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## Tis the (ADV) Season: 8 Common Headaches & Practical Solutions for Form ADV Updates

### EXECUTIVE SUMMARY

- Even among the most established investment managers, administering Form ADV updates can prove particularly painful and vexing. Regardless of size or level of sophistication, investment managers routinely encounter any one of 8 common challenges when assessing and/or administering Form ADV updates.
- These common challenges include: making “materiality” determinations; making “prompt” updates to and deliveries of Form ADV upon certain triggering events; experiencing historical reporting inconsistencies; managing information & data sourcing; lacking supporting policies & procedures; noticing mistakes after-the-fact; being vulnerable to administrative single-points-of-failure (SPOFs); and experiencing inconsistencies amongst the Form ADV’s various Parts.
- These challenges, however, can often be alleviated or lessened with certain practical and purpose-oriented solutions.
- Practical measures include, but are not limited to: creating rationale logs and staff redundancies; implementing “four eyes” checks; adopting Form ADV update “playbooks; implementing synchronization checklists; and implementing systematic policy & procedure reconciliations & validations, among other measures.
- Additionally, understanding and appreciating the two fundamental purposes of the Form ADV – investor protection and enabling SEC oversight – can also provide a guidepost when navigating certain scenarios that may not be addressed by the Form’s Instructions themselves.

### INTRODUCTION

By now, I imagine most investment managers are well into the ritual of preparing their annual Form ADV updating amendments. I also imagine that for most, the ritual is beset by at least a few headaches, with some perhaps reaching the point of migraines. Invariably, no matter how finely tuned of an engine an investment manager has to alleviate these, the same types of categorical problems seem to occur. But, the degree and volume of those headaches can often be lessened to a meaningful degree with several simple yet effective practices. This month’s essay is intended to identify some of those practices, both for the Form ADV’s annual updating requirement, as well as instances where an investment manager must navigate other-than-annual amendments (“OTAAAs”).

As with last month's essay, I recognize this topic may be of varying levels of interest and value to the *Headspace* readership. But, given what I'd call the "blunt misery" of the Form ADV season (quoting a poet friend who resides in Maine), the time for a "headier" *Headspace* seems better for another day. This month, it's meat and potatoes, blocking and tackling, etc. To those ends, this essay will focus on the following:

- ❖ **A reminder of the fundamental purposes of Form ADV itself;**
- ❖ **8 common challenges and scenarios investment managers encounter when performing or evaluating the need to perform Form ADV updates; and**
- ❖ **Corresponding practical solutions investment managers should consider adopting to address these challenges.**

While the ADV season will never be marked by the same merry cheer and festiveness as an actual holiday, it still doesn't have to be marked by the "blunt misery" so many registrants often experience. Through understanding the above items, investment managers can be better positioned to make their Form ADV updating processes administratively less painful, substantively more accurate and precise, and fundamentally more meaningful and useful for the Form's two biggest stakeholders: the SEC, and prospective and existing clients.

And with that, let's ring in some ADV cheer . . .

### **THE PURPOSES OF FORM ADV**

**Notwithstanding the SEC's attempt to provide clarity for all Parts of the Form ADV, the Form's Instructions can seem utterly unhelpful when an investment manager needs them most. However, keeping in mind the two basic purposes of the Form ADV can help investment managers navigate scenarios of ambiguity. These two purposes are: enabling the SEC to conduct adequate investment manager oversight, and enabling investors to make fully informed decisions on employment of an investment manager.**

**Purpose #1: SEC Oversight & Form ADV Part 1.** Unlike Form ADV Parts 2-3 (the Brochure and Client Relationship Summary), Part 1 does not have to be delivered to prospective or current investors (though it has to be available on the SEC's public website). When comparing Part 1 to Parts 2-3, Part 1 is far more raw data-oriented (e.g. requesting detailed breakdowns of client types, assets by client types, books & records locations, auditor information, control persons and officers, and the like). Although Part 1 can be of interest to prospective and current clients, it is predominantly more for the SEC's use than the general public. The more data-oriented, "radio button" nature of the Form allows the SEC to quickly assemble and review investment manager profiles and complexions, which can allow them to reprioritize any intended examination plans it may have in store for registrants. For example, if the SEC wanted to prioritize examining private fund advisers or advisers to pooled investment vehicles one year, the data collected in Part 1 allows the SEC to determine those registrants quickly. Similarly, if an investment adviser undergoes a change in control and has to amend its Part 1 before the next annual updating cycle, this OTAA allows the SEC to timely reach out to the investment manager to inquire more.

The reason this is important to keep in mind is because, whenever an investment manager may be wrestling with what may be the correct/most correct way to respond to a particular question on Form ADV Part 1, an investment manager should be guided by the following question when all else in the Instructions seems to fail: ***"Am I trying to avoid answering a question in a certain way, or am I trying in good faith***

*to provide the SEC what it needs to conduct its oversight function, even if they may disagree with a response later?”*

The latter can be highly effective. Rarely is the SEC noting in fines and bringing enforcement actions solely due to deficiencies in an investment manager’s Part 1. Unless reported information in Part 1 amounts to outright fraud or misleading the SEC or investors, or unless it raises questions about systemic data sourcing integrity, seldom does the SEC seem to come down on investment managers with formal actions for Part 1 reporting (though it could come up in exam findings of deficiency). To the extent Form ADV does appear in enforcement actions, it generally is in the context of deficiencies noted in the more investor-oriented Parts of the Form.

**Purpose #2: Investor Protection.** If the primary audience of Part 1 is the SEC, the primary audience for the Brochure (Part 2A), Brochure Supplement (Part 2B) and Client Relationship Summary (Part 3) is the investing public. Unlike Part 1, these other Parts are more narrative based. They are informed by the SEC’s position that when deciding whether to employ or continue to employ an investment manager, prospective and current investors should have access to certain types of information – described in plain English – to inform their decisions. The reason this basic understanding is worth mentioning – however obvious – is because it can serve as basis for any number of decisions regarding Parts 2A-B and 3 – from how to describe certain practices of an investment manager, to whether delaying mailing a Part 2A OTAA by a few days past 30 days is acceptable. Similar to the fundamental question that should guide an investment manager’s interpretative application for Part 1, the following question should serve as a guide when all else in the Instructions Parts 2A-B and 3 seem to fail: *“Am I trying to avoid, hide, or inappropriately color something from/for a prospective or future client, or is what I am trying to do really out of consideration of a prospective or existing client’s best interests, be it substantive or administrative?”*

Unlike Part 1, in many enforcement actions against investment managers that are required to prepare and file a Part 2A, 2B, or 3, the SEC does note various problematic practices in these Parts of the Form. Because these Parts can in many ways be viewed as the ultimate disclosure document an investment manager provides to a prospective or existing client, the SEC treats them as critical to prevent fraud against the investing public. For example, rarely (if ever) is the SEC taking formal action against investment managers for making decisions to hold off on mailing an OTAA to Part 2A until day 35 because an investment manager wanted to consolidate it with another mailing that was already in queue. Similarly, seldom do you see findings from the SEC that amount to bickering over wordsmithing. Instead, the types of Parts 2A-B and 3 problems one sees that get noted in enforcement actions generally include: statements that an investment adviser does or does not engage in certain practices when the opposite is true, intentionally overstating assets under management so as to misleadingly bolster its credibility, failing to adopt policies & procedures to ensure representations made about practices remain true, or other types of statements that are intentionally or negligently put forth and could well shape a prospective or existing client’s decision to employ an investment manager.

When evaluating interpretative questions to these more investor-oriented Form ADV Parts, an investment manager can avoid a good deal of stress and headaches if they are able to look themselves in the mirror. The investment manager should feel that how they are handling a certain interpretative question is in good faith to enable client/prospective client decisioning, rather than inducing employment of the investment manager or obfuscating less flattering practices or realities.

**8 COMMON CHALLENGES & PRACTICAL SOLUTIONS**

Despite what appear to be very simple purposes of the Form ADV, investment managers routinely run into challenges regarding the Form’s interpretation, application, and administration. These challenges, however, can be cured (or at least lessened) through a variety of very practical solutions.

**Overview.** At a categorical level, eight common challenges investment managers often encounter are included in the below table. Possible corresponding solution(s) to these challenges are also identified at a categorical level. The specific nature of these challenges and their corresponding solutions are discussed more fully in the sections that follow, but the following table serves as a general overview.

<b><u>FORM ADV COMMON CHALLENGES &amp; SOLUTIONS</u></b>	
<b><u>COMMON CHALLENGES</u></b>	<b><u>SOLUTIONS TO CONSIDER</u></b>
1. “Materiality” Determinations (p. 4)	▶ Create Rationale Logs
2. “Prompt” Updates & Delivery (p. 5)	▶ Implement Monthly OTAA Checklists ▶ Have Client & SEC-Centric Justifications for Post-30-Day Updates & Deliveries
3. Historical Inconsistencies (p. 6)	▶ Create Interpretation & Application “Playbooks”
4. Information & Data Sourcing (p. 7)	▶ Create Sourcing Maps ▶ Implement Four-Eyes Checks
5. Lack of Supporting Policies & Procedures (p. 7)	▶ Conduct Systematic Policy & Procedure Reconciliations
6. Noticing Mistakes After-the-Fact (p. 8)	▶ Default to Form ADV Instructions
7. Single Points of Failure (SPOFs) (p. 8)	▶ Create Staff Redundancies
8. Inconsistent Parts (p. 9)	▶ Implement Synchronization Checklists

**I. Challenge #1: “Materiality” Determinations.**

Outside of an investment manager’s annual updating amendment, certain events of or changes to an investment manager’s business can require an OTAA. As a quick recap, changes that require an OTAA most notably (though not exclusively) include the below. Of course, there are various exceptions noted in the Form ADV Instructions regarding how certain sections of the below-

identified Parts do not require a corresponding OTAA. But on a topical level, the below Parts represent the “red zones,” so to speak, for those aspects of the Form ADV that require updating, depending on the nature of the inaccuracy.

INACCURATE IN ANY WAY	MATERIALLY INACCURATE
Part 1A – Items 1 ( <b>Identifying Information</b> ), 3 ( <b>Form of Organization</b> ), 9 ( <b>Custody</b> ) or 11 ( <b>Disclosure Information</b> )	Part 1A – Items 4 ( <b>Successions</b> ), 8 ( <b>Participation or Interest in Client Transactions</b> ), or 10 ( <b>Control Persons</b> )
Part 1B – Items 1, 2.A-F, or 2.I	Part 1B – Item 2.G
	Part 2A – Any Information
	Part 2B – Any Information
	Part 3 – Any Information

Form ADV does not define what constitutes “material;” however, the SEC has indicated that the standard is whether there is a substantial likelihood that a reasonable investor would have considered such information under the facts and circumstances. Though an attempt to be helpful, this guidance obviously is not a cure-all for every fact pattern an investment manager may encounter. Understandably, and in fairness to the SEC, it can’t be. When thinking about all of the myriad client types and business models that exist for investment managers, what may be “material” to one set of investors may be entirely irrelevant to others. Thus, while the more principles-based regulatory framework of the Advisers Act is meant to account for all sorts of varieties and permutations, it can result in uncertainty for investment managers that are attempting to maintain their Form ADVs appropriately and in good faith. Indeed, one day an investment manager (after considerable internal discussion) may determine an event or change to be material such that an OTAA is warranted, and the following day, views it another way – and both views are probably reasonable!

***Practical Solution* → Create Rationale Logs.**

To mitigate risk associated with materiality “tough calls,” an investment manager should consider documenting the rationale used to reach its materiality determination in a log. This documentation can help inform an investment manager’s future thinking on potentially similar scenarios, as well as help the investment manager demonstrate to the SEC why a particular decision was made (particularly when a determination was that a particular event or change was not deemed material).

**II. Challenge #2: “Prompt” Updating & Delivery Timing.**

As most if not all readers know, whenever there is the occasion for an investment manager to file and deliver an OTAA, the Form ADV Instructions require such actions to be taken “promptly.” The generally accepted standard is that “promptly” means within 30 days of a triggering event. This generally accepted standard is not, however, a hard-and-fast, codified requirement. Oftentimes, investment managers spend considerable time fretting over whether they may have to engage in

multiple client mailings or Form ADV filings given the timing of when certain triggering events occur relative to one another or to other, non-regulatory mailings that may be in process. Additionally, sometimes investment managers simply forget that a certain type of change in their business has triggered a “prompt” updating requirement.

There is generally no need to consternate over these considerations as much as investment managers often do. Yes, it’s highly advisable to perform updates, with corresponding filings and mailings, within 30 days of a triggering event, but it shouldn’t be taken as a wholly inflexible standard. Particular facts and circumstances may justify pushing past the typical 30-day timeframe to a degree. Generally, so long as an investment manager can demonstrate it still acted in the client’s or investing public’s best interest and was intentional and thoughtful about its approach/decision to push past 30 days, an investment manager’s worry should resolve considerably. Of course, the further one goes past 30 days, the harder the justification becomes, and I’m not sure I’d advise going more than a few days past.

***Practical Solutions* → Implement Monthly OTAA Checklists; Have Client & SEC-Centric Justifications for Post-30-Day Updates & Deliveries.**

To better ensure an investment manager is positioned to actually be aware of events or changes that would require an OTAA, a designated area within an investment manager (be it Compliance or otherwise) should have a standard monthly process whereby they assess a checklist of all items noted in the Form ADV Instructions that may necessitate an OTAA. This creates intentional validation of whether any events or changes occurred with respect to those items.

When evaluating whether a “prompt” update should be made strictly within 30 days of its occurrence or if there is flexibility, investment managers should adhere to a 30-days standard as much as possible. However, if there are other circumstances that make such rigid application more sensible from a client-experience perspective (e.g. folding the update into another mailing that was already in queue), an investment manager can likely have some latitude. These decisions should be thoughtful and intentional on an investment manager’s part and should be keeping the client’s interests and experience top of mind. In such instances, an investment manager should consider documenting any decision for going past the 30-day standard in case the manager is ever asked to explain its decision to the SEC at later date.

**III. Challenge #3: Historical Inconsistencies.**

Another challenge investment managers often confront during the annual updating process is reengineering thinking on how they may have interpreted a particular Form ADV question or Instruction in the past – and even arriving at a different view than the past. Different people may have joined an investment manager’s organization since the last updating amendment, and such individuals may have different – and reasonable – views on how certain aspects of Form ADV should be interpreted and applied. Additionally, the same people involved in the prior year’s updating process may look at the same question or instruction on Form ADV and simply not be able to fathom they may have interpreted or applied a particular Instruction or question in the way they did. The result can be inconsistencies in terms of what may require disclosure or reporting

and how certain information is reported, which can in turn raise flags with the SEC. These flags could be questions about the integrity of an investment manager’s reporting or the soundness of an investment manager’s practices when sourcing Form ADV information.

***Practical Solution* → Create Interpretation & Application “Playbooks.”**

Investment managers should consider adopting and implementing comprehensive Form ADV interpretation and application “playbooks.” This document should speak to how the investment manager applies each Form ADV Instruction, or interprets each “Instruction-less” question, in relation to an investment manager’s business (e.g. is a manager considering one of its UCITS products to be a pooled investment vehicle or an investment company?). A “playbook” can help guide an investment manager year-over-year so they are not re-inventing the interpretive wheel each time, and also positioning themselves to have more consistent responses to the SEC (and clients) year-over-year. “Playbooks” also allow investment managers to document rationales for why they may have decided to change an approach to a certain question in any given year.

- IV. **Challenge #4: Information & Data Sourcing.** Another common headache investment managers encounter relates to information & data sourcing. Surprisingly, those responsible for facilitating Form ADV updates – be they OTAAAs or annual updating amendments – may not be clear on who the right parties are within their organization who should be viewed as the appropriate sources of information for responses to Form ADV requested information. Additionally, for those parties within a firm who are responsible for sourcing information for various parts of the Form, they may lack sufficient quality controls to ensure the data they are provisioning to others is in fact accurate and devoid of errors or problems. This also applies to those who are responsible for making the Form ADV filing itself and transposing data received from internal parties into the SEC’s IARD system.

***Practical Solutions* → Create Sourcing Maps; Implement Four-Eyes Checks.**

Investment managers should consider adopting Form ADV sourcing maps that identify who within their organization is responsible for supplying the information and data needed for the annual updating process, as well as who would have information and data that could potentially trigger an OTAA. For each area or individual responsible for sourcing such information, they should correspondingly have “four eyes” quality control checks to ensure the information they are providing to the ultimate assembling and filing party is accurate. Similarly, the party within an investment manager that is responsible for pooling all Form ADV information together and performing the filing should itself have a “four eyes” quality control check. This is to ensure that the information it has been provided has been transferred successfully into the final Form ADV documents that are to be filed and mailed.

**V. Challenge #5: Lack of Supporting Policies & Procedures.**

One need only read any of last year’s Marketing Rule enforcement actions or “cherry picking” enforcement actions to notice that one consistent item noted was how an investment manager’s Part 2A Brochure: (a) may represent it does or does not do one thing, but the representation does not match actual practices; (b) contains representations about business practices that are not supported by underlying policies & procedures; and/or (c) contains representations about certain practices that are not periodically tested to ensure such representations remain true and accurate. Oftentimes, investment manager business and/or Compliance personnel mistakenly think that policies & procedures only need to be tied to express regulatory requirements or expectations. However, policies & procedures should also be in place to ensure that any representations an investment manager makes about its business or practices are in fact true (which is rooted in the catchall Adviser’s Act anti-fraud provisions).

***Practical Solution* → Conduct Systematic Policy & Procedure Reconciliations.**

As part of the annual Form ADV update process or annual Compliance review process, investment managers should consider systematically evaluating their Form ADVs to ensure that representations being made about an investment managers practices are buttressed by underlying policies and procedures designed to ensure that such representations can be fulfilled. These policies and procedures should in turn be linked to periodic tests to verify they are being followed.

**VI. Challenge #6: Noticing Mistakes after the Fact.**

At some point, every investment manager will encounter a situation where they notice an error in one or more Parts of their Form ADV. This is not for reasons such as the business changed in some way, but because, for example, someone may have erroneously selected they have clients in the Virgin Islands (VI in the IARD selection boxes) rather than Virginia (VA in the IARD selection boxes). Or perhaps someone forgot to accept redlines during the internal drafting process and filed and/or delivered an earlier draft of a document. When these scenarios arise, investment managers can struggle with uncertainty on what to do, including whether to do anything at all. One the one hand, no one likes to call out a mistake to a client or the SEC, but at the same time, no one likes to have information out in the world that they know is incorrect in some way. These scenarios, however, simply should be perceived as any other inaccuracy that may merit some type of update.

***Practical Solution* → Default to Form ADV Instructions.**

In these instances, an investment manager should simply default to the Instructions in the Form ADV itself regarding whether an update is required.



**VII. Challenge #7: SPOFs (Single-Points-of-Failure).**

More and more investment managers run lean, and no one particularly enjoys being the one to make Form ADV submissions in IARD or having to post and facilitate delivery of Brochures and Client Relationship Summaries. As a result, many investment managers only have one individual in their organization who (a) has access to IARD and (b) knows how to actually make IARD submissions. The consequences of this can range from short-lived headaches to actually missing or running afoul of Form ADV filing requirements. If an investment manager has not established any type of continuity plan (even informally) to ensure that required Form ADV updates can be made even if an individual primarily responsible for facilitating such updates goes out unexpectedly, the investment manager risks erroneous or untimely Form ADV processing.

***Practical Solution* → Create Staff Redundancies.**

Investment managers, either formally or informally, should consider having at least two people in their organization familiar with facilitating the Form ADV annual update and OTAA processes. These individuals should also be versed in and have access to the SEC IARD system to make required filings.

**VIII. Challenge #8: Inconsistent Parts.**

Certain information in Form ADV Part 1 also can be the same as or at least impactful to Part 2A (and vice versa). For instance, assets under management need to be reported in each, as does information about the investment manager's types of clients, participation and interest in client transactions, and disciplinary actions, to name a few. With the same information appearing in or impacting multiple locations, the risk for inconsistencies is heightened. And yet, many investment managers do not have a systematic process as part of their Form ADV updating protocols to ensure that related/connected Parts of the Form ADV are reviewed for consistency. This can lead to questions from the SEC and clients, and depending on the nature of the inconsistency, even claims of misrepresentations.

***Practical Solution* → Implement Synchronization Checklists.**

For those Parts of the Form ADV with Items that require the reporting of the same or similar information in multiple Parts, an investment manager should consider creating a checklist that prompts verification of consistency.

**PARTING THOUGHTS**

Whether it's an OTAA or annual amendment process, maintaining one's Form ADV can be a labor intensive and intellectually maddening exercise. The eight "common" challenges discussed in this essay are by no means exhaustive. However, the same principles that underlie many of the solutions discussed above can be used to address other challenges as well. The use of checklists, workbooks, systematic reconciliations, and the like can all reduce complexity and increase reporting accuracy and integrity.

Additionally, while not every practical solution will cure or lessen headaches for every possible scenario, the two primary purposes of the Form ADV – positioning the investing public to make fully informed decisions regarding an investment manager, and providing the SEC with the information it needs to conduct adequate oversight – should always serve as the guideposts in such scenarios. Luckily, Form ADV mishaps by themselves seldom result in formal enforcement actions by the SEC (though the SEC certainly has that prerogative). While an investment manager should always be putting forth a good faith effort to ensure Form ADV updates are made timely and accurately, the Form ADV is not something to necessarily wring one's hands over each year. With some very basic yet effective practices in place, investment managers should be able to maintain credible relationships with clients and the SEC alike . . . and reduce their Tylenol spend accordingly.

Thanks for reading (and happy filings) . . .