

IM

Guidance Update

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STAFF GUIDANCE CONCERNING INVESTMENT ADVISER RELIANCE ON PREDECESSOR REGISTRATIONS

The staff of the Division of Investment Management has received numerous inquiries over the years concerning when, and under which circumstances, an entity may be able to rely on a predecessor's registration as an investment adviser with the Securities and Exchange Commission ("SEC" or "Commission"). Through this guidance, the staff seeks to address the following instances in which an investment adviser may be able to rely on special registration provisions for "successors"¹ to SEC-registered advisers, and the method by which a succession is effectuated:

- a change of the state or territory in which a business is organized and/or a change in its form of organization;
- a change in control or a change in leadership at an investment adviser;
- a change in ownership of an investment adviser;
- an acquisition of a portion of an investment advisory business; and
- an internal reorganization at an investment adviser.



US Securities and Exchange Commission
Division of Investment Management

Statutory and Regulatory Background

In general, a successor to the business of a predecessor registered investment adviser may rely on the registration of its predecessor if the successor files an application to register as an investment adviser within thirty days after taking over the predecessor's business.² The Commission has previously explained that the purpose behind the ability of a successor to rely on the registration of its predecessor is to facilitate the legitimate transfer of business between two or more entities and to enable the successor to operate without an interruption of business.³

Investment advisers that elect to rely on a predecessor's registration may do so under two methods, depending on the circumstances:

- **Succession by application.** If the successor is an unregistered entity and is acquiring or assuming substantially all of the assets and liabilities of the advisory business of an SEC-registered adviser (and the acquired adviser is no longer conducting advisory activities), the successor must file a new application for registration on Form ADV within thirty days after succession (this type of election is referred to as "*succession by application*"), and the successor may rely on the registration of the acquired adviser until the SEC declares the successor's new registration effective.⁴
- **Succession by amendment.** Alternatively, if the successor is a new investment adviser formed solely as a result of a change in form of organization, a reorganization, or a change in the composition of a partnership and there has been no "practical" change in control or management,⁵ the successor may amend the registration of the SEC-registered adviser by filing an amended Form ADV within thirty days after the change or reorganization to reflect such changes rather than file a new application (this type of election is referred to as "*succession by amendment*").⁶

An adviser that fails to file a substantially complete Form ADV that indicates that the adviser is submitting a filing as a *succession by application* or *succession by amendment* within the statutory time would have to file a new application to register on Form ADV.⁷ Such an investment adviser would be conducting an investment advisory business without being registered.

Common Questions

1. “Does a change in business organization raise succession concerns?”

Advisers often ask whether a change of the state or territory in which their businesses are organized and/or a change in their forms of organization (with no change in control⁸) raises succession concerns. Whether an adviser may rely on the succession rules depends on the particular facts and whether a new legal entity is created.

The Commission has stated that an adviser that changes its form of organization, legal status, or the composition of its partnership (such that the partnership was considered dissolved under state law)⁹ without a change of control may file as a successor by amending its Form ADV (*i.e., succession by amendment*) during the thirty days following the change.¹⁰ The premise behind the ability of an adviser to file as a successor by amending its Form ADV is that a change of the place of incorporation from one state to another and/or a change of the form of a business—e.g., converting from an LLC to limited partnership—results in the dissolution of the previous organization and the *de facto* creation of a new legal entity that has taken over the business of the previous organization.¹¹

Under other circumstances that the Commission has not already addressed, it is less clear whether an entity has dissolved and a new legal entity has been created. In such situations, whether a previous organization has dissolved is a matter of state law.¹² If a dissolution is deemed to have occurred under state law, a new registration is required within thirty days by the new legal entity and may be done as a *succession by amendment* to the predecessor’s registration, if there is no practical change in control or management.¹³ If there has been both a dissolution and a practical change in control or management, the new legal entity must register within thirty days and may do so by filing a *succession by application*.

An adviser for which a new legal entity has not in fact been created (and consequently has no reason to rely on succession rules) should note the following with respect to its Form ADV:

- the adviser should answer “no” to Item 4,¹⁴ but should consider providing an explanation on Schedule D, citing to the particular applicable state statute or provision that supports its position that a new legal entity has not been created;
- the adviser should not answer “yes” to Item 4, because a yes answer triggers issues of successor filings involving the thirty-day statutory filing deadline; and

- changes to identifying information such as the name of the adviser should be updated by amending the registrant's Form ADV.

2. “Does a change in control raise a succession concern?”

We frequently receive questions involving the transfer of a controlling¹⁵ block of a registered adviser's securities to a new owner or owners or a change in leadership (e.g., new chief executive officer). In these situations, the new controlling party or parties, however, do not cause an unregistered entity to acquire or assume substantially all of the assets and liabilities of a registered adviser, and they do not change the registered adviser's form of legal entity (e.g., an entity was, and remains, a limited liability company formed in State X).

There would be no need to rely on the successor provisions under these facts. As a practical matter, the adviser generally would need to:

- amend its Form ADV to show the new ownership on Schedules A and B;¹⁶ and
- answer “no” to the succession question in Item 4, and should consider whether to provide an explanation in the miscellaneous section of Schedule D for the benefit of staff examiners and the clients of the adviser who are reviewing the form.

On the other hand, if the new controlling party or parties (a) cause an unregistered separate or new legal entity to acquire or assume substantially all of the registered adviser's assets and liabilities and to continue the business of the registered adviser (and that acquired adviser ceases its advisory activities), or (b) change the registered adviser's form of legal entity, the acquiring or resulting adviser must register and may do so by filing a *succession by application*.¹⁷

3. “Does a change in ownership raise succession concerns?”

Sometimes inquirers seek clarification as to what level of ownership change triggers the need to amend Form ADV to show new material owners or to submit a successor filing. In particular, they ask about the implications of ownership changes that result in what they refer to as a “minor” change in control.

A change in ownership of an adviser, *by itself*, does not implicate successor concerns, even if the change in ownership results in a change in control of the adviser. Changes of ownership would need to be reported in an amendment to the adviser's Form ADV if the changes would alter the answers on Schedules A and B or other parts of the Form ADV.¹⁸

4. “Can we rely on the succession provisions if we purchase a portion but not substantially all of a registered adviser’s business?”

The fact pattern that often gives rise to this type of question involves the purchase of a registered adviser’s client list or portion of its advisory business by an unregistered entity without the unregistered entity acquiring or assuming substantially all of the assets and liabilities of the business. In some cases, the registered adviser remains in business, but it may change the type of advisory business it conducts or the client pool that it intends to serve.

Despite continuity in advisory services to the clients of the prior adviser, the purchaser is not acquiring or assuming substantially all of the assets and liabilities of the registered adviser, and thus, the purchaser is not entitled to rely on the successor provisions.¹⁹ Instead, it must wait until its own registration with the SEC (or state, if applicable) becomes effective before engaging in business as an investment adviser.²⁰ In this situation, the registered adviser would need to:

- amend its Form ADV to show the change of its business in its next annual updating amendment,²¹ or
- file a Form ADV-W if it intends to withdraw its registration as an investment adviser.

We note that if a *registered* adviser purchases another registered adviser’s client list or portion of its advisory business or acquires substantially all of the assets and liabilities of another registered adviser, there is no need to rely on successor provisions. Both advisers would need to amend their Form ADV filings or withdraw registration, as appropriate.²²

5. “Can we rely on succession by amendment for internal reorganizations?”

We sometimes receive questions regarding internal reorganizations involving a registered adviser. In certain cases, a registered adviser may undergo an internal reorganization or restructuring in which an unregistered entity acquires substantially all of the assets and liabilities of the registered adviser, which is owned by the same parent corporation. If the unregistered entity acquires or assumes substantially all of the assets and liabilities of the registered adviser owned by the same parent corporation and continues the business of that registered adviser (and the registered adviser ceases its advisory activities), the unregistered entity may rely on *succession by amendment* provided that the unregistered entity continues to be wholly owned by the same parent corporation.²³

Such unregistered entity may not rely on *succession by amendment*, however, if there has been a change of control of the unregistered entity (e.g., there has been a change in the beneficial ownership and it is no longer wholly owned by the same parent corporation).²⁴ In this case, the unregistered entity would be required to file its own registration application and may rely on *succession by application*.²⁵ In either case, the predecessor adviser would be required to file Form ADV-W.

A variation of this involves an entity that is dually registered as a broker-dealer and investment adviser and is wholly owned by a parent corporation that undergoes an internal reorganization or restructuring to separate its services by transferring its advisory activities to an unregistered entity owned by the same parent corporation. If the unregistered entity acquires substantially all of the assets and liabilities of the advisory operation or division (and the predecessor entity ceases its advisory activities), and there is no change of control of that operation or division, such unregistered entity may rely on *succession by amendment*.²⁶ If there is a change in control of the advisory operation or division, the unregistered entity would be required to file its own registration application and may rely on *succession by application*. In either case, the dual registrant would be required to file Form ADV-W.

Endnotes

- 1 In a 1992 interpretive statement, the Commission provided that a “successor” is an unregistered entity that assumes and continues the business of a registered investment adviser that ceases its advisory activities. Registration of Successors to Broker-Dealers and Investment Advisers, SEC Release No. 34-31661, IA-1357 (December 28, 1992) (Adoption of Rule Amendments; Interpretive Statement) (“1992 Interpretive Statement”). SEC staff understands an “unregistered entity” to include natural persons operating as sole proprietorships. The 1992 Interpretive Statement also discussed filings of broker-dealer successions in a parallel fashion to the analysis involving investment advisers.
- 2 Section 203(g) of the Investment Advisers Act of 1940 (“Advisers Act”). Rule 203-1 under the Advisers Act requires investment advisers to file Form ADV to apply for registration with the Commission as an investment adviser.
- 3 See 1992 Interpretive Statement. The Commission has also stated that the successor rules are intended to be used only where there is a direct and substantial business nexus between the predecessor and the successor and that they are not designed to allow registered advisers to sell their registrations, eliminate substantial liabilities, spin off personnel, or to facilitate the transfer of the registration of a “shell” organization that does not conduct any business. *Id.*

- 4 Form ADV, Instructions for Part 1A, Item 4(a)(1).
- 5 See Form ADV, Instructions for Part 1A, Item 4(a)(2) (“no practical change in control or management” includes situations in which a new legal entity is formed solely as a result of a change in form of organization, a reorganization, or a change in the composition of a partnership, but the control and management of the adviser have not otherwise changed). See *also* 1992 Interpretive Statement, footnote 21 and accompanying text.
- 6 Form ADV, Instructions for Part 1A, Item 4(a)(2).
- 7 Although largely uncommon today, the Commission noted in the 1992 Interpretive Statement that situations occasionally arise in which an adviser submits an application within thirty days of the succession but, because it is incomplete in certain minor respects (e.g., failure to check “yes” in Item 4), such application is not considered “filed” until after the thirty-day period has expired. In such situations, the successor may still rely on the predecessor’s registration if the application or amendment, as the case may be, is substantially complete. The successor should promptly file an amendment curing the minor discrepancies. The successor may not, however, “lock in” the thirty-day period by submitting an application that is incomplete in major respects (e.g., failure to update the ownership information), or by otherwise failing to file an application that represents a good faith attempt at compliance with the successor provisions.
- 8 See definition of “control” in Form ADV Glossary.
- 9 In discussing the change of composition of a partnership that could give rise to a successor filing, the 1992 Interpretive Statement focused on whether there was a dissolution of the previous organization under local law.
- 10 See 1992 Interpretive Statement, Section III.B and Form ADV, Instructions for Part 1A, Item 4(a)(2). See *also* Section 203(g) of the Advisers Act.
- 11 The 1992 Interpretive Statement noted that other changes in legal status that may be completed by filing an amendment include: (i) a change from general corporation to S corporation status under subchapter S of the Internal Revenue Code of 1986, as amended; and (ii) a change in a registered entity’s name that results in the dissolution of the entity under local law.

- 12 Increasingly, states have passed laws allowing for continuity of a legal entity when a change of the form of a business's organization or composition of partnership takes place, including provisions allowing the new business to keep its tax identification number and other indicia of continuity with the previous entity. Advisers sometimes seek to rely on these state law provisions to argue that, in fact, a new legal entity has *not* been created under state law, and no succession filing is necessary. The staff does not undertake to interpret or analyze the laws of the states and territories in connection with reviewing the filings of investment advisers or applicants for investment adviser registration. As noted above, the Commission has identified specific circumstances under which it views an adviser to have dissolved and a new entity to have been created. Under other circumstances, the staff would defer to state law when considering whether a previous organization has dissolved and a new legal entity has been created. If an adviser should have filed as a successor and did not do so, it risks liability for doing business as an unregistered investment adviser.
- 13 See *supra* note 5.
- 14 Form ADV Item 4 asks whether the adviser is succeeding to the business of a registered investment adviser, and if yes, the date of succession. Item 4 also requires that the successor adviser complete Section 4 of Schedule D, which asks for the identifying information of the acquired registered investment adviser.
- 15 See definition of "control" in Form ADV Glossary.
- 16 Note that the adviser would also have to address issues arising under an event of an assignment (e.g., obtaining client consent). See Section 205(a)(2) of the Advisers Act. See also Dean Witter, Discover & Co.; Morgan Stanley Group Inc., SEC No-Action Letter, (April 18, 1997) (SEC staff noted that the transfer or issuance of a block of stock in connection with a merger involving two issuers generally would not by itself cause an assignment of the advisory contracts of their advisory subsidiaries, for purposes of the Investment Company Act of 1940 or the Advisers Act, unless (1) a person who had control of either issuer prior to the transaction does not have control of the surviving entity after the transaction, (2) a person who did not have control of either issuer prior to the transaction gains control of the surviving entity, or (3) the transaction results in an advisory subsidiary being merged out of existence).
- 17 See the response to question 3 below for more on this topic.
- 18 See, e.g., the response to question 2 above for more on this topic.

- 19 In the 1992 Interpretive Statement, the Commission stated that to ensure that there is a legitimate connection between the predecessor and successor, no entity may rely on the successor rules unless it is acquiring or assuming substantially all of the assets and liabilities of the predecessor's advisory business. Although the Commission stated in the 1992 Interpretive Statement that under this standard the successor need not acquire every asset and liability of the predecessor, it may not exclude any significant asset or liability.
 - 20 To ensure continuity of advisory services to clients, an adviser that is not registered, and has a reasonable expectation that it will be eligible for SEC registration within 120 days of registering, may wish to register with the SEC prior to the time it anticipates engaging in business as an investment adviser. See rule 203A-2(c) under the Advisers Act and Form ADV, Instructions for Part 1A, Item 2.
 - 21 See Form ADV, General Instruction 4 to determine whether an amendment is required to be made sooner.
 - 22 The specific item numbers in Form ADV that would need to be amended would depend on the circumstances of the purchase. Both advisers should review all items to determine which items need to be amended, and may wish to review in particular Form ADV, Part 1A, Item 5, which asks for information with respect to employees, clients, compensation arrangements, regulatory assets under management, and advisory activities.
- 23 1992 Interpretive Statement, footnote 23.
- 24 *Id.*
- 25 In either case, if the acquiring entity does not purchase substantially all of the registered adviser's business, the acquiring entity may not rely on the successor provisions. See the response to question 4 above.
 - 26 See 1992 Interpretive Statement, Part III.C.4., particularly footnotes 30-31 and accompanying text.

IM Guidance Updates are recurring publications that summarize the staff's views regarding various requirements of the federal securities laws. The Division generally issues *IM Guidance Updates* as a result of emerging asset management industry trends, discussions with industry participants, reviews of registrant disclosures, and no-action and interpretive requests.

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