



XALT RIA FORUM 2019

POLICIES & PROCEDURES BEST PRACTICES

AGENDA

1

Key Definitions

2

Key Regulatory Issues

3

Onboarding Alternative Investments



DEFINITIONS

DEFINITIONS

Accredited
Investor

Income

Net Worth

Alternative
Investment

ACCREDITED
INVESTOR

Income Test

**\$200K of Annual “Income”
for an Individual (or \$300K
Joint) prior 2 years and
expectation for current year**

WHAT IS INCOME?

Yes	No
<ul style="list-style-type: none">• Employment Income• Alimony• Social Security• Investment Income• Pension Income	<ul style="list-style-type: none">• Winnings• Judgments• Liens• Bonuses

ACCREDITED
INVESTOR

Net Worth Test

\$1,000,000 of Net Worth

WHAT IS “NET WORTH”?

Total Net
Worth

Investable
Net Worth

Liquid Net
Worth

INVESTABLE NET WORTH

- ☐ Assets minus liabilities except primary home, furnishings, primary automobile, & mortgage on primary home
- ☐ Add amount house is “under water” to liabilities
- ☐ Add any increase in mortgage balance in last 60 days to liabilities
- ☐ Adjust value of investments down by any transaction fees, redemption fees, or CDSCs

LIQUID NET WORTH

- ❑ Investable Net Worth minus assets that cannot be easily converted to cash, such as:
 - ❑ Real Estate
 - ❑ Business
 - ❑ Investments subject to significant liquidation penalties

WHAT IS
“ALTERNATIVE
INVESTMENT”?

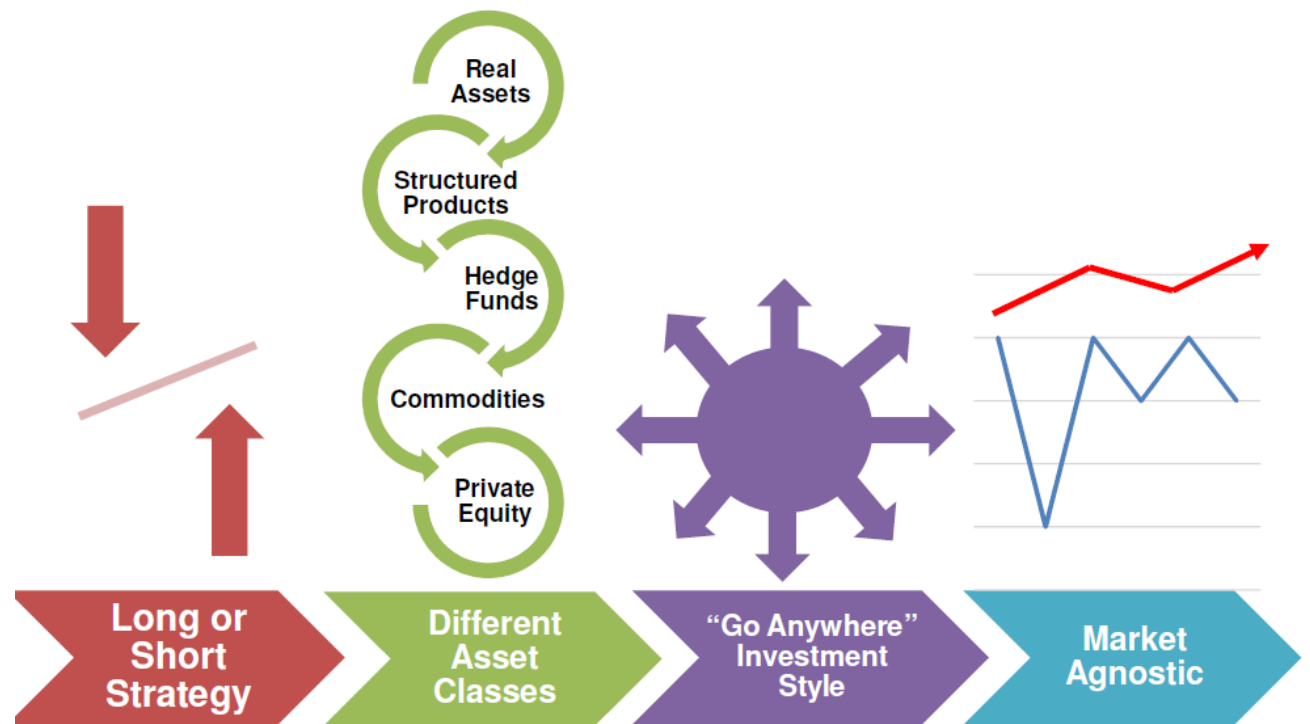
Definition
of Exclusion

Definition
of Inclusion

DEFINITION OF EXCLUSION

**Anything that is not a long
position in traded stocks,
bonds, and cash**

CONTEMPORARY UNDERSTANDING ON ALTERNATIVE INVESTMENTS



DEFINITION OF INCLUSION

By Asset Class

By Structure

By Return
Characteristics

ASSET CLASSES

Real Assets

Hedge Funds

Private
Equity

Commodities

Structured
Products

OFFERING
STRUCTURE
FEATURES

Regulatory

Trading

Compensation

Asset Location

RETURN CHARACTERISTICS

Correlation

Illiquidity

Inefficiencies

“ALTERNATIVE INVESTMENT” DEFINITION CHECKLIST

- ☐ Do you have a protocol for defining “Alternative Investments”
- ☐ Do you maintain an alternative investment blotter?
- ☐ Do you have alt-specific guidelines:
 - ☐ Additional Disclosures?
 - ☐ Firm-Level Suitability Standards?
 - ☐ Concentration Guidelines?
 - ☐ Exception Handling?



KEY REGULATORY ISSUES

FINRA
GUIDELINES

Notice
13-18

Notice
05-59

Rule 2310

NOTICE 13-18 SUMMARY

- ❑ Communications with the public regarding alternative investments
- ❑ Must be fair, balanced, and not misleading
- ❑ Guidance on discussing distribution rates, stability claims, redemption features, liquidity events, prior performance, pictures of properties

NOTICE 13-18

DETAILS

Disclosures:

- ☐ Risks must be presented clearly and prominently

Stability / Volatility Claims:

- ☐ May not assert stability of program without sound basis
- ☐ May not assert the price will not fluctuate

NOTICE 13-18

DETAILS

Distribution Rates:

- ☐ Must not describe it as a yield comparable to fixed income investment
- ☐ Must state distributions are not guaranteed and may vary
- ☐ Must disclose components: cash flows, return of principal, and borrowing

NOTICE 13-18

DETAILS

Redemption & Liquidity:

- ☐ Restrictions to redemption program must be clearly stated
- ☐ Must clearly state if redemption program subject to change or cancelation

Prior Performance:

- ☐ May not “cherry pick” favorable programs

NOTICE 13-18

DETAILS

Comparisons:

- ☐ If referencing a real estate index, must disclose that index does not reflect program

Pictures of Specific Properties:

- ☐ If using pictures, must state whether property is within program or not

NOTICE 13-18

DETAILS

Capitalization Rates:

- ☐ Explain how cap rate was calculated
- ☐ Disclose that cap rate applies to individual property
- ☐ Disclose that cap rate does not reflect return or distribution
- ☐ May not blend cap rates of multiple properties

NOTICE 05-59 SUMMARY

- ☐ Communications to Investors
- ☐ Discretionary Accounts
- ☐ Reasonable-Basis Suitability Determination
- ☐ Customer-Specific Suitability Determination
- ☐ Supervision and Training of Associated Persons

NOTICE 05-59

DETAILS

Communication:

- ☐ Must be fair and balanced
- ☐ Avoid portraying investments as “conservative” or a source of “predictable income”

Discretionary Accounts:

- ☐ Must receive prior written approval before transacting in discretionary accounts

NOTICE 05-59

DETAILS

Reasonable Suitability Basis:

- ☐ Firm must perform (and document) appropriate due diligence to ensure it understands the nature of product, including its potential risks and rewards

NOTICE 05-59

DETAILS

Customer-Specific Suitability:

- ☐ Must examine (i.e., document) customer's financial status, tax status, and investment objectives.
- ☐ Must have “a reasonable basis for believing customer has sufficient knowledge and experience in financial matters that she may be expected to be capable of evaluating the risk of the recommended transaction and is financially able to bear the risks”

NOTICE 05-59

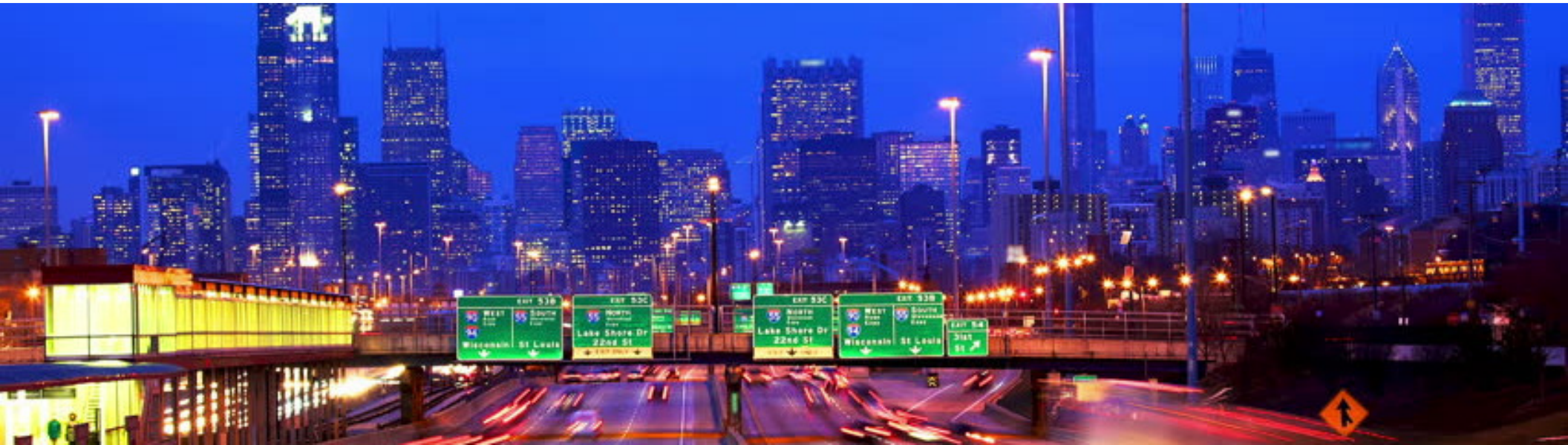
DETAILS

Training:

- ☐ Must demonstrate (i.e., document) registered personnel training of characteristics, risk, and rewards
- ☐ Must include training on determining investor suitability

RULE 2310

- ☐ Customer is in position appropriate to realize benefits described in offering memorandum
- ☐ Customer has net worth sufficient to sustain loss of entire investment



PREPARING FIRM TO ONBOARD ALTERNATIVE INVESTMENTS

POLICIES & PROCEDURES

WSPs

Alt Investment
Blotter

ADV Part 2A

Fee
Agreement

New Client
Form

New Account
Application

Risk Tolerance
Form

Prospectus
Receipt

Purchase
Authorization
Form

Additional
Risk
Disclosures

Switch
Authorization

Transaction
Suitability
Checklist

WRITTEN SUPERVISORY PROCEDURES

- ☐ Definitions
- ☐ Client Suitability
- ☐ Client Communications
- ☐ Due Diligence
- ☐ Recordkeeping
- ☐ Sales Supervision
- ☐ Advisor Training – Initial and Ongoing

WRITTEN SUPERVISORY PROCEDURES

Investment Guidelines:

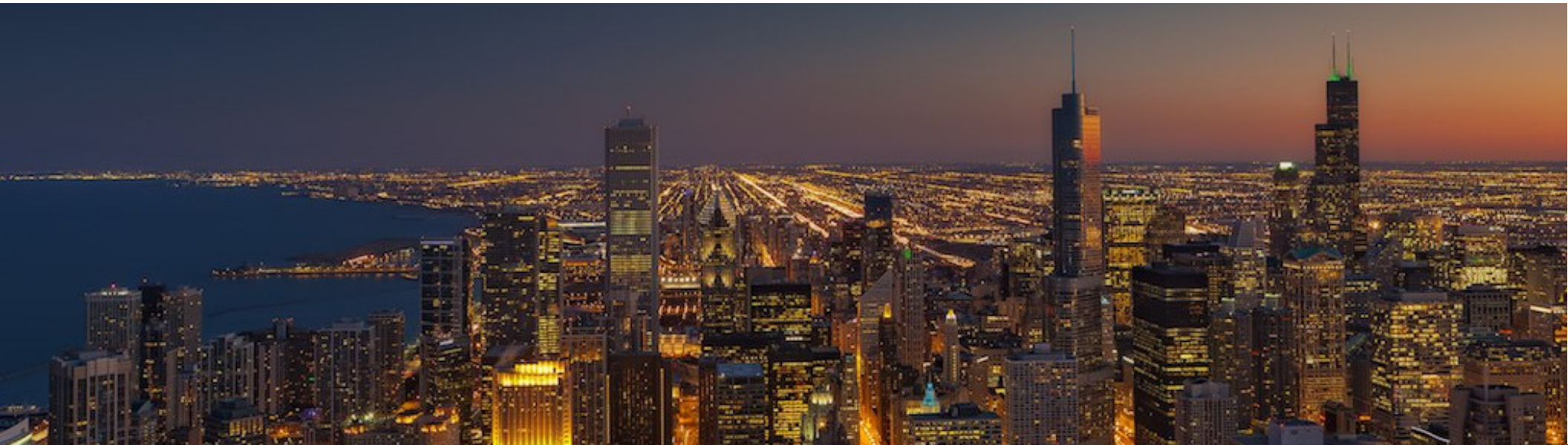
- ☐ Global Program Limitations
- ☐ Individual Program Limitations
based on Risk/Return and Time
Horizon
- ☐ Global Sponsor Limitations
- ☐ Global Allocation Limitations
- ☐ Exception Handling

APPROVED ALTERNATIVE INVESTMENT BLOTTER

- ☐ Firm Level Due Diligence
- ☐ Advisor Training Requirements
- ☐ Firm Level Suitability and Concentration Limits
- ☐ Additional Risks

ADV PART 2A

- ☐ Define Investment Program
- ☐ Client Suitability
- ☐ Investment Guidelines
- ☐ Additional Considerations:
 - ☐ Risk
 - ☐ Liquidity
 - ☐ Valuation/Pricing/Billing
 - ☐ BD Concessions
 - ☐ Custody Assets



THANK YOU

WWW.ALISOADVISORS.COM
