MONTHLY COMPLIANCE TASKS

Please be sure to check your SmartRIA CCO portal to keep up with your monthly Compliance tasks.

- For login information or questions regarding the portal, please contact Sara Sparks at ssparks@thecomplianceresource.com
- For task related questions, please contact Nancy Harry at nharry@thecomplianceresource.com

Attached "Resources" this month include:

- ***SAMPLE Annual IAR Attestation*** – Please tailor to your firm and its practice.
- ***ADV Annual Amendment Checklist*** – Our team will be reaching out to firms to schedule time to review the ADV.

CALCULATING YOUR REGULATORY ASSETS UNDER MANAGEMENT

Not correctly calculating regulatory assets under management (AUM) is one of the most common compliance deficiencies. The SEC staff defines AUM for the purposes of Item 5.F on the Form ADV Part 1 as *securities portfolios for which you provide continuous and regular supervisory or management services*. The SEC staff further expands on what constitutes a *securities portfolio* as well as *regular supervisory or management services.*

**State registered Advisors - please note that the states have adopted this definition as well.

The SEC's definition of ***securities portfolios*:**

- **Cash and cash equivalents** are considered securities.
- **At least 50% of the total value of the account must consist of securities** for the account to be considered a *securities portfolio*.
- **Family accounts, accounts for which you receive no compensation, accounts for non-US persons, and all assets within in a private fund,** including any uncalled mandatory commitments, must all be counted as securities.

The SEC's definition of ***continuous and regular supervisory or management services*:**

- Firm *has discretion over an account,* and your advisory firm provides ongoing supervisory or management services with respect to the account, (or)
- Firm *does not have discretion over an account*, but you have an ongoing duty to select or make recommendations based upon the needs of your client and if the client accepts your investment recommendation, you are responsible for arranging or effecting the purchase or sale.

Even if the firm does not have discretion of the account and the firm is not directly executing the recommended transactions, the firm may be in a situation which the client's portfolio should NOT be considered regulatory AUM for the purposes of the Form ADV.

A challenge today is that the offering of comprehensive financial planning services – where advisors provide holistic financial planning advice on *all* of a client's net worth. This does *not* mean the advisor can claim all of those assets as regulatory AUM. In fact, most of the time the advisor should *not* include outside 401(k) plans and other non-managed assets that were advised upon as part of the financial plan, nor the value of brokerage accounts holding mutual funds and

various types of annuities (unless the advisor *truly* provides ongoing management services), nor Third Party Managed accounts or separately managed account assets (unless the advisor retains the *discretionary* right to hire/fire the Third Party Manager and reallocate to another one). In fact, even having discretion over an account doesn't automatically ensure it is counted as regulatory AUM, particularly if it's a passive buy-and-hold account unless the advisor can actually substantiate that monitoring and due diligence is occurring outside of any periodic client review meetings!

For advisors who want to report *some* number representing the total scope of their *advice* – including the amount of assets that don't count as regulatory AUM – it is permissible to report on Assets Under Advisement (AUA) in the advisor's marketing and in Part 2 of Form ADV, as long as the advisor can document and substantiate the calculation process. But the fact that it's permissible to report both AUM and also a (typically large) AUA amount doesn't change the fact that, when reporting regulatory AUM itself, it's crucial to report the right number on the Part 1 filing!

The SEC further provides a few factors to help you evaluate if your firm **is** providing ***continuous and regular supervisory or management services*** to an account:

- Does your **advisory contact** with client suggest you provide ongoing management services of the account?
- Does your **actual management practice** also reflect ongoing management services?
- Are you **compensated** based on the average value of the client's assets you manage?

In other words, even meeting with clients "regularly" on a quarterly basis is not *continuous and regular* asset management; the advisor must also substantiate that due diligence monitoring and other management services are occurring between the quarterly (or less frequent) meetings as well!

The SEC suggests that if you receive compensation like either of the following scenarios, it's likely that your firm **DOES NOT** *provide continuous and regular supervisory or management services to an account*:

- You are compensated based on the time spent with a client (or)
- You are paid a retained based on a percentage of assets covered under a financial plan.

In addition, the SEC indicates when calculating the *value of the portfolio* by providing the following guidance:

- Only include the value of each securities portfolio for which you *provide continuous and regular supervisory or management services*.
- Exclude assets that are *managed by another person or firm.*
- *Real estate or business operations* that you manage on behalf of a client rather than as an investment.
- Do not deduct any outstanding indebtedness, etc. on the securities portfolio.

And lastly, the SEC attempts to outline further a few common scenarios in which an RIA firm **would likely NOT be considered to have regulatory assets under management** from an RIA compliance standpoint. Those scenarios include:

- Only provide market timing recommendations to a client but do not have any ongoing management responsibilities.
- Only provide market newsletters or commentary.
- Help a client with an initial asset allocation but do not continuously and regulatory monitor the account.

- Only provide advice on a periodic or intermittent basis such as only when a client calls, when there is a market event, or only on a specific date each quarter, etc.

Third-Party Money Management

Regulatory AUM also becomes a tricky topic if you are an investment adviser who utilizes third-party asset or investment managers (e.g. turn-key asset management providers (TAMPs), sub-advisers, etc.). The SEC states that in such *manager of manager* situations, an RIA firm ***may be able*** to count such assets as AUM for regulatory purposes if the firm has *discretionary authority to* ***hire and fire*** *managers and reallocate assets among them.*

Illiquid Assets

While the SEC does provide substantial latitude to the advisor in determining what is a "reasonable" estimate of value – which is straightforward for market-traded securities, but can be more challenging *for infrequently traded or illiquid assets*. However, the SEC does expect that the advisor is consistent in using the same values for AUM calculation purposes that are used to report values to clients (e.g., in quarterly or annual portfolio statements) and when calculating the advisor's own fees. *There needs to be documentation and client disclosure for assets that are not valued on a regular basis by the vendor or Custodian.* Key Takeaway on Illiquid Asset Reporting - Retain your documentation……Don't get caught on an exam without it!