietary information."[18] Although the Form ADV data is less extensive than some of the information on Form PF, the Proposal notes that some of the information requested is comparable to Form PF data. Thus, similar principles should apply to the collection on information in the Proposal, particularly to proprietary data related to the derivatives exposures and investments of an adviser's separately managed account clients.

It is our understanding that even if the SEC made this data non-public under 210(c), it could nevertheless be available to the public under a request under the Freedom of Information Act ("FOIA"). We suggest that, in addition to making the information non-public, the SEC should allow firms to request confidential treatment.[19] This approach would achieve the Commission's regulatory goals while fully protecting confidential and proprietary data about the adviser's business and its clients and preventing potentially misleading public disclosure about an adviser's clients' investments and gross notional derivatives exposures.

2. *If Public, There Should be a Generic Response Option for Categories with Few Accounts*

If the Commission determines that responses to Sections 5.K.(1) and (2) must be public, then we strongly recommend that the Commission make two changes that would mitigate some of our concerns. First, we recommend that the Commission permit advisers to give a more generic answer for the number of accounts, such as "fewer than five," in those instances where an adviser has a limited number of accounts in a certain category. We would recommend a similar option for Item 5.D (number of accounts per type of client). Given this option, an adviser

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[16] Section 204(b)(10)(A) states that, "[a]ny proprietary information of an investment adviser ascertained by the Commission from any report required to be filed with the Commission pursuant to this subsection shall be subject to the same limitations on public disclosure as any facts ascertained during an examination, as provided by section 210(b) of this title."

[17] Section 204(b)(10)(B) of the Advisers Act.

[18] *See* Rules Implementing Amendments to the Investment Advisers Act of 1940, SEC Rel. No. IA-3221 (June 21, 2011) at 51 ("2011 Implementing Release"), available at http://www.sec.gov/rules/final/2011/ia-3221.pdf).

[19] *See* 17 CFR 200.83 (Commission Confidential treatment procedures under the Freedom of Information Act); *see also*, *Securities and Exchange Commission Confidential Treatment Procedure Under Rule 83*, at https://www.sec.gov/foia/conftreat.htm (rule applies in the context of examinations, inspections, and investigations, and in other cases where no procedures exist for requesting confidential treatment for particular categories of information).

would not have to identify one particular client in a client type category and risk inadvertently disclosing that client's identity or proprietary information.

Statistical information from Form ADV filings suggests that many advisers may benefit from this option to report "fewer than five." If the $150 million threshold were adopted as proposed, we estimate that 2,120 advisers that have 25 or fewer clients would have to report Section 5.K.(2) data. About two thirds of these (1,362) have 10 or fewer clients.[20] We assume that these advisers would have a high likelihood of having a small number of clients in one or more of the twelve NAV subcategories in Section 5.K.(2).

Second, we recommend the SEC change the proposed NAV breakpoints in Section 5.K.(2) so that the highest range begins at $500 million.[21] Accounts sized at $1 billion or greater are rare and therefore more likely to result in the isolation of a single account. A $500 million top threshold would reduce this risk by increasing the likelihood of having multiple accounts in the highest category.

III. <u>Derivatives Disclosure and the Use of "Gross Notional" Concepts</u>

As noted above, we are very concerned that the disclosure of certain metrics based on gross notional values for derivatives would be misleading in a public filing.[22] Gross notional values can often be very large amounts that do not directly represent the amount of money (or value) that is truly at risk.

Under the Proposal, all advisers would use gross notional exposure to determine the number of accounts in each NAV range in answering Section 5.K.(2). Advisers with at least $10 billion in regulatory AUM attributable to SMAs would provide the weighted average gross notional value (aggregate gross notional value of derivatives divided by the aggregate net asset

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[20] Form ADV data as of April 8, 2015, which forms the basis for the IAA's *2015 Evolution Revolution* report, shows that:

SMA RAUM ≥ $150m < $10b	Maximum #	% of All Such Advisers
0 Clients	20	0.3%
1-10 Clients	1,362	20.2%
11-25 Clients	758	11.3%
26-100 Clients	1,089	16.2%
More than 100 Clients	3,507	52.1%
Total Advisers	6,736	

[21] Accordingly, the NAV ranges would be $10,000,000 - $249,999,999; $250,000,000 - $499,999,999; and $500,000,000 or greater.

[22] We question the use of gross notional exposure in general. However, our concerns are mitigated if the data is filed confidentially and used solely for internal regulatory purposes.

value of the relevant accounts) with respect to the six categories of derivatives.[23] This disclosure would come under the heading "Average Derivatives Exposures."

The Commission states that it is "proposing to collect information about gross notional exposure, borrowings, and gross notional value of derivatives" because it believes it is important for the Commission to "better understand the use of derivatives and borrowings by advisers in separately managed accounts."[24] The Commission states that it is "proposing to use these measures because they are commonly used metrics in assessing the use of derivatives and are comparable to information collected in Form PF."[25] The SEC seeks comment on whether gross notional exposures and gross notional values are appropriate measures of the use of derivatives, or whether there are alternative or additional measures that it should consider.

We are concerned that the disclosure of weighted average gross notional exposures would be misleading in a public filing. Many in the public might assume that this value is a measure of leverage or risk. It is not. Gross notional value, at best, is a measure of volume (*i.e.*, how many contracts are put in place) that does not take into account factors that may result in lower economic exposure, such as netting or the posting of collateral. While the Commission could use its judgment in interpreting this disclosure and avoid using it as a basis for making regulatory judgments about leverage or risk, the public would be less likely to understand its limitations.[26] Accordingly, we strongly recommend against its use in a public disclosure document.

If the Commission decides to make this disclosure public, it should allow advisers to adjust gross notional exposures to take into account various factors that reduce or better reflect risk, such as netting agreements that close out positions, adjustments to reflect duration, or whether or not the derivatives are centrally cleared.[27] More specifically, we recommend the

[23] Comments on the specific categories of derivatives are in the Appendix.

[24] Proposal at 11 and n. 19 (noting that several commenters, including the IAA, to FSOC's Notice Seeking Comment on Asset Management Products and Activities, 79 FR 77488 (Dec. 24, 2014), discussed a variety of "measures for reporting leverage (which includes derivatives and borrowings)").

[25] *Id*. We note that Form PF, questions 13 and 44, request information on aggregate value of all "derivatives positions," and Instruction 15 states that "if a question requests information regarding a 'position' or 'positions,' you should determine whether a set of legal and contractual rights constitutes a 'position' in a manner consistent with your internal recordkeeping and risk management procedures (*e.g.*, some advisers may record as a single position two or more partially offsetting legs of a transaction entered into with the same counterparty under the same master agreement, while others may record these as separate positions)."

[26] If the Commission decides to make this disclosure public, the Commission should clearly explain in the Form what the gross notional exposure and gross notional value metrics measure and what they do not measure, including their uses and limitations.

[27] *See* FSB/IOSCO Assessment Methodologies for Identifying Non-Bank Non-Insurer Global Systemically Important Financial Institutions (Mar. 4, 2015) at 39, n.60, available at http://www.financialstabilityboard.org/wp-content/uploads/2nd-Con-Doc-on-NBNI-G-SIFI-methodologies.pdf (in discussing gross notional exposure for investment funds, noting "the calculation of the global exposure as defined in EU regulation through the so-called 'commitment approach' allows adjustment of GNEs based on clearly-defined hedging and netting rules"). *See also,* Letter from PIMCO to FSB/IOSCO on Second Consultation (May 29, 2015), available at http://www.financialstabilityboard.org/wp-content/uploads/PIMCO.pdf; Letter from AIMA to FSB/IOSCO re:

Commission permit firms to net across "derivative positions" similar to its guidance to advisers of private funds, which allows an adviser to net across positions if doing so is consistent with the adviser's internal recordkeeping and risk management procedures.[28] Further, we request the Commission acknowledge, as in the guidance for Form PF, that in reporting the value of derivatives positions, an adviser should not include any closed-out positions, if those positions were closed out with the same counterparty and result in no credit or market exposure to the client.[29]

IV. Custody Questions in Form ADV Part 1A

The Commission asks "whether there are any ambiguities or concerns" that it should address in Form ADV, the instructions or the Glossary.[30] As we have noted in past comment letters,[31] Item 9 on custody is confusing in its use of the terms "you" and "your related persons." The General Instructions to Form ADV, Part 1A state that "'you' means the investment adviser (*i.e.*, the advisory firm)." However, the Advisers Act custody rule 206(4)-2 is broader and states that "you" [the adviser] are deemed to have custody if your related person has custody "in connection with advisory services you [the adviser] provide to your clients."

Response to the second FSB and IOSCO Consultation Paper on Assessment Methodologies for Identifying Non-Bank Non-Insurer Global Systemically Important Financial Institutions (June 1, 2015) at 8, 12, available at http://www.financialstabilityboard.org/wp-content/uploads/Alternative-Investment-Management-Association-AIMA.pdf (noting that "GNE does not directly represent an amount of money (or value) that is at risk. It is a reference figure used to calculate profits and losses.")

[28] *See* Question 44.1 of the SEC's Division of Investment Management, *Form PF Frequently Asked Questions* (last updated Dec. 5, 2014) ("Form PF FAQs"), available at http://www.sec.gov/divisions/investment/pfrd/pfrdfaq.shtml?utm_source=page&utm_medium=/financial-reporting-network/insights/2014/updates-form-pf-frequently-asked-questions.aspx&utm_campaign=download ("Question 44 requires you to report the aggregate 'value' of all derivatives positions. Value is defined in Instruction 15 and requires that the fund report the gross notional value of its derivative positions without netting across positions. Instruction 15 defines 'positions' and requires advisers to determine whether a set of legal and contractual rights constitutes a single 'position' in a manner consistent with the fund's internal recordkeeping and risk management procedures. In accordance with this Instruction, you may only net across your positions if doing so is consistent with your internal recordkeeping and risk management procedures, regardless of whether your ISDA agreement with the swap dealer allows netting….").

We also request the Commission amend the text in Section 5.K.(2) to state: "the gross notional exposure of an account is the percentage obtained by dividing (i) the sum of (a) the dollar amount of any borrowings (b) the gross notional value of all derivative *positions*, by (ii) the net asset value of the account." (emphasis added).

[29] *See* Form PF FAQ 44.1, *supra* n. 28 ("Further in reporting the aggregate value of all derivatives positions in Question 44, you should not include any closed-out out [sic] positions, if those positions were closed out with the same counterparty and result in no credit or market exposure to the fund."). We also request the Commission confirm this guidance applies to reporting derivatives as an asset type in SMAs in Section 5.K.(1) of Schedule D.

[30] Proposal at 43.

[31] *See* IAA Letter to SEC re: Custody of Funds or Securities of Clients by Investment Advisers, File No. S7-09-09, Rel. No. IA-2876 (July 24, 2009); IAA Letter to SEC re: Rules Implementing Amendments to the Investment Advisers Act of 1940; File No. S7-36-10; Rel. No. IA-3110 (Jan. 24, 2011).

As a result of these differences and the definitional confusion around the term "custody,"[32] we make a number of recommendations in the Appendix that relate to Item 9 and the General Instructions. These improvements should assist in understanding disclosures about an adviser's custody practices and would benefit advisers, their clients and potential clients, and the Commission in its oversight of advisers.

V. Additional Recommendations

1. Parallel Managed Accounts

The Proposal would require, in new Section 5.G.(3) of Schedule D, that advisers or sub-advisers to RICs or BDCs "provide the [value of] regulatory assets under management of all parallel managed accounts" to the RIC or BDC which are proposed to include "any managed account or other pool of assets that the adviser advises and that pursues substantially the same investment objective and strategy and invests side by side in substantially the same positions as the identified RIC or BDC that the adviser advises."[33] The concept of parallel managed accounts was included in Form PF in order to ensure the reporting of the existence of accounts managed similarly to private funds and to implement aggregate reporting thresholds. This rationale, however, is not present with respect to accounts managed similarly to RICs or BDCs, and no reporting thresholds are relevant for RICs or BDCs on Form ADV. We question the benefit and relevance of this information and have several comments with respect to this new reporting requirement.

a. Identifying a Series of a RIC

Under the Investment Company Act and registration rules adopted by the Commission, a RIC is the "registrant" and has one Investment Company Act file number as a registrant. However, a typical mutual fund today operates as a series company or series trust, or a single corporation or state business trust established under one set of organizational documents and a board of directors or trustees, but offering investors several investment portfolios (series).[34]

[32] The reporting of custody in Item 9 would be more consistent if the SEC staff would clarify when advisers have custody under various scenarios, including when they have authority to transfer funds under standing letters of authorization from their clients or transferring funds among the same client's accounts. This is a source of continuing confusion and inconsistent interpretations. The March 4, 2013 Office of Compliance Inspections and Examinations National Exam Program Risk Alert, "Significant Deficiencies Involving Adviser Custody and Safety of Client Assets," noted that failure by advisers to recognize they have custody is one of the biggest areas of concern. That Risk Alert, however, did not address the very common adviser authority to transfer client funds. The IAA and several major custodians of adviser client accounts are working with SEC staff to resolve some of these uncertainties.

[33] A parallel managed account in Form PF is defined as "any managed account or other pool of assets that you advise and that pursues substantially the same investment objective and strategy and invests side by side in substantially the same positions as the identified *private fund*." *See* Glossary of Form PF.

[34] *See, e.g.,* SEC Division of Investment Management Guidance Update No. 2014-06 (June 2014), available at https://www.sec.gov/investment/im-guidance-2014-06.pdf ("typical mutual fund today operates as a 'series company,' or a single corporation or state business trust established under one set of organizational documents and a

Each series may be managed by different advisers and sub-advisers and has its own investment objective and strategy and its own different types of portfolio holdings. Thus, the concept of a "parallel managed account" could only be applied in the RIC context on a series-by-series basis, given that each series of a fund may pursue different investment objectives and strategies. We recommend the Commission revise Section 5.G.(3) accordingly, to require identification of a particular RIC or series, as appropriate, for which an adviser has any "parallel managed account" and the RAUM attributable to that particular RIC or series, as appropriate.[35] We also urge the Commission to delete "or other pool of assets" in the definition of parallel managed account so as not to capture private funds, non-U.S. pools, and other pooled vehicles instead of managed accounts.

b. Calculating RAUM of Parallel Managed Accounts to RICs/BDCs

We also seek confirmation from the Commission that when calculating the value of a "parallel managed account" that holds derivatives in its investment portfolio, the adviser should use the market value of the derivatives held in the parallel managed account, instead of the gross notional value, if that is how the value of the account is reported to the account holder. This approach is consistent with the SEC staff's view on Form PF.[36]

2. Custodians

The Proposal would require advisers to file a separate Schedule D, new Section 5.K.(3) for each custodian that "holds 10 percent or more" of the adviser's SMAs and include location information for the custodian's office. We have several recommendations to this section.

First, a custodian should only be included if it has been appointed by clients for 10 percent or more of the adviser's separately managed accounts *and* serves as custodian for $1

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board of directors or trustees, but offering investors several investment portfolios (series). Organization as a 'series company' affords the mutual fund various operational cost savings. Each series, however, has its own investment objectives and policies, and its own set of shareholders separate from those of any other series. Each series also is a separate investment company for purposes of the investor protections afforded by the Investment Company Act of 1940 (1940 Act)."). Under Form N-1A, the SEC form used by registered investment companies to register under the Investment Company Act, the term "fund" means "the Registrant or a separate Series of the Registrant." A "series" is defined in Form N-1A to mean shares offered by a Registrant that represent undivided interests in a portfolio of investments and that are preferred over all other series of shares for assets specifically allocated to that series in accordance with rule 18f-2(a) under the Investment Company Act.

[35] This change would be consistent with Parts A.1 and A.2 of proposed Form N-PORT. *See* Investment Company Reporting Proposal.

[36] Question 11 of Form PF asks for the "value of all parallel managed accounts related to the reporting fund." Question 11 of the SEC's Form PF FAQs on reporting value states that, "[w]hen calculating the value of a parallel managed account for purposes of either determining whether it is a dependent parallel managed account that is aggregated with the reporting fund or reporting its value in Question 11, you should use the market value of the derivatives held in the parallel managed account, instead of the gross notional value, if that is how the value of the account is reported to the account holder."

billion or more of an adviser's SMA RAUM. This would provide a more meaningful indicator of a custodial relationship without being as burdensome or costly, especially for smaller advisers.

Second, we strongly urge the Commission to eliminate the requirement to identify the "location of the custodian's office responsible for the custody of the assets," as proposed in Section 5.K.(3)(c). The client selects the custodian and is responsible for its own custodial relationship. An adviser may not know the exact location of the client's selected custodian, and an office street address and location are not particularly meaningful or relevant, as most custody is an electronic recording of ownership rather than physical custody. As a result, many advisers do not maintain this physical location information, and it would be somewhat burdensome to gather this information. More importantly, however, the information is largely unnecessary, given that the custodian's SEC registration number (if a broker-dealer) or legal entity identifier will be included. Therefore, the SEC will easily be able to identify the legal entity that is the custodian to the clients' assets without imposing an impractical and burdensome reporting requirement.

Third, in some cases, custodians have more than one registration number or legal entity. We recommend that the Commission provide guidance as to how custodians should be grouped (*e.g.*, different legal entity or different registration number) for purposes of this disclosure. We note that the issue could become increasingly complex with respect to the use of international or affiliated custodians.

Finally, the Commission should clarify whether assets managed in a sub-advised account should be considered for this item.

3. Books and Records Related to Performance Data Communications

The Proposal would amend Advisers Act books and records rule 204-2(a)(7) to require advisers to maintain originals of all written communications received and copies of written communications sent by an adviser related to a new, fourth category of records—"the performance or rate of return of any or all managed accounts or securities recommendations." We do not think this new category is necessary, given that rule 204-2(a)(7)(i) currently requires advisers keep originals of all written communications received and copies of all written communications sent by the adviser relating to "any recommendation made or proposed to be made and any advice given or proposed to be given." To the extent the Commission believes the recordkeeping rule needs to expressly address performance figures, it could do so by amending rule 204-2(a)(7)(i). To the extent the Commission determines that it should be a separate category, the new section (iv) should precede the existing proviso in the rule that relates to unsolicited communications.[37]

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[37] In the Federal Register, new section (iv) appears at the end of rule 204-2(a)(7). We do not think this was intended. We believe that it should have immediately followed subsection (iii) and preceded the proviso. As it appears in the Federal Register, it is unclear whether an adviser would be required to maintain records relating to

4. Information about the Use of "Third-Party Compliance Auditors"

The Commission seeks comment on whether advisers should be requested to provide information about the use of third-party compliance auditors and, if so, the types of information that should be requested.[38] For the reasons discussed below, we recommend that this disclosure not be included as part of this rulemaking.

As we noted earlier, we recognize the Commission's goals in obtaining more information for regulatory purposes and support efforts to enhance SEC examination and oversight of advisers. However, we have significant concerns about requiring advisers to disclose information about the use of third parties for compliance audits. Depending upon the nature and scope of the disclosure,[39] there could be unintended consequences such as negative or inaccurate inferences regarding an adviser's decision to use, or not to use, outside parties to conduct compliance reviews.

Advisers may engage one or more third parties—including law firms, accounting firms, compliance consultants, or other vendors—for various reasons relating to their compliance programs.[40] For example, advisers may hire an outside party to review certain compliance areas or to perform a gap analysis of the firm's compliance program. The purpose of that type of audit would be to simply confirm that the firm's policies and procedures work as intended or to identify areas in need of improvement. Some advisers may hire third parties for specified expertise or additional staffing capacity. Larger advisers, which typically have more resources, may hire multiple third parties for a number of different purposes. On the other hand, an adviser may instead choose to conduct compliance reviews in-house, for reasons including the significant costs associated with hiring third parties or the presence of a robust compliance program with internal audits or compliance resources from affiliated companies. Finally, some reviews may be conducted by or at the direction of attorneys pursuant to privileged engagements.

Given all of these variables, it is difficult to know how the fact that an adviser hired one or more third parties would be interpreted, and the prospect of incorrect negative inferences from the disclosure might discourage advisers from retaining assistance that might be otherwise appropriate. For example, disclosures relating to third party audits could be viewed as a "red flag" that the firm has identified a material compliance violation and has hired an outside auditor

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unsolicited market letters or other communications discussing the performance of securities that the adviser recommended to its clients.

[38] Proposal at 21.

[39] We note that views of commenters on this matter may differ significantly depending on the nature and scope of the required disclosure.

[40] According to a recent survey of registered investment advisers, reasons for engaging third parties may include, for example: conducting SEC mock examinations or annual reviews, drafting policies and procedures, or obtaining assistance in areas requiring highly specialized expertise (*e.g.*, cybersecurity). *See* 2015 Investment Management Compliance Testing Survey (available at: https://www.investmentadviser.org/eweb/Dynamicpage.aspx?webcode=PN_RB#AMOCS_Survey).

as a result. Conversely, some might view the fact that an adviser chose *not* to hire outside parties to perform compliance audits as a negative—an equally incorrect inference.

We are skeptical that the benefits of including an item on the use of third parties would be meaningful for clients or the SEC from a risk monitoring perspective given the variety of consultants, the differing services they may provide, and the customized scopes within these services. In light of these concerns, we recommend that this disclosure not be included as part of this rulemaking.

5. Securities Lending

The Commission requests comment on whether advisers should be required to report the use of securities lending and repurchase agreements in separately managed accounts.[41] For a number of reasons, we do not think that such a disclosure requirement would provide much meaningful information to the Commission.

Anecdotally, we understand that relatively few clients with separately managed account mandates engage in securities lending, although some large pension funds and other institutional investors may choose to engage in the practice. In any event, that decision to lend the client's securities is made by the client, not the adviser, pursuant to a securities lending agreement between the client and the custodian. Advisers often have little or no visibility to the securities lending arrangements that may be established by their clients from time to time, and may not even know when clients' securities lending agents have loaned client portfolio securities. As a result, disclosure of the value of securities that individual clients have on loan is not particularly relevant to reporting by advisers. The SEC should not require reporting in this area.

VI. The Commission Should Provide a Reasonable Compliance Date

The Commission seeks comment about whether advisers readily have access to the data and information requested by the proposed changes. We understand that many advisers do not have access to this data readily or in the format requested. For example, we understand that advisers do not currently break down their aggregate SMA assets into the asset types as specified in Section 5.K.(1) or characterize their client accounts according to NAV range, borrowing, and gross notional exposure, as specified in Section 5.K.(2). Advisers will need to develop, implement, and maintain reporting processes to identify clients, categorize clients and RAUM in the way the Commission is proposing, identify the data, ensure the collection of data is correct, and complete the mechanics of reporting the data on Form ADV.

We note that the Proposal estimates that "each adviser will spend, on average, 2 hours to complete the proposed questions regarding separately managed accounts."[42] We believe, however, that this estimate is substantially too low and that the time required for an adviser to

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[41] Proposal at 15.

[42] Proposal at 58, n.111.

understand the new reporting requirements, identify all the data points required, ensure that its portfolio accounting and data systems are capturing the data as requested by the new reporting requirements, and report the new data will take significantly longer than two hours. Already, many of our members have taken quite a bit more time than that to interpret the proposed definitions and reporting requirements.

For all of these reasons, we respectfully request that the Commission provide a sufficient period of time to comply with the new information requests. We believe that an implementation date of twelve months **after** the adoption of the final rules and form changes would be appropriate in this regard. For example, if the new rules and forms were adopted in 2015, the Commission should require advisers with fiscal year ends on or after December 31, 2016 to file new Part 1 no sooner than their next annual updating amendment (*i.e.*, March 2017 for calendar year filers and later for others). In addition, we request that larger advisers be given sufficient time to create the required systems to capture mid-year data (for Sections 5.K.(1) and 5.K.(2)). Depending on the timing of the adoption of the amendments, the Commission might consider a phased-in approach where mid-year data is not required in the first year of reporting.

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We appreciate the opportunity to provide comments on the Proposal and would be pleased to meet with the Commission and its staff regarding our comments and to provide any additional information. Please contact the undersigned or Monique S. Botkin, IAA Associate General Counsel, at [redacted] with any questions regarding these matters.

Respectfully,

/s/

Robert C. Grohowski
General Counsel

cc: The Honorable Mary Jo White, Chair
The Honorable Luis A. Aguilar, Commissioner
The Honorable Daniel M. Gallagher, Commissioner
The Honorable Kara M. Stein, Commissioner
The Honorable Michael S. Piwowar, Commissioner

David Grim, Director, Division of Investment Management
Diane Blizzard, Associate Director, Division of Investment Management
Daniel Kahl, Assistant Director, Division of Investment Management

Appendix

Specific Comments on Proposed Amendments to Form ADV, Part 1A

Item 1: Identifying Information

- **Item 1.I. Social Media Disclosure.** We support the Commission's approach not to require disclosure of all the social media accounts of an adviser's employees or disclosure of whether an adviser permits employees to have social media accounts associated with the adviser's business and the number or percentage of employees that have those accounts. This information would be extremely burdensome to disclose and would not meaningfully benefit the Commission's regulatory oversight of advisers. The proposal to include an advisory firm's social media websites is more appropriate. We also request that the Commission clarify that advisers need only disclose public-facing social media sites used to promote the adviser's business to clients or potential clients.

- **Item 1.J. Chief Compliance Officer.** The proposed amendment would require disclosure if the chief compliance officer is "compensated or employed" by any person other than the adviser (or a related person of the adviser) for providing chief compliance officer services. In many instances, where the same individual serves as both adviser and RIC CCO, the RIC will be responsible for a portion of the CCO's compensation. We do not think it was the SEC's intent to collect this type of information in the proposed item, and we recommend the Commission clarify that these situations are excluded from the disclosure.

Item 5: Information About Your Advisory Business

- **Item 5.D. Clients (Type of Client).** The Commission has proposed to eliminate the percentage ranges of types of clients and instead require the exact number of accounts and RAUM attributable to specific client types. Given the historical use of ranges, many advisers with large numbers of clients typically employ some estimation in the categorization of client types. As stated in the Proposal, the Commission's goal is to obtain *aggregate* information about an adviser's separately managed accounts. The Commission should explicitly recognize in the adopting release the use of reasonable estimation or approximation reported in good faith. We also request that the Commission move the category "Corporations or other businesses not listed above" toward the bottom of the list, as it may conflict with insurance company and, possibly, foreign official institution.

  Sub-Advised RICs and Sub-Advised Pooled Investment Vehicles, Including Private Funds. For purposes of Form ADV Part 1A reporting on SMAs, we seek confirmation that an adviser can report a sub-advised registered investment company as an "investment company" client under Item 5.D.(d), even if the advisory contract is with another investment adviser. Likewise, we seek confirmation for purposes of Form ADV Part 1A reporting on SMAs that an adviser can report a sub-advised pooled investment vehicle, including a sub-advised private fund, as a "pooled investment vehicle" client under Item 5.D.(f), even if the advisory contract is with another investment adviser or other entity. This approach is consistent with the intent and purposes of the Proposal, which focuses on SMAs and excludes RAUM attributable to RICs and pooled investment vehicles, including private funds. We also seek confirmation that insurance company separate accounts would not be considered SMAs.

Sovereign Wealth Funds and Foreign Official Institutions. Proposed Item 5.D(m) would require the number and RAUM of sovereign wealth funds and foreign official institutions. The Commission should consider further clarifying the definitions of these entities. For example, it is unclear whether the account of any government or quasi-government entity or agency would be included in this item.

- **Item 5.K. and Section 5.K of Schedule D: Separately Managed Accounts**
  - **Item 5.K. Use of the term "Separately Managed Account."** To calculate SMA RAUM, advisers would need to subtract amounts of RAUM attributable to RICs (other than pooled investment vehicles), BDCs, and pooled investment vehicles.[1] We have two comments with regard to the term "separately managed account." First, we seek confirmation from the Commission in the adopting release that "pooled investment vehicle (other than investment companies)" in Item 5(f) of Form ADV Part 1A and in the Proposal includes, in addition to private funds, funds that are not private funds, such as collective trusts, funds offered outside the U.S., or other pooled vehicles. Second, we note that because the term "separately managed account" is not defined in the Advisers Act or rules thereunder and has different meanings across the financial services industry, the term may prove to be confusing. For example, many financial services firms offer services called "managed account advisory services," "separately managed accounts," or other options where a client can select from a universe of investment advisers managing assets on a discretionary basis for the client and can select from a universe of pre-selected investment options (such as mutual funds or other investment options).[2]

[1] SMA clients, excluding RICs, BDCs and pooled investment vehicles, would include the following remaining clients listed in Item 5.D: individuals (other than high net worth individuals), high net worth individuals, banking or thrift institutions, pension and profit sharing plans (but not the plan participants or government pension plans), charitable organizations, corporations or other businesses not listed, state or municipal government entities (including government pension plans), other investment advisers, insurance companies, sovereign wealth funds and foreign official institutions, and "other."

[2] For example, the Money Management Institute defines "SMA programs" to include:

> [M]anaged account programs sponsored by a financial institution such as a broker-dealer, bank, or investment adviser that offer discretionary investment advisory services to clients, typically pursuant to arrangements with other firms. SMA programs are not specifically defined by the rules of the [SEC], but include so-called "wrap fee" programs – which the SEC defines as programs "under which any client is charged a specified fee or fees not based directly upon transactions in a client's account for investment advisory services (which may include portfolio management or advice concerning the selection of other investment advisers) and execution of client transactions" – as well as programs where the customers receive the same complement of services in unbundled form. Unlike clients in pooled vehicles such as U.S. registered investment companies, in SMA programs clients retain direct and sole ownership of their account assets, which are held with a regulated custodian.

See http://www.financialstabilityboard.org/wp-content/uploads/Money-Management-Institute-MMI.pdf. The SEC's Division of Investment Management's topical reference guidance identifies these types of

Other entities offering "SMAs" in the financial services industry define them as individual portfolios of stocks and bonds run by specialist money managers based on a specific investment style. To prevent potential confusion, the Commission should address the current different uses of the term "separately managed account(s)" in the adopting release and could instead consider using a term such as an "individually managed account."

- **Section 5.K.(1) of Schedule D (Separately Managed Accounts)**

  - **Categorizing Asset Types**. The Proposal would require all advisers that manage SMAs to annually report the approximate percentage of RAUM attributable to SMAs on an aggregate basis invested in ten asset categories: exchange-traded equity securities, U.S. government/agency bonds, US. state and local bonds, sovereign bonds, corporate bonds – investment grade, corporate bonds – non-investment grade, derivatives, securities issued by RICs or BDCs, securities issued by pooled investment vehicles (other than RICs), and a category of "other" for which firms would include a general description of assets included. As a preliminary matter, we note that advisers may not generally maintain their client accounting and reporting systems in a manner that allows them to efficiently categorize assets based on the asset types as proposed by the SEC. The Commission should recognize that firms may categorize assets differently and should permit firms to use reasonable and documented systems and methodologies for determining in which category an instrument belongs and should explicitly recognize in the adopting release the use of reasonable estimation or approximation reported in good faith. In addition, the Commission asks whether it should require disclosure about investment strategies used in SMAs as opposed or in addition to asset types. We recommend the Commission not require disclosure about strategies in Part 1A, given the different definitions of strategies used by advisers and that such information is included in Part 2A of Form ADV.

  - **"U.S. Government/Agency Bonds."** With regard to "U.S. government/agency bonds," we seek clarification as to whether this includes investments such as agency collateralized mortgage obligations, agency debentures and agency strips, agency mortgage-backed securities, and U.S. Treasuries (including strips).

  - **"Corporate Bonds - Investment Grade."** With regard to the definition of "corporate bond - investment grade," the Proposal defines a security as investment grade if it is sufficiently liquid that it can be sold at or near its carrying value within a reasonably short period of time and is subject to no greater than moderate credit risk. We note the proposed definition is used in Form PF and in proposed Form N-PORT. Given the Commission's current focus on liquidity issues, particularly with regard to RICs, we suggest the Commission seek a consistent approach to liquidity-related concepts across various reporting and disclosure regimes.

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accounts as "Wrap Accounts/Separately Managed Accounts." *See* http://www.sec.gov/divisions/investment/guidance.shtml.

- **"Derivatives."** The Proposal does not define the term "derivatives." We recommend that the Commission not include a definition of derivatives. We understand Form PF requires disclosure of derivative positions. In the event the Commission seeks to define the term derivatives, the definition should be consistent with Form PF.

- **"Other."** We seek clarification as to what "other" would include (for example: cash and cash equivalents; sweep vehicles for uninvested cash; repurchase agreements; reverse repurchase agreements; payables for investments purchased either on a delayed delivery, when-issued or other firm commitment basis, or on a standby commitment basis; asset-backed securities; participatory notes (P-notes); exchange-traded notes; and/or convertible preferred stock).

- **Section 5.K.(2) of Schedule D (Separately Managed Accounts; Use of Borrowings and Derivatives)**

  - **Instructions.** The proposed instructions for Section 5.K.(2) require reporting of information on derivatives if the amount of RAUM attributable to SMAs is "at least $10 billion." This language is unnecessarily confusing, and we recommend the instruction be revised (and similar instructions elsewhere in the Form and instructions) to read if the remaining amount is "$10 billion or more…".

  - **Use of term "Net Asset Value."** We question the use of the term "net asset value" to identify relevant value thresholds for SMA reporting. The concept of "net asset value" is not generally applicable to individual investment advisory accounts, but rather to collective or pooled investment funds where an investor in a fund purchases and redeems fund interests based on NAV (*i.e.*, the value of the fund's interests by calculating assets less liabilities). However, in some instances, a client's accounting or valuation agent might provide a net asset value or fair market value upon which the adviser calculates its advisory fees. Thus, we recommend the Commission require the adviser to use either the value the adviser receives from the client's accounting or valuation agent or the value reported to the client, as an alternative to "NAV."

    If, however, the Commission determines to use the term "NAV" to require advisers to calculate the current value of an individual separate account, we request confirmation that an adviser may calculate NAV without deducting deferred compensation that might otherwise be a liability (such as performance fees) where the adviser does not deduct such deferred compensation when reporting the value of the account to the client.

  - **"Borrowing" Transactions (also used in Item 5.K.(2)).** The proposed definition of "borrowings" in the Form ADV Glossary includes secured borrowings and unsecured borrowings, collectively. The definition provides that secured borrowings are obligations for borrowed money in respect of which the borrower has posted collateral or other credit support and should include any reverse repos (*i.e.*, any sale of securities coupled with an agreement to repurchase the same (or similar) securities at a later date at an agreed price); and unsecured borrowings are obligations for borrowed money in respect of which the borrower has not posted collateral or other credit support.

We seek clarification as to whether SEC guidance issued on the definition of "borrowing" in Form PF would apply to the definition of "borrowing" in Form ADV.[3] We note that some concepts of borrowing in Form PF for private funds may not translate to separately managed accounts.[4] Current Commission guidance is based on pooled investment vehicles that have a balance sheet.[5] Individual investment advisory separate accounts do not have balance sheets prepared under particular accounting standards.

- **"Interest Rate Derivative."** We note the definition for interest rate derivative in the Proposal does not include the additional clarifying note that the "information must be presented in terms of 10-year bond equivalents," as is included in Form PF.[6] We recommend the Commission harmonize the definition of interest rate derivative in Part 1 of Form ADV to the definition in Form PF. Further, in responding to Section 5.K.(2), firms should be permitted to rely on their existing practices when providing information about clients' interest rate derivatives for purposes of the proposed reporting, as provided for in Form PF.

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[3] *See, e.g.,* Form PF FAQ Question 12.1; Section 2b, Item D, Question 43 of Form PF ("Classify secured borrowing according to the legal agreement governing the borrowing (*e.g.*, Global Master Repurchase Agreement for reverse repo and Prime Brokerage Agreement for prime brokerage). Please note that for reverse repo borrowings, the amount should be the net amount of cash borrowed (after taking into account any initial margin/independent amount, 'haircut' and repayments). Positions under a Global Master Repurchase Agreement should not be netted."); Section 2a, Item A., Question 26 of Form PF ("[p]rovide the absolute values of short positions" when including exposures of hedge fund assets.)

[4] For example, we note that Form PF FAQ Question G.2 provides guidance on how to treat short positions, derivatives, repurchase agreements, total return swaps, and other financial instruments for purposes of calculating a private fund's gross asset value. The SEC has stated that if a private fund has a balance sheet, it may rely on the gross assets reflected on the balance sheet to calculate gross asset value, thereby permitting the adviser to rely on the applicable accounting standard. *See* Form PF FAQ, Question G.2 and Frequently Asked Questions on Form ADV and IARD: Item 7.B ("Form ADV FAQs"), available at https://www.sec.gov/divisions/investment/iard/iardfaq.shtml#item7b (citing the 2011 Implementing Release at 23, n. 83 ("We expect that advisers will continue to calculate their gross assets as they do today.")).

[5] In Form ADV FAQs: Item 7B, the SEC stated that, typically, in the case of a fund, "a short sale will be recorded as a short sale liability (because the fund has an obligation to replace the security) together with an asset for the proceeds received or due from the counterparty (e.g., cash received or due from a broker). In that case, the short sale liability would neither be included as an asset nor deducted from assets in the calculation of 'gross asset value,' although the proceeds received would be included in 'gross asset value.' However, if the fund takes a short position using a derivative, the derivative itself may have a positive fair value and be recorded as an asset. In this case, the short position would be included as an asset in the calculation of 'gross asset value.'"

[6] Form PF requires firms to report exposure for interest rate derivatives after adjusting to 10-year bond equivalents, instead of requiring advisers to report duration. We note that Commission in adopting Form PF stated that it is "giving advisers the option of instead reporting weighted average tenor or 10-year bond equivalents because we understand from comments received that advisers use a wide range of metrics to measure interest rate sensitivity. We expect that this revised approach will reduce the burden of reporting because advisers will generally be able to rely on their existing practices when providing this information."

- **"Equity Derivative."** The proposal defines "equity derivative" to include "listed equity derivative" and derivative exposure to unlisted securities. The Form PF FAQs provide guidance regarding the meaning of "listed."[7] We seek confirmation that the term "listed" as used in Form ADV has the same meaning as in Form PF.

Item 8: Participation or Interest in Client Transactions

- The Proposal states that "in order to address a frequent question from filers, [the SEC] propose[s] to clarify that advisers should answer Item 8 based on the types of participation and interest the adviser expects to engage in during the next year." We are concerned with a disclosure requirement about an adviser's potential practices in the future rather than on current practices. It may be difficult to predict what an adviser may do in the year ahead. Additionally, this may lead to unreported conflicts such as the scenario where an adviser does not expect to engage in an activity and then subsequently determines to engage in the activity after the Form ADV is filed, but does not anticipate engaging in the activity in the following year. An adviser should not be required to estimate potential activities it might engage in the Form ADV but rather disclose what activities it does engage in currently. Accordingly, the Commission should remove the language, "during the next year," and tailor the disclosure to current practices.

Item 9: Custody

- **New General Instruction to Form ADV Part 1A for Item 9:** The Commission should add a new General Instruction for Item 9 or revise the introduction instruction under Item 9 by adding a second sentence stating, "The term 'custody' as used in this Item is a specific defined term in rule 206(4)-2 of the Advisers Act and means more than actual physical custody of client assets. Please consult the definition in the rule before responding to these items." The Commission should also revise the General Instructions to Form ADV and the Form text to incorporate the Item 9 "Completion Reminder" that the Division of Investment Management emailed to registrants on March 5, 2014, which stated:

  > "All SEC-registered advisers that have custody of client assets should answer all questions in Item 9 of Part 1A of Form ADV. Each adviser's answers will vary depending on facts and circumstances. For example, advisers that have custody solely because they deduct fees from client accounts would respond 'no' in Item 9.A. Additionally, these advisers would likely respond 'no' in Items 9.B., and 9.D., and they likely would not need to provide information in Items 9.C. or 9.E. However, in Item 9.F., these advisers likely would need to indicate that there is at least one person acting as qualified custodian for their clients in connection with advisory services they provide to clients."

[7] *See* Question 26.1 of SEC Form PF FAQs ("The term 'listed equity derivatives' refers to the fund's exposures to derivatives for which the underlying asset is listed equities. For example, if a fund has purchased an over-the-counter option from a bank on the equity securities issued by a software company that are listed on a regulated exchange, you would include the delta adjusted notional value of the option under the sub-heading 'other listed equity derivatives' identified under the 'listed equity derivatives' asset class.")

- **Item 9.A.(1).** We recommend that the Commission amend the instructions under Item 9.A.(1) to state: "Subject to the exceptions below, answer 'yes' to Item 9.A.(1) if you are deemed to have custody because your related person has custody of client assets in connection with advisory services you provide to clients."

- **Item 9.A.(2).** We recommend that the Commission amend the second sentence of the instructions under Item 9.A.(2) to state: "If you are deemed to have custody of certain client assets because your related person (other than employees or officers of your firm) has custody of those client assets in connection with advisory services you provide to your clients, do not include the amount of those assets and the number of those clients in your response to Item 9.A.(2). Instead include that information in your response to Item 9.B.(2). However, if you have custody of client assets because individuals employed by your firm have custody of those assets (*e.g.*, by serving as trustee), do include those assets in your response to Item 9.A.(2)."

- **Item 9.B.** The Commission should clarify under Item 9.B that the adviser should respond only with respect to related persons that are not employees or officers acting in that capacity.

- **Item 9.D.** The concept of "qualified custodian" arises most substantively for the first time in Item 9.D. Confusion continues to exist about the difference between having "custody" and being a "custodian," and data in response to this Item is frequently misinterpreted by the press and is likely misinterpreted by clients and potential clients. Thus, we recommend that the Commission define "qualified custodian" in this question and provide a statement about the difference between having "custody" and being a "custodian."

- **Item 9.F.** We recommend the Commission include the following clarifications regarding acting as qualified custodian:

  > "If an adviser has custody regarding at least one client account, but does not have custody regarding all of its clients' accounts, in answering Item 9.F, the adviser should include only the total number of qualified custodians used by all advisory clients for whom the adviser has custody (by any means, physical or constructive, including by virtue of deducting fees directly from the account, acting as general partner of a limited partnership, etc.).
  >
  > "If the same qualified custodian is custodian for multiple client accounts for which the adviser has custody (by any means), that qualified custodian should be counted once. Do not double count custodians."

- **Section 7.A.(8) of Schedule D.** Section 7.A.(8)(a) of Schedule D asks whether your "related person act[s] as a qualified custodian for your clients in connection with advisory services you provide to clients?" Section 7.A.8(b) asks whether, if so, you have overcome the presumption that you are not operationally independent from the related person. Some firms check the box for 8(b), even if the related person is not acting as a qualified custodian for clients as indicated in 8(a). The Commission should include a completeness check so that only firms that respond "yes" to 8(a) are permitted to respond to 8(b). In addition, instead of using the technical, double negative "overcome the presumption" formulation in the instructions in Item 9.A and Section 7.A.(8)(b) of Schedule D, the Commission should use the simpler and clearer formulation in Item 9.D (*i.e.*, you have determined the related person to be operationally independent under rule 206(4)-2 of the Advisers Act).

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