

Comments on SEC's Reproposed Amendments to Form ADV Due by May 16, 2008

The SEC is accepting comments through May 16, 2008 on its repropose amendments to Part II of Form ADV and related rules under the Investment Advisers Act of 1940 ("the Reproposed Amendments").

Designed to promote enhanced disclosure, the rule changes would require registered investment advisers to prepare and deliver to clients and prospective clients narrative brochures written in "plain English," as well as supplemental brochures (with portfolio manager information) in place of the current Form ADV Part II. In addition, the Reproposed Amendments would require registered investment advisers to file the narrative brochures electronically with the SEC which, in turn, would make the brochures available to the general public through its Investment Adviser Public Disclosure website. The Reproposed Amendments and the newly-proposed disclosures set forth therein are described in more detail below.

Background

The SEC release dated March 3, 2008 containing the Reproposed Amendments ("the Proposing Release") indicates that the SEC seeks to revise Form ADV Part II (to be renamed Part 2) because it believes the existing format does not provide clear and meaningful disclosure to investment advisory clients. The Reproposed Amendments modify an earlier proposal to amend Form ADV II, reflecting comments the SEC received on its earlier proposal.

New Form ADV Part 2

Under the Reproposed Amendments, new Form ADV Part 2 would contain two parts: Part A and Part B. Part A would contain nineteen separate disclosure items, each covering a different topic. Part A would require an adviser to disclose more detailed information about its business practices, conflicts of interest, and disciplinary history than is required under the current Form ADV Part II. Part B would require disclosure about the qualifications and disciplinary history of specific advisory employees who give advice to clients.

The Narrative Brochure

The Reproposed Amendments would require an investment adviser's narrative brochure to disclose, in "plain English," the adviser's services, fees, and business practices, as well as any conflicts of interest with clients. The SEC explains in the Proposing Release that the proposed format (i.e., disclosure in "plain English") should greatly improve the ability of clients and prospective clients to evaluate advisers and advisory personnel, and to understand the conflicts of interests that they face.

Specific Disclosure Items

Many of the new disclosure items relate to conflicts of interest between an adviser and its clients. The Proposing Release

explains that, in effect, the Reproposed Amendments are designed to provide advisers with additional guidance to fulfill their existing fiduciary obligations. The Reproposed Amendments also address a number of developing areas of disclosure concern, such as conflicts of interest arising from side-by-side management of clients who pay performance fees and those who do not and conflicts of interest arising from an adviser's receipt of compensation from issuers of financial products that the adviser recommends. Key aspects of the specific disclosure items are summarized below.

Item 4: Advisory Business

- An adviser would be required to describe its firm, including specific types of advisory services offered, total client assets under management, and whether the adviser holds itself out as specializing in a particular type of advisory service.

Item 5: Fees and Compensation

- An adviser would be required to describe its compensation, including how it computes fees and other costs clients may pay, such as brokerage and custody fees or fund expenses.
- An adviser would be required to disclose the fact that it receives brokerage commissions for selling securities, the conflict of interest this practice creates, and how the adviser addresses those conflicts.

Item 6: Performance Fees and Side-By-Side Management

- An adviser would be required to disclose whether it charges performance fees.
- If an adviser only charges performance fees to certain accounts, the adviser would be required to disclose the conflicts of interest this practice creates and how it addresses those conflicts.

Item 7: Types of Client

- An adviser would be required to describe the types of clients to whom it provides advice and any specific requirements for opening an account with the adviser.

Item 8: Methods of Analysis, Investment Strategies and Risk of Loss

- An adviser would be required to disclose its methods of analysis and investment strategies, as well as the risks clients face by following the adviser's advice or by permitting the adviser to manage their assets.
- An adviser focusing on a particular type of strategy or investment would be required to disclose the risks specific to that strategy or investment.

Item 9: Disciplinary Information

- An adviser would be required to disclose facts about legal or disciplinary events that may be material to a client's evaluation of the integrity of the adviser or its management.
- The proposed revision to this Item includes a non-exhaustive list of events presumed to be material, subject to rebuttal by an adviser.

Item 10: Other Financial Industry Activities and Affiliations

- An adviser would be required to disclose material relationships with related financial industry participants. In addition, an adviser would be required to disclose any material conflicts of interest those relationships create and how the adviser addresses those conflicts.

Item 11: Code of Ethics, Interest in Client Transactions, Personal Trading

- An adviser would be required to describe briefly its code of ethics, explaining that a copy is made available on request.

- If an adviser or its related person recommends to, or buys or sells for, its clients securities in which the adviser or a related person has a material financial interest, the adviser's brochure would be required to discuss the related conflicts of interest.
- An adviser would be required to disclose personal trading by it and its personnel. In addition, the adviser would be required to discuss the conflicts of interest this presents and how the adviser addresses those conflicts.

Item 12: Brokerage practices

- An adviser would be required to disclose how it selects brokers for client transactions, as well as how it determines the reasonableness of such brokers' compensation.
- The revised Item, as proposed, would require specific disclosure about how the adviser addresses conflicts of interest arising from the receipt of soft dollars.
- If an adviser uses client brokerage to reward brokers for client referrals, disclosure about this practice, and the conflicts of interest it creates would be required, as well as disclosure about any procedures designed to address such conflicts.
- An adviser would be required to disclose whether and to what extent it aggregates client trades.
- An adviser would be required to disclose its directed brokerage practices, and whether those practices are permitted or, rather, routinely recommended, requested, or required of clients.

Item 13: Review of Accounts

- An adviser would be required to disclose whether and how often it reviews clients' accounts or financial plans and who conducts the review.

Item 14: Payment for Client Referrals

- An adviser would be required to describe any cash or other payments it or a related person receives or makes for client referrals, as well as benefits it receives from non-clients for providing advisory services to clients.

Item 15: Custody

- An adviser would be required to explain that clients receive account statements from custodians.
- If clients do not receive account statements for all funds and accounts over which the adviser has custody, the adviser would be required to explain this fact and the related risks.

Item 16: Investment Discretion

- An adviser with discretionary authority over a client's account would be required to disclose the arrangement, and any limitations clients may (or customarily do) place on this authority.

Item 17: Voting Client Securities

- An adviser would be required to disclose its proxy voting practices, including information about any third party proxy voting services it uses.
- Advisers who lack authority to vote client proxies would be required to disclose how clients receive proxies and other solicitations.

Item 18: Financial Information

- This Item would require disclosure of certain financial information when material to clients.



Wrap Fee Programs

Advisers who sponsor wrap fee programs would continue to be required to prepare a separate, specialized brochure for clients. The SEC is proposing disclosure changes for such brochures corresponding to those proposed for Part A. The SEC also is proposing additional disclosure requirements specific to wrap fee programs, including a requirement to disclose whether a related person is a portfolio manager in a wrap fee program, and the related conflicts of interest.

Delivery and Updating of Brochures

Updating the Brochure. An adviser would be required to update its brochure promptly whenever information becomes materially inaccurate. All updates would be filed through the IAPD system.

Annual Delivery/Interim Updates. Under the Reproposed Amendments, advisers would be required to deliver a current brochure to existing clients at least annually, no later than 120 days after the adviser's fiscal year end. In addition, an adviser would be required to indicate the material disclosure changes from the prior year's brochure. If an adviser amends the brochure to add a disciplinary event or any material change disclosure responsive to Item 9 of Part A, the adviser would be required to deliver an interim update to its clients.

Part B: The Brochure Supplement

The Reproposed Amendments would require advisers to provide clients, along with the brochure, brochure supplements disclosing information about the advisory personnel on whom the client relies for investment advice. This required disclosure would include information about the individual's or individuals' educational background, business experience, disciplinary history, and other business activities, additional compensation, and how an advisory firm monitors the individual or individuals. Advisers would be required to update supplements when information becomes materially inaccurate. Updates would be delivered to any new clients in the form of a sticker, provided electronically or in paper form.

Contact Information

If you have any questions, please contact your regular Ropes & Gray attorney.

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