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CLIENT MEMORANDUM

SEC Adopts Amendments to Form ADV to Add Separately Managed Account Disclosure and "Umbrella Registration" for Relying Advisers

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AUTHORS

Benjamin J. Haskin | Scott A. Arenare | Martin R. Miller | Justin L. Browder | Anne C. Choe | Kelly L. Donnelly

On August 25, 2016, the Securities and Exchange Commission (the "SEC") adopted multiple amendments to Part 1A of Form ADV ("Form ADV"), which include (i) requiring advisers to provide certain aggregated portfolio-level information about their separately managed account clients and (ii) a method for related private fund adviser entities that operate a single advisory business to register using a single Form ADV ("Umbrella Registration"). The SEC also adopted clarifying, technical and other amendments to existing Form ADV items and instructions and amendments to the books and records rule under the Investment Advisers Act of 1940 (the "Advisers Act") that will require advisers to maintain additional materials related to the calculation and distribution of performance information.[1]

The amendments were proposed in a May 20, 2015 release (the "Proposing Release").[2] The amendments to Form ADV will become effective October 31, 2016, and any adviser filing an initial Form ADV or an amendment to an existing Form ADV on or after October 1, 2017 will be required to provide responses to the revised form. Advisers with a December 31 fiscal year end will need to comply with the Form ADV amendments no later than the annual amendment filing due by the end of March 2018. Amendments to the books and records rule will apply to communications circulated or distributed after October 1, 2017.

According to the SEC's adopting release (the "Release"), the amendments to Form ADV are designed to improve the depth and quality of information collected from investment advisers, facilitate risk monitoring initiatives, assist the SEC

staff in its risk-based examination program, and provide clients and the public with additional information regarding investment advisers.

Amendments to Form ADV

A. Requirements to Disclose Information Regarding Separately Managed Accounts

Amendments to Item 5 of Form ADV will require the reporting of additional data regarding an adviser's institutional and retail separately managed account ("SMA") clients. These new requirements will not apply to exempt reporting advisers ("ERAs") because they do not complete Item 5. The information will need to be filed once a year as part of an adviser's annual update to Form ADV. For purposes of the reporting requirements, SMAs are all advisory accounts other than pooled investment vehicles (*i.e.*, registered investment companies, business development companies, or pooled investment vehicles that are not registered with the SEC, including, but not limited to, private funds). SMAs include managed accounts that invest alongside with, and are managed according to the same strategy as, an adviser's pooled investment vehicle clients ("Parallel Managed Accounts"). Given that, based on Investment Adviser Registration Depository system data as of May 2016, 73% of registered investment advisers reported managing assets attributable to SMAs, the new reporting requirements are expected to affect a significant portion of the asset management industry.

The type of information, level of detail required to be reported, and frequency of reporting will vary depending on an adviser's regulatory assets under management ("RAUM") attributable to SMAs.[3] The reporting requirements are as follows:

SMA RAUM	Reporting Requirements	Reporting Period(s)[4]
Less than $500 million	• Approximate percentage of SMA RAUM invested in each of 12 broad asset categories: (i) exchange-traded equity securities, (ii) non exchange-traded equity securities, (iii) U.S. government/agency bonds, (iv) U.S. state and local bonds, (v) sovereign bonds, (vi) investment grade corporate bonds, (vii) non-investment grade corporate bonds, (viii) derivatives, (ix) securities issued by registered investment companies or business development companies, (x) securities issued by pooled investment vehicles other than registered investment companies or business development companies, (xi) cash and cash equivalents, and (xii) other • Identifying information concerning any custodians that hold at least 10% of SMA RAUM, and the amount of the adviser's RAUM attributable to SMAs held by the custodian	Year-end

SMA RAUM	Reporting Requirements	Reporting Period(s)[4]
$500 million but less than $10 billion	• Approximate percentage of SMA RAUM invested in each of the 12 broad asset categories noted above • Amount of SMA RAUM and the dollar amount of borrowings attributable to those assets that correspond to three specified ranges of gross notional exposure[5] • Identifying information concerning any custodians that hold at least 10% of SMA RAUM, and the amount of the adviser's RAUM attributable to SMAs held by the custodian	Year-end
$10 billion or more	• Approximate percentage of SMA RAUM invested in each of the 12 broad asset categories noted above • Amount of SMA RAUM and the dollar amount of borrowings attributable to those assets that correspond to three specified ranges of gross notional exposure • Derivatives exposures across six derivatives categories: (i) interest rate derivatives, (ii) foreign exchange derivatives, (iii) credit derivatives, (iv) equity derivatives, (v) commodity derivatives, and (vi) other derivatives	Mid-year and year-end
	• Identifying information concerning any custodians that hold at least 10% of SMA RAUM, and the amount of the adviser's RAUM attributable to SMAs held by the custodian	Year-end

Advisers who manage at least $500 million in RAUM attributable to SMAs are permitted (but not required) to provide in Section 5.K.(2) of Schedule D a narrative description of the strategies and/or manner in which borrowings and derivatives are used in the management of the SMAs that they advise.

The SEC indicated in the Release that a single-investor fund (*i.e.*, a "fund-of-one") may be an SMA depending upon the particular facts and circumstances.[6] The SEC also clarified that if an adviser has a contract with another adviser to sub-advise a pooled investment vehicle, the adviser should categorize its client as either an investment company, business development company or pooled investment vehicle, and not as an investment adviser.[7]

Asset Categories. In the Release, the SEC acknowledged that some assets may be classified into more than one category. To avoid double-counting, the SEC stated that advisers should use their own reasonable, consistently applied methodologies in selecting the category in which to report such assets. The SEC also noted that advisers need not "look

through" investments in funds or exchange-traded funds, for example, and report the underlying asset type. The updated instructions include clarifying language in Schedule D to indicate as such ("Investments in derivatives, registered investment companies, business development companies, and pooled investment vehicles should be reported in those categories. Do not report those investments based on related or underlying portfolio assets.").

Borrowings. "Borrowings" is defined, consistent with the definition in Form PF, to include both unsecured and secured borrowings. The SEC staff previously stated in response to an FAQ that, for purposes of Form PF, "borrowings" include: (i) selling securities short; (ii) securities lending transactions; (iii) reverse repurchase agreements; (iv) transactions in which variation margin is owed, but as a result of not reaching a certain set threshold, has not been paid by a fund; or (v) transactions involving synthetic borrowings (*e.g.*, total return swaps that meet the failed sale accounting requirements).[8] However, the SEC indicated in the Release that, for purposes of amended Form ADV, it is not seeking disclosure regarding securities lending or repurchase agreements for SMAs at this time.

Derivatives. The SEC declined to provide a definition of the term "derivative," noting that Form ADV, which collects aggregate portfolio information, is similar to Form PF, which also does not include a definition for "derivative." Accordingly, for purposes of Form ADV, an adviser should interpret the term "derivative" in the same manner it interprets that term for purposes of Form PF.

It is possible that the approach taken by the SEC may result in increased regulatory scrutiny concerning derivatives exposures and may provide inaccurate information to the public about the scope of an adviser's systemic risk profile. For example, because the required disclosure is based on gross notional value as opposed to mark-to-market exposure, the size of an adviser's reported derivatives positions will appear significantly larger than the actual exposures held by accounts. In addition, the disclosure may result in overstating outstanding exposures under derivatives because the requirements do not appear to eliminate offsetting positions. Finally, the systemic risks inherent in derivative positions vary considerably depending upon the duration of the derivatives held by an SMA and the intended use by the SMA of the derivatives, but neither of these metrics is required to be reported on amended Form ADV. For example, short-term derivatives used solely for hedging purposes (such as one-month currency forwards) present a significantly different level of risk than long-term (*e.g*., 30-year) speculative, unhedged positions.

Confidentiality Concerns. Although the SMA portfolio information that is required to be disclosed will be aggregated across clients[9] and does not include specific portfolio holdings or names of derivatives counterparties, it will be publicly available upon filing. This stands in contrast to Form PF, which elicits comparable information with respect to private fund clients but is maintained by the SEC on a confidential basis. The Form ADV disclosures could provide information to the market about changes in asset composition and adviser focus (*e.g.,* a shift from equities to fixed income), which may have a signaling effect on other market participants and could adversely affect trading strategies for certain advisers. The potential commercial implications of these disclosures would be heightened for advisers that manage a very small number of SMAs (such as a single Parallel Managed Account). To address confidentiality concerns voiced by commenters in response to the Proposing Release, the SEC revised the proposed rule by (a) reducing the number of categories of gross

notional exposure from four to three; and (b) removing the requirement to report the number of accounts corresponding to the accounts' net asset value and gross notional exposure, instead requiring reporting of RAUM based on ranges of gross notional exposure of accounts.

B. Additional Form ADV Amendments and Clarifying Changes

In addition to soliciting specific information regarding an adviser's SMAs, certain existing Items of Form ADV Part 1A were amended to require additional disclosure about an adviser's client base, business operations, and use of social media. The SEC indicated that the additional information will assist the agency's risk assessment process and enable the SEC staff to conduct more effective examinations.[10]

The amendments include the following, among others:

Category	Required Disclosure
Central Index Key ("CIK") Number	*Item 1.D.(3)*: Disclosure of the adviser's SEC-assigned CIK numbers, if assigned, regardless of whether the adviser is a public reporting company under Section 12 or 15(d) of the Securities Exchange Act of 1934. Currently, only public reporting company advisers must provide CIK numbers.
Social Media	*Item 1.I.*: In addition to disclosure of the adviser's website(s), Form ADV will now also require disclosure of accounts on publicly available social media platforms, such as Twitter, Facebook and LinkedIn, and a listing of the addresses of all such social media pages and websites. This disclosure is limited to accounts on social media platforms where the adviser controls the content.
Branch Offices	*Section 1.F. of Schedule D*: A listing of the total number of the adviser's offices (other than the adviser's principal office and place of business) at which the adviser conducts its advisory business and information about each of the adviser's 25 largest offices (measured by number of employees), including number of employees who perform advisory functions from such office, branch Central Registration Depository ("CRD") number, securities-related activities and investment-related business conducted at such office. Currently, the addresses and phone numbers of the five largest offices by number of employees are required, along with disclosure of whether any location is a private residence.
Outsourced Chief Compliance Officers ("CCOs")	*Item 1.J.*: In addition to the requirement to provide the name and contact information for the CCO, Form ADV will ask now whether the adviser's CCO is compensated or employed by any person other than the adviser (or a related person of the adviser) for providing compliance services to the adviser and, if so, the name and IRS Employer Identification Number for the person providing such compensation.

Category	Required Disclosure
Proprietary Assets	*Item 1.O.*: With respect to advisers with assets of $1 billion or more, disclosure of the approximate amount of such assets according to the following ranges: (i) $1 billion to less than $10 billion, (ii) $10 billion to less than $50 billion, and (iii) $50 billion or more.[11]
Non-RAUM Assets	*Item 5.C.*: A requirement to report the number of clients for whom the adviser provides advisory services, but whose assets are not counted toward the adviser's RAUM.
Client Types	*Item 5.D.*: A requirement to report the number of advisory clients and amount of RAUM attributable to each category of clients, as of the date the adviser determines its RAUM.[12] Currently, an adviser is only required to provide approximate ranges for these data points.
Non-U.S. Clients	*Item 5.F.*: The approximate amount of RAUM attributable to clients that are non-U.S. persons.
Parallel Managed Accounts	*Section 5.G. of Schedule D*: The RAUM for all Parallel Managed Accounts related to a registered investment company (or a series thereof) or business development company.
Wrap Fee Programs	*Item 5.I. and Section 5.I.(2) of Schedule D*: Whether the adviser participates in a wrap fee program, and if so, the total amount of RAUM attributable to the adviser acting as: (i) a sponsor to a wrap fee program; (ii) portfolio manager for a wrap fee program; and (iii) sponsor to and portfolio manager for the same wrap fee program. An adviser will also be required to provide any SEC file number and CRD number for sponsors of all wrap fee programs for which the adviser serves as portfolio manager.
Client Asset Computations	*Item 5.J.*: Whether the adviser uses a different method to compute "client assets" for purposes of Part 2A than the method used to compute RAUM for purposes of Item 5 of Part 1A.
CIK and PCAOB Numbers for Related Persons and Auditing Firms	*Section 7.A. and 7.B.(1) of Schedule D*: Advisers will now be required to report the CIK numbers, if any, of certain related persons and the PCAOB-assigned numbers, if any, of firms used to audit private funds.
Private Fund Reporting	*Section 7.B.(1) of Schedule D*: An adviser to a private fund that qualifies for the exclusion from the definition of investment company under Section 3(c)(1) of the Investment Company Act of 1940 must report whether it limits sales of fund interests to "qualified clients" as defined in Rule 205-3 under the Advisers Act.

Category	Required Disclosure
Compensation Related to Client Referrals	*Item 8.H.*: Whether the adviser or any related person, directly or indirectly, compensates any person that is not an employee for client referrals; and whether the adviser or any related person, directly or indirectly, provides any employee compensation that is specifically related to obtaining clients for the firm (cash or non-cash compensation in addition to the employee's regular salary). Currently, Item 8.H. asks only whether the adviser or any related person directly or indirectly compensates any person for client referrals.

C. Umbrella Registration of Private Fund Advisers

The SEC also adopted amendments to Part 1A to provide a more efficient method for the registration on one Form ADV of multiple private fund adviser entities operating a single advisory business. The SEC staff previously provided guidance to private fund advisers regarding Umbrella Registration in a 2012 No-Action Letter to the American Bar Association (the "ABA No-Action Letter").[13] The amendments are intended to codify that guidance directly into Form ADV, make the availability of Umbrella Registration more widely known to advisers, and provide more consistent data about, and create a clearer picture of, groups of private fund advisers that operate as a single advisory business. The SEC considers the following factors as indicia of a "single advisory business": (1) commonality of advisory services and clients, (2) a consistent application of the Advisers Act to all advisers in the business, and (3) a unified compliance program. The following conditions, which are included in the amended instructions of Form ADV, are designed to demonstrate these factors:

1. The filing adviser and each relying adviser advise only private funds and clients in SMAs that are "qualified clients"[14] and are otherwise eligible to invest in the private funds advised by the filing adviser or a relying adviser and whose accounts pursue investment objectives and strategies that are substantially similar or otherwise related to those private funds.

2. The filing adviser has its principal office and place of business in the United States and, therefore, all of the substantive provisions of the Advisers Act and the rules thereunder apply to the filing adviser's and each relying adviser's dealings with each of its clients, regardless of whether any client of the filing adviser or relying adviser providing the advice is a United States person.

3. Each relying adviser, its employees and the persons acting on its behalf are subject to the filing adviser's supervision and control and, therefore, each relying adviser, its employees and the persons acting on its behalf are "persons associated with" the filing adviser (as defined in Section 202(a)(17) of the Advisers Act).

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 adopted in accordance with SEC Rule 204A-1 and a single set of written policies and procedures adopted and implemented in accordance with SEC Rule 206(4)-7 and administered by a single CCO in accordance with that rule.

Under the amendments, if a group of related advisers chooses to file an Umbrella Registration, the filing adviser must file a single Form ADV that contains all of the required information relating to both the filing adviser and the relying adviser(s), and must include this same information in any other reports or filings it must make under the Advisers Act or the rules thereunder (*e.g.*, Form PF). The filing adviser will also be required to file a new Schedule R with respect to each relying adviser. Schedule R includes (a) identifying information regarding the relying adviser, (b) the basis of (*i.e.*, eligibility for) the relying adviser's SEC registration, (c) the form of organization of the relying adviser, and (d) a list of its control persons (*i.e.*, direct and indirect owners and executive officers). In addition, the filing adviser will be required to disclose in Schedule D to Part 1A of Form ADV the name of the filing adviser and/or relying adviser that sponsors or manages each specified private fund. Advisers qualifying for Umbrella Registration are permitted (but are not required) to file consolidated registrations under the amendments.

While one of the stated intentions of the proposal is to codify the relief provided in the ABA No-Action Letter and thereby streamline the filing process for private fund advisers operating as a single business through multiple legal entities,[15] the amendments may be more limiting than the no-action relief. For example, the Release states that "Condition 1 limits eligibility for Umbrella Registration to private fund advisers with a commonality of advisory services and clients." The ABA No-Action Letter, however, included no such restrictive language, and the actual language of Condition 1 set forth in new Form ADV requires only that any SMAs pursue investment objectives and strategies that are substantially similar or related to the private funds. It therefore remains somewhat unclear as to whether the SEC intends to require related advisers seeking to use the Umbrella Registration methodology to pursue the same or similar investment objectives and strategies with respect to all of their clients or, alternatively, whether related advisers utilizing Umbrella Registration will be able to pursue different strategies with respect to their clients, as long as each advised SMA pursues the same or similar strategy as at least one private fund client.

Exclusion from Umbrella Registration. The SEC expressly declined to make Umbrella Registration available to: (i) ERAs, which include many venture capital fund advisers and other private fund advisers with less than $150 million in RAUM in the United States; and (ii) filing advisers based outside the United States. With respect to ERAs, the SEC reasoned that some of the conditions required for Umbrella Registration reflect certain requirements that apply only to registered advisers. Specifically, ERAs are not subject to the requirement for compliance policies and procedures pursuant to Rule 206(4)-7 under the Advisers Act or for a code of ethics pursuant to Rule 204A-1 under the Advisers Act. With respect to filing advisers based outside the United States, the SEC expressed concern that, absent Condition 2 (requiring that the filing adviser have its principal place of business in the United States), a group of related advisers based inside and outside of the United States could designate a non-U.S. adviser as a filing adviser and assert, based on the theory of operating a single advisory business, that the Advisers Act's substantive provisions generally would not apply to the U.S.-based relying advisers' dealings with their non-U.S. clients.

The SEC did acknowledge, however, that the views of the staff as expressed in a set of "Frequently Asked Questions on Form ADV and IARD" that permit certain ERAs to file a single Form ADV on behalf of multiple special purpose entities have not been withdrawn due to the amendments.[16] In the ABA No-Action Letter, the SEC staff also granted relief to enable a special purpose vehicle that acts as a private fund's general partner or managing member to rely on its related investment adviser's registration with the SEC rather than separately register. Absent any specific guidance to the contrary, we assume that the SEC also did not intend to withdraw this guidance due to the amendments.

Amendments to Rule 204-2

As noted above, in addition to adopting broad changes to Form ADV, the SEC also implemented amendments to the books and records rule under the Advisers Act—Rule 204-2(a)—to require registered advisers to retain: (i) records substantiating performance claims or rates of return; and (ii) originals of all written communications received and copies of all written communications sent by the investment adviser relating to the performance or rate of return of any or all managed accounts or securities recommendations.

Advisers Act Rule	Current Rule	Changes
Rule 204-2(a)(7)	Retention of originals of all written communications received and copies of all written communications sent by such investment adviser relating to (i) any recommendation made or proposed to be made and any advice given or proposed to be given, (ii) any receipt, disbursement or delivery of funds or securities, or (iii) the placing or execution of any order to purchase or sell any security.	Requires advisers to also maintain originals of all written communications received and copies of written communications sent by an investment adviser relating to the performance or rate of return of any or all managed accounts or securities recommendations.
Rule 204-2(a)(16)	Retention of records or documents forming the basis for the calculation of performance information regarding a managed account or securities recommendation contained in a communication distributed to 10 or more persons.	Removal of the phrase "10 or more persons," replacing it with "any person." Advisers will be required to maintain the materials listed in Rule 204-2(a)(16) that demonstrate the calculation of the performance or rate of return in any communication that the adviser circulates or distributes, directly or indirectly, to any person.

Timing

Effective Date. All amendments will be effective October 31, 2016.

Compliance Dates. All advisers filing an initial Form ADV or an amendment to an existing Form ADV on or after October 1, 2017 will be required to utilize the amended form. Therefore, advisers with a December 31 fiscal year end will need to comply with the Form ADV amendments no later than the annual amendment filing due by the end of March 2018. Amendments to Rule 204-2 will apply to communications circulated or distributed after October 1, 2017.

Implications for Advisers

Since the financial crisis, the SEC has greatly expanded its capacity for electronic data gathering and analysis to support all of its programs. The focus by the SEC on data collection is another step in this direction, with the goal of collecting additional information that may be used to identify firms for review or to support enforcement investigations. In order to be in a position to comply with the SEC's data-based oversight regime, advisers may be required to invest more heavily in internal data collection and aggregation and to implement more rigorous data review and monitoring procedures.

Although the effective compliance date for annual amendment filings for advisers with a December 31 fiscal year end is not until the end of March 2018, we advise you to get ahead on compiling the information needed for the updated requirements in order to be fully prepared for the Form ADV amendments.

If you have any questions concerning the foregoing or would like additional information, please contact Benjamin J. Haskin (202-303-1124, bhaskin@willkie.com), Scott A. Arenare (212-728-8252, sarenare@willkie.com), Martin R. Miller (212-728-8690, mmiller@willkie.com), Justin L. Browder (202-303-1264, jbrowder@willkie.com), Anne C. Choe (202-303-1285, achoe@willkie.com), Kelly L. Donnelly (202-303-1245, kdonnelly@willkie.com) or the Willkie attorney with whom you regularly work.

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[1] Form ADV and Investment Advisers Act Rules, Advisers Act Release No. 4509 (Aug. 25, 2016), available here.

[2] Amendments to Form ADV and Investment Advisers Act Rules, Investment Advisers Act Release No. 4091 (May 20, 2015), available here. A copy of our client memorandum on the initial proposal is available here. The proposed changes were published in tandem with new disclosure requirements for registered investment companies about portfolio holdings and risk metrics that have not yet been adopted by the SEC.

[3] The term "regulatory assets under management" was adopted by the SEC in connection with the rules adopted to implement the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") in 2011. Advisers are currently required to disclose the amount of their RAUM in response to Item 5 of Form ADV, Part 1A.

[4] Year-end refers to the date used by the adviser to calculate its RAUM, while mid-year refers to the date six months before the year-end date. The information regarding the SMA custodians is only required to be reported as of the year-end.

[5] Disclosures are divided into three ranges of gross notional exposure: (i) less than 10%, (ii) 10-149%, and (iii) 150% or more. For the purposes of this reporting requirement, the "gross notional exposure" is the percentage calculated by dividing (i) the sum of (a) the dollar amount of any borrowings and (b) the gross notional value of all derivatives by (ii) the RAUM of the account. "Gross notional value" is defined as "[t]he gross nominal or notional value of all transactions that have been entered into but not yet settled as of the reporting date. For contracts with variable nominal or notional principal amounts, the basis for reporting is the nominal or notional principal amounts as of the reporting date. For options, use delta adjusted notional value."

[6] For example, a fund that seeks to raise capital from multiple investors but has only a single, initial investor for a period of time could be a private fund, as could a fund in which all but one of the investors have redeemed their interests. Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers With Less Than $150 Million in Assets Under Management, and Foreign Private Advisers, Advisers Act Release No. 3222 (June 22, 2011) at p. 79, available here.

[7] The SEC noted that a sub-adviser to an SMA should provide information only about the portion of the account that it sub-advises.

[8] *See* Form PF Frequently Asked Questions, Question 12.1 (posted July 19, 2012).

[9] In connection with the SMA-related amendments, the SEC added two new categories of clients to Form ADV Item 5.D.: "sovereign wealth funds" and "foreign official institutions." The SEC also clarified that government pension plans (*i.e.*, federal, state and local) should be counted as state or municipal government entities and not pension and profit-sharing plans.

[10] Proposing Release at p. 22.

[11] This information is designed to assist the SEC in establishing methodologies for stress testing investment advisers and funds as required by Section 165 of the Dodd-Frank Act.

[12] Client types include: (a) individuals (other than high-net-worth individuals), (b) high-net-worth individuals, (c) banking or thrift institutions, (d) investment companies, (e) business development companies, (f) pooled investment vehicles (other than investment companies), (g) pension and profit sharing plans (but not the participants of government pension 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 previously listed, and (n) other. To address commenters' concerns regarding the potential disclosure of confidential or proprietary information, the SEC also added a "Fewer than 5 Clients" column, allowing an adviser to avoid reporting the exact number of clients in a particular category if they have fewer than five.

[13] American Bar Association, Business Law Section, SEC Staff Letter (Jan. 18, 2012), available here.

[14] As defined in Rule 205-3 under the Advisers Act.

[15] Proposing Release at p. 28.

[16] *See* Frequently Asked Questions on Form ADV and IARD, *Reporting to the SEC as an Exempt Reporting Adviser* (Apr. 15, 2015), available here.