



**Risk Management Update  
February 2015**

**FORM ADV – IMPORTANT THINGS YOU NEED TO KNOW ABOUT UPDATES**

**Introduction**

Rule 204-1<sup>1</sup> of the Securities and Exchange Commission ("SEC"), requires registered investment advisers to file an "annual updating amendment" to the firm's Form ADV Part 1 and 2A (also known as the "Brochure") within 90 days after the firm's fiscal year end (most firms fiscal year ends on December 31<sup>st</sup>). This amendment reaffirms the information previously filed and updates any other sections for which information may be outdated. This Risk Management Update will help highlight and clarify the definitions of a few parts of the Form ADV that can cause some firms confusion.

**1. Calculating Assets Under Management - Did I Do It Correctly?**

One of the most frequently misunderstood portions of the Form ADV Part 1 that requires updating during the annual amendment is under Item 5.F which requires the adviser to report total Assets Under Management or "AUM." In determining the amount of your firm's regulatory AUM, you must include the securities portfolios for which you provide continuous and regulatory supervisory or management services as of the date of filing your annual amendment. The SEC's expectation is that you retain, within your Books and Records, any tools or materials that you use in order to calculate the AUM for reporting. Having a system in place to accurately calculate the AUM for your firm and maintain the documentation to arrive at those numbers is critical to maintaining regulatory compliance.

**2. Discretionary versus Non-discretionary**

According to the SEC's Form ADV instructions and glossary<sup>2</sup>, the difference between discretionary and non-discretionary management is as follows:

**Discretionary:** You may provide continuous and regular supervisory or management services for an account if you:

- have *discretionary authority* to allocate client assets among various mutual funds;
- do not have *discretionary authority*, but provide the same allocation services, and satisfy the criteria as set forth above;
- allocate assets among other managers (a "manager of managers"), but only if you have *discretionary authority* to hire and fire managers and reallocate assets among them; or
- you are a broker-dealer and treat the account as a brokerage account, but only if you have *discretionary authority* over the account.

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<sup>1</sup> <http://www.sec.gov/rules/final/2010/ia-3060.pdf>

<sup>2</sup> <http://www.sec.gov/about/forms/formadv-instructions.pdf>

**Non-discretionary:** You do not provide continuous and regular supervisory or management services for an account if you:

- provide market timing recommendations (i.e., buy or sell), but have no ongoing management responsibilities
- provide only *impersonal investment advice* (e.g., market newsletters);
- make an initial asset allocation, without continuous and regular monitoring and reallocation; or
- provide advice on an intermittent or periodic basis (such as upon *client* request, in response to a market event, or on a specific date, e.g., the account is reviewed and adjusted quarterly).

**Non-managed:** If you provide continuous and regular supervisory or management services for only a portion of a securities portfolio, include as regulatory assets under management only that portion of the securities portfolio for which you provide such services. Exclude, for example, the portion of an account<sup>3</sup>:

- under management by another person; or
- that consists of real estate or businesses whose operations you “manage” on behalf of a client but not as an investment.

For instance, if you have a client with an account value of \$1,000,000 and your firm manages only \$200,000 of the securities, you may only include the \$200,000 your firm manages in your AUM.

### **3. Number of Clients and Number of Accounts - What is the Difference?**

When calculating AUM, the firm also must report the total number of "accounts" that are discretionary and non-discretionary under Item 5.F. There can be confusion as to the definition of what constitutes a "client" and what constitutes an "account." For instance, a client can be determined by the taxpayer ID or Social Security number.

*Example:* John Doe as an individual signs an agreement with the firm using his Social Security number to open five accounts to be managed by the investment advisory firm. In this relationship, the advisory firm holds one client relationship with Mr. Doe, but would list five accounts in their calculations for Item 5.F.

### **4. Delivery Requirements**

SEC rules stipulate a firm has 120 days from the end of its fiscal year to provide clients with a summary changes in Item 2 and offer clients a full copy of the firm's Brochure. Advisers are not required to provide a copy of the Form ADV Part 1 to clients. While this seems like a straightforward delivery requirement, there are some additional items or best practices tips that your firm should consider as well:

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<sup>3</sup> Do not deduct any outstanding indebtedness or other accrued but unpaid liabilities.

- If your firm files its annual amendment prior to the March 31 deadline, though it is not required that you provide the updated brochure to clients within 30 days of the date of filing, as a best practice it is recommended that you do so. For example, if you file on February 20th, *technically*, you have until April 30th to deliver the Brochure to clients. However, in this scenario it is recommended that you provide the Brochure to clients within 30 days of filing which would be March 20th.
- While a firm is only required to deliver Item 2 ("Material Changes") of the Brochure to clients annually, the firm must provide the client with information on how they can request a copy of the full Brochure.
- You may deliver the offering letter and Material Changes electronically, only to those clients that have provided prior consent to electronic communications. In all other instances you must provide the client with a paper copy.

## Conclusion

In conclusion, when preparing to file your annual amendment it is important to remember to thoroughly review all sections for accuracy prior to submission. There are several useful tools available for your assistance in preparing the filing. These include (i) Glossary of Terms<sup>4</sup> which provides definitions of frequently used terms in the Form ADV; (ii) instructions on how to prepare Forms ADV Part 1<sup>5</sup>, Part 1A<sup>6</sup>, and Part 2<sup>7</sup>; and (iii) the IARD Call Center for live assistance with filing related questions<sup>8</sup>.

For more information, or to learn about how CCLS may be of assistance in preparing your Form ADV annual amendment, please do not hesitate to contact us at (619) 278-0020 or visit [www.corecls.com](http://www.corecls.com).

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<sup>4</sup> See SEC's Form ADV Glossary of Terms at <https://www.sec.gov/rules/final/2011/ia-3221-appc.pdf>

<sup>5</sup> <http://www.sec.gov/about/forms/formadv-instructions.pdf>

<sup>6</sup> <http://www.sec.gov/about/forms/formadv-part1a.pdf>

<sup>7</sup> <http://www.sec.gov/about/forms/formadv-part2.pdf>

<sup>8</sup> [http://www.iard.com/support\\_contacts.asp](http://www.iard.com/support_contacts.asp)