Form ADV – Ignore it at Your Peril

[Editor’s Note: This is a guest post from website advertiser Johanna Turner, CPA, CFP, RLP with Fox and Company Wealth Management (see ADV2 here.) It is an important subject I’ve been meaning to write about for a long-time, but have never gotten around to it, about an important step to take when evaluating a financial planner or investment manager. Reviewing the ADV is an important step I take when determining which financial advisors I allow to advertise on this site. This is not a sponsored (i.e. paid for) post and thus no compensation was given or received for it.]

One of the most important decisions an investor will ever make is their choice of financial advisor. Whether you have decided to hire a financial planner or just want the guidance of an investment advisor, your choice will have a tremendous effect – positive or negative – on your standard of living. From the day you sign the on the dotted line until you either die or decide you’ve made a mistake, your wealth will be impacted by the skills and the costs of your advisor.

When people search for a financial advisor, they typically visit their website, ask around at work, and schedule an
interview. Unfortunately, few people understand the significance of the information contained in an advisor’s ADV. Unlike a website, where you are seeing advisors at our glamorized best, an ADV doesn’t slant information. You get just the facts.

The Form ADV

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Form ADV is the informational document the SEC (Securities and Exchange Commission) requires all investment advisors to file and update annually. It is free, publicly available, and must be offered in electronic format. Best of all, you do not have to submit any identifying information to get a copy so your investigation is totally anonymous. Investment advisers are required to submit their ADVs to either the SEC ($100M+ in assets under management) or state securities authorities (firms with less than $100M under management).

The ADV is divided into two parts:

- Part 1 – the “data”, which includes the number of clients, owners of the firm and advisors, office location(s), states where registered, disciplinary information and so on.
- Part 2 – a narrative “brochure” that advisors are
required to provide to all of their clients annually. Advisors are also required to upload Part 2 to the IARD but states do not always enforce this requirement. In other words, you will occasionally find a non-compliant advisor with a Part 1 online but no Part 2. Either call or email the advisor’s office to ask for a copy.

While the ADV is far easier to disseminate than in the past, the amount of information can be overwhelming, even intimidating, if you don’t know where to look for a particular piece of data. I’m writing this article to help you use the ADV as an effective tool during your search for the “perfect” advisor.

**How To Find Form ADV**

It’s not always easy to find a firm’s ADV. Some advisors include it on their website, *[I’m far more impressed with an advisor who puts their ADV and their fee schedule on their website-ed]* but it’s simpler to go to the Investment Advisor Public Disclosure (IAPD) website, where you’ll find a search function allowing you to look up information by Individual or Firm name.

- By entering the *individual’s* name, you’ll see the “Public Disclosure Report”, which summarizes jurisdictions where licensed, any past disciplinary actions, exams passed, employment history, and other business activities. Interesting, but not where you’ll find the real meat.
- You’ll need to click on “Firm” and enter all or part of the firm’s name to pull up Form ADV.
- You can also search by zip code to see all registered advisors within a certain radius of your selected city. An interesting exercise is to compare ADVs of firms near you by entering the zip code – the variety of billing methods can be quite a shock.
Breaking It Down

So you’ve found the ADV! But what does it all mean and what do you do with it?

**Part 1** is a check-the-box, fill-in-the-blank format. You’ll find very little narrative here and it can seem a bit boring. The best way to review Part 1 is by clicking on “View Form ADV by Section” on the left-hand navigation bar. This will bring up advisor responses highlighted in red to help you differentiate the information entered from the form itself. You can also click on View Latest Form ADV Filed in the dark blue box to get the complete ADV Part 1. You’ll see the date the ADV was filed (upper left) but not have the helpful red indicators.

ADV by Section pulls up an index in a separate window organized by “Item”. Probably the most significant Items are:

- **#5**: Information About Your Advisory Business, where you’ll find the number of employees, number and types of clients, compensation arrangements, assets under management, and types of advisory activities.
- **#11**: Disclosure Information – past charges, convictions, suspensions and most everything else beyond traffic violations.
- **#1B**: Disclosure Questions – specifically asks about
charges, complaints, and convictions with regard to the investment advisory business, along with potential conflicts of interest.

Part 2, Brochure will yield the most fruitful results for your search. To make Part 2 more user-friendly, the SEC mandated in 2011 that advisors must file a “plain English” version annually. Many firms groused about the change, as you might expect, but it has really helped consumers standardize their quest to compare firms side-by-side.

Part 2 is made up of:

- ADV Part 2A (the Brochure) and
- ADV Part 2B (the Brochure Supplement)

ADV Part 2A, which is available online, must follow the same format and numbering scheme for every advisory firm. You can find the SEC’s instructions for advisors to complete Part 2A here. State-registered advisors must cope with differing disclosure requirements by each state in which they are registered so the information provided in some Parts 2A may be more robust than in others depending upon the requirements of the particular states in which a firm is registered. Part 2A (“The Brochure”) contains the following:

- **Item 1: Cover Page**
- **Item 2: Material Changes** since the last brochure was filed.
- **Item 3: Table of Contents**
- **Item 4: Advisory Business** is a description of the firm, including kinds of services offered and how they are offered.
- **Item 5: Fees and Compensation** includes detailed explanations not only of the various types of fees, but also how they are calculated. If fees are or may be negotiable, it must say so.
You will find a lot of creative writing in Item 5 but there is no getting around the disclosure of AUM fees. These fees are very easy to compare from firm to firm; be sure to find out what other services are included. You’ll also find a disclosure of any indirect compensation (such as commissions and money/goods paid to the firm by sources other than then client).

- **Item 6: Performance-Based Fees/Side-by-Side Management** is rarely applicable.
- **Item 7: Types of Clients** is a brief description of the types of entities served.
- **Item 8: Methods of Analysis/Strategies/Risk of Loss** is divided into four sections. The first two are the most important; the last two are pretty much boilerplate.
  1. **Methods of Analysis**: Find out if your advisor believes in passive or active analysis and why.
  2. **Investment Strategies**: This is an especially important section and should be your guide as to whether your advisor’s ideas about investing correlate with yours. If not, and you aren’t willing to compromise, this could be a deal killer. Keep an open mind, though – you might learn something new!
  3. **Material Risks Involved**: Boilerplate
  4. **Risks Associated With Securities**: Boilerplate
- **Item 9: Disciplinary Information** Have they or haven’t they?
- **Item 10: Other Activities and Affiliations** details other companies they own or are affiliated with.
- **Item 11: Code of Ethics, etc.** will be explained here, along with any advisory firm members’ personal involvement in client transactions. (Unfortunately, compiling a Code of Ethics is no guarantee that it will be followed.)
- **Item 12: Brokerage Practices** describes fees and practices of any custodians used by the firm.
- **Item 13: Review of Accounts** describes how and how frequently the firm reviews investment accounts.
- **Item 14: Client Referrals and Other Compensation** is a disclosure of any fees received from resources other than clients.
- **Item 15: Custody** tells you whether the firm takes custody of client assets (for example, Bernie Madoff had custody of his clients’ assets.)
- **Item 16: Investment Discretion** explains the amount of power the firm has over a client’s account. In other words, we do not take custody of client funds, but our clients give us the authority to select and implement portfolios at a third-party custodian (TDA) on their behalf.
- **Item 17: Voting Client Securities** discloses whether the firm has any involvement in proxy votes for client-owned securities. Boilerplate.
- **Item 18: Financial Information** is intended to demonstrate that the advisor is capable of meeting any financial obligations to clients and does not accept prepayments of more than $500 six months or more in advance. Boilerplate.
- **Item 19 (optional): Requirements for State-Registered Advisors** is included only by advisors who have less than $100M under management and are supervised by the various states in which they do business rather than by the SEC.

In my opinion, the sections you should spend the most amount of time on are:

- Item 4
- Item 5
- Item 8, A & B
- Item 9
- Item 14

**ADV Part 2B** is a business resume’ of each “supervised person”
(advisor at the firm who may be involved with investing at the firm) and includes:

- Educational background and business experience,
- Disciplinary information,
- Other business activities that the supervised person is involved in,
- Compensation received as a result of business activities (excluding wages) from sources other than the client, and
- The manner in which the “supervised person” is supervised.

I hope this detailed look at what an ADV can tell you will help you begin the search for your next advisor. The ADV is full of hidden gems in plain sight, just begging to be mined for valuable information. The right “chemistry” with your advisor is important, but don’t base your decision on a sales pitch. Take the time to kick the tires and look under the hood first. Better to invest time in making an informed decision now than to find out, thousands of dollars later, that you selected the wrong advisor.

[Editor’s Note: There is no sense in meeting with an advisor before reading the ADV2A part 4, 5, 8, 9, and 14. You can do 90% of your work selecting an advisor from the comfort of your own computer. Figure out how they get paid and how much they get paid. If the fees are too high, move on. If they have disclosure information, probably move on. If their investing methods don’t gel with what you read on this site, move along. If they pass all those tests, then it is probably worth having a sit down (or virtual sit down if they aren’t local to you) with them. When you sit down you may also wish to ask them the questions I ask in my application for financial advisors to advertise on this site. ]

What do you think? Have you ever looked up a Form ADV? Did you learn anything interesting? If you use an advisor, what did
you look for? How did you decide on one? Comment below!