



Risk Management Update June 2017

WHAT ADVISERS NEED TO DO TO PREPARE FOR UPCOMING CHANGES TO FORM ADV

In their continued quest to obtain “big data” from registrants, the U.S. Securities and Exchange Commission (“SEC”) issued a final rule in August 2016, which significantly expands the information required in Form ADV.¹ The compliance date for the rule is October 1, 2017, and all investment advisers making Form ADV filings on and after that date will need to include the additional information, as applicable. A majority of the changes are contained in Form ADV Part 1. Below is a summary of the areas in the document that are materially affected:

- Item 1 – Identifying Information
- Item 5 – Information about Your Advisory Business

In addition, there are a number of changes to the Schedule D applicable to these items, along with a new schedule (Schedule R) for advisers filing under an “umbrella” registration (*i.e.*, one or more advisers relying on the same registration).

This Risk Management Update discusses in detail the information that will be required in each of the above referenced areas and provides preparation steps for advisory firms to consider for complying with the new mandates.

Form ADV Part 1 Changes

The following outlines the new data required under each section and each applicable Schedule D and can be used as a checklist for applicability.

Item 1 – Identifying Information

- Item 1.B – Check a box when registering more than one adviser under same registration (umbrella registration).
- Item 1.D & 1.E – Include all Central Index numbers (CIK) and Central Registration Depository numbers (CRD) applicable to the firm.
- Item 1.F – List the total number of offices, other than principal office where firm conducts advisory business.
- Item 1.I – Check a box if the firm utilizes social media sites (*e.g.*, LinkedIn, Facebook etc.).
- Item 1.J – Provide name and Tax ID of any person or company (outside the firm) that employs and/or compensates the firm’s Chief Compliance Officer.

¹ See <https://www.sec.gov/rules/final/2016/ia-4509.pdf>.

- Item 1.O – Check a box indicating the amount of firm assets (based on a range) over \$1 billion from firm’s most recent balance sheet.

Schedule D for Item 1 Questions

- Schedule D – Item 1.F – Include the: (i) CRD number if branch office is registered with FINRA via Form BR, (ii) number of employees at location, (iii) other type of business activities performed from location, (iv) description of other investment related activities.
- Schedule D – Item 1.I – Include addresses of all firm controlled social media sites.

Item 5 - Information about Your Advisory Business

- Item 5.C – Provide the number of clients as of date of last fiscal year end (no longer range of number of clients).
- Item 5.D – Provide the number of clients for each type listed, with corresponding regulatory assets under management (“RAUM”) (this chart replaces the requirement to include approximate percent of clients by type).
- Item 5.F – Provide amount of RAUM that is attributed to non-U.S. clients.
- Item 5.I – Provide amount of RAUM that is attributed to wrap program participation as a sponsor, portfolio manager, and as a sponsor and portfolio manager for the same wrap program.
- Item 5.J – Indicate whether the AUM reflected in Form ADV Part 2A is calculated differently than the RAUM reported in Form ADV Part 1.
- Item 5.K – New section requiring information pertaining to separately managed account (“SMA”) clients,² which includes whether the firm:
 - Item 5.K(1) Has RAUM attributable to SMA clients;
 - Item 5.K(2) Engages in borrowing transactions for SMA clients;
 - Item 5.K(3) Engages in derivative transactions for SMA clients; and
 - Item 5.K(4) Has RAUM of SMA clients where any custodian holds 10% or more of such assets.

Schedule D for Item 5 Questions

- Schedule D – Item 5.G(3) – Provide the RAUM of all parallel managed accounts³ related to the registered investment company or business development company advised by the firm.
- Schedule D – Item 5.I – Provide name of sponsor for each wrap program participated in by the firm, including the sponsor’s SEC and CRD numbers.

² Defined as advisory accounts other than pooled investment vehicles (e.g., registered investment companies, business development companies and private funds).

³ Defined as any managed account or other pool of assets advised by the firm and that pursues substantially the same investment objective and strategy and invests side by side in substantially the same positions as the identified investment company or business development company also advised by the firm.

- Schedule D – Item 5.K(1) – Complete a chart reflecting the percent of RAUM by asset type for separately managed accounts. If total RAUM for separately managed accounts is \$10 million or more, then both mid-year and end of year (as defined in Schedule D) percentages must be provided. If total is less than \$10 million, only end of year must be provided.
- Schedule D – Item 5.K(2) – For total RAUM in SMAs of \$10 million or more, complete a chart reflecting the amount of RAUM, borrowing, and derivative exposure for the firm’s SMA clients, listed by type of derivative for varying levels of gross notional exposure.⁴ For RAUM in SMAs over \$500 million and less than \$10 billion, the chart only requires RAUM and borrowing by varying levels of gross national exposure.
- Schedule D – Item 5.K(3) – Provide information for each custodian that holds 10% or more of aggregate RAUM in SMAs, including how much of the firm’s SMA RAUM is attributable to the custodian.

Form ADV Part 1 – New Schedule R for Relying Advisers

The following outlines the data required under the new Schedule R, which must be completed for each relying adviser:

- *Section 1 – Identifying Information:* Provide information on the relying adviser, including but not limited to legal name, primary business name, principal address, business operation information, and telephone and fax numbers.
- *Section 2 – SEC Registration:* Check box indicating independent reason for SEC eligibility.
- *Section 3 – Form of Organization:* Provide information on type of entity, month ending for fiscal year, and state or country of organization.
- *Section 4 – Controls Persons:* List owners, executive officers, and indirect owners (similar information as required in Schedule A and B).

Preparation Guidelines

The SEC has issued a “marked to show changes” copy of the paper version of Form ADV Part 1,⁵ which can serve as a helpful tool in understanding the details of the changes and additional data required. In preparation for this newly required filing, Chief Compliance Officers should consider taking the following steps:

⁴ For purposes of the chart, the gross notional exposure of an account is the percentage obtained 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 regulatory assets under management of the account.

⁵ See <https://www.sec.gov/rules/final/2016/ia-4509-form-adv-summary-of-changes.pdf>.

1. Review the Form ADV changes in detail and make a list of all new information required that is applicable to your firm.
2. Work with operations and accounting personnel in determining how best to gather the data, both for the initial filing and subsequent amendments.
3. Use technology to the extent possible. For example, consider whether portfolio accounting system can be programmed to capture and/or provide special reports containing required client and transactional data.
4. Create spreadsheets for information needed in Item 5.K Schedule Ds using the example charts provided in the marked Form ADV Part 1.
5. Implement policies, procedures and controls to help ensure applicable data will be gathered going forward in a timely and effective manner.
6. Implement testing protocols to ensure data gathered is accurate.
7. Ensure backup substantiating the information collected is maintained as part of the firm's books and records.

Conclusion

Given the extensive amount of data required for Form ADV filings made on or after October 1, 2017, firms should begin preparing now. Senior managers should be involved in the process in order to ensure resources are allocated as necessary to gather and retain applicable data.

For assistance, please contact us at info@corecls.com, at (619) 278-0020 or visit us at www.corecls.com for more information.

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