(CORRECTED)

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 275 and 279

[Release No. IA-2711; 34-57419; File No. S7-10-00]

RIN 3235-AI17

Amendments to Form ADV

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule and form amendments.

SUMMARY: The Securities and Exchange Commission is reproposing amendments to Part 2 of Form ADV, and related rules under the Investment Advisers Act, to require investment advisers registered with us to deliver to clients and prospective clients a brochure written in plain English. These amendments are designed to require advisers to provide clients and prospective clients with clear, current, and more meaningful disclosure of the business practices, conflicts of interest (including those related to soft dollar practices), and background of investment advisers and their advisory personnel. Advisers would file their brochures with us electronically, and we would make them available to the public through our Web site. The Commission also is proposing to withdraw, as duplicative, the Advisers Act rule requiring advisers to disclose certain disciplinary and financial information.

DATES: Comments should be received on or before May 16, 2008.

ADDRESSES: Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/proposed.shtml); or

- Send an e-mail to rule-comments@sec.gov. Please include File Number S7-10-00 on the subject line; or
- Use the Federal eRulemaking Portal (http://www.regulations.gov). Follow the instructions for submitting comments.

Paper comments:

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number S7-10-00. This file number should be included on the subject line if e-mail is used. To help us process and review your comments more efficiently, please use only one method.

The Commission will post all comments on the Commission's Internet Web site (http://www.sec.gov/rules/proposed.shtml). Comments are also available for public inspection and copying in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549 on official business days between the hours of 10:00 a.m. and 3:00 p.m. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

FOR FURTHER INFORMATION CONTACT: David W. Blass, Assistant Director, Daniel S. Kahl, Branch Chief, or Vivien Liu, Senior Counsel, at (202) 551-6787 or <IArules@sec.gov>, Office of Investment Adviser Regulation, Division of Investment Management, U.S. Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-5041.

SUPPLEMENTARY INFORMATION: The Securities and Exchange Commission ("Commission") is proposing amendments to rules 203-1, 204-1, 204-2, and 204-3 [17 CFR 275.203-1, 275.204-1, 275.204-2, and 275.204-3]; and amendments to Form ADV [17 CFR 279.1] under the Investment Advisers Act of 1940 [15 U.S.C. 80b] ("Advisers Act" or "Act").[1] The Commission is also proposing to withdraw rule 206(4)-4 [17 CFR 275.206(4)-4] under the Advisers Act.

TABLE OF CONTENTS

I. BACKGROUND

Investment advisers provide a wide range of investment advice to numerous types of clients. From individuals and families seeking to save for college and plan for

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[1] Unless otherwise noted, when we refer to rule 203-1, 204-1, 204-2, or 204-3, or any paragraph of these rules, we are referring to 17 CFR 275.203-1, 275.204-1, 275.204-2, or 275.204-3, respectively, of the Code of Federal Regulations in which these rules are published.

retirement to multinational institutions managing billions of dollars, clients seek the services of investment advisers to help them evaluate their investment needs, plan for their economic future, develop and implement investment strategies, and cope with the ever-growing complexities of the financial markets. Today, the more than 10,000 advisers registered with us provide advice to nearly 20 million clients.[2]

Unlike the laws of many other countries, the U.S. federal securities laws do not prescribe minimum experience or qualification requirements for persons providing investment advice. They do not establish maximum fees that advisers may charge. Nor do they preclude advisers from having substantial conflicts of interest that might adversely affect the objectivity of the advice they provide. Rather, investors have the responsibility, based on disclosure they receive, for selecting their own advisers, negotiating their own fee arrangements, and evaluating their advisers' conflicts. Therefore, it is critical that clients and prospective clients receive sufficient information about the adviser and its personnel to permit them to make an informed decision about whether to engage an adviser, and having engaged the adviser, how to manage that relationship.

Since 1979, the Commission has required investment advisers registered with us to provide clients and prospective clients with a disclosure statement providing information about the adviser, its business practices, the fees it charges, and its conflicts of interest.[3] Part 2 of Form ADV, the form advisers use to register with us under the

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[2] These figures are based on data derived from investment advisers' responses to questions on Part 1A of Form ADV reported through the Investment Adviser Registration Depository ("IARD") as of January 31, 2008.

[3] *Investment Adviser Requirements Concerning Disclosure, Recordkeeping, Applications for Registration and Annual Filings*, Investment Advisers Act Release No. 664 (Jan. 30,

Advisers Act, sets out the requirements for the disclosure statement.[4] Today, Part 2 requires advisers to respond to a series of multiple-choice and fill-in-the-blank questions organized in a "check-the-box" format, supplemented in some cases with brief narrative responses. Advisers have the option of providing information in an entirely narrative format in lieu of the "check-the-box" approach, although we believe few do.

In April 2000, we proposed to require each adviser registered with us to give clients a narrative brochure that describes the adviser's business, conflicts of interest (including conflicts resulting from the adviser's receipt of "soft dollar" benefits), disciplinary history, and other important information necessary to make an informed decision about whether to rely on the adviser for advice.[5] Our proposal was designed to require advisers to disclose this information in a clearer, more meaningful format than the current check-the-box approach.[6] We received more than 70 comments in response to

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1979) [44 FR 7870 (Feb. 7, 1979)] (adopting rule 204-3 requiring brochure delivery to advisory clients and prospective clients).

4 Advisers use Form ADV to apply for registration with us or with state securities authorities, and must keep it current by filing periodic amendments as long as they are registered. *See* rules 203-1 and 204-1. Form ADV has two parts. Current Part 2 contains the requirements for the disclosure statement that advisers must provide to prospective clients and offer to clients annually. Part 2 currently is designated as "Part II." For ease of reference, we refer to the second part of Form ADV as "Part 2" throughout this release. Part 1 of Form ADV provides us with information that we need to process registrations and to manage our regulatory and examination programs.

5 *Electronic Filing by Investment Advisers; Proposed Amendments to Form ADV*, Investment Advisers Act Release No. 1862 (Apr. 5, 2000) [65 FR 20524 (Apr. 17, 2000)] ("Proposing Release") at Section II.D.2. We noted in the Proposing Release that in some cases an adviser's response to a question using a check-the-box approach may be accurate but a client may, because of the mandated format of the disclosure, not accurately perceive the adviser's practices.

6 In the Proposing Release, we also proposed extensive amendments to Part 1 of Form ADV, including changes necessary to permit advisers to file that part of the form with us electronically. In September 2000, we adopted amendments to Part 1A and related rules, but, as we noted at the time, we deferred adoption of amendments to Part 2 so that we could consider more fully the many comments we received on Part 2. *Electronic Filing by Investment Advisers; Amendments to Form ADV*, Investment Advisers Act Release

our 2000 proposal.[7] We continue to believe that we need a better approach to client disclosure than the current "check-the-box" approach. In light of the time that has passed since the original proposal, and in order to provide all persons who are interested in this matter an opportunity to comment on some of the modifications we have made in response to comments on our 2000 proposal, we are today reproposing amendments to Part 2 of Form ADV and related rules under the Advisers Act.[8] In light of the changes we are proposing to Part 2, the Commission also is proposing to withdraw rule 206(4)-4 (requiring advisers to disclose certain financial and disciplinary information to clients).

No. 1897 (Sept. 12, 2000) [65 FR 57438 (Sept. 22, 2000)] ("Electronic Filing Adopting Release"). Today, all SEC-registered advisers must file Part 1A (as well as amendments) electronically through IARD. IARD was built and is maintained for the Commission and the state securities administrators by the Financial Industry Regulatory Authority ("FINRA"). In September 2001, we launched a Web site (http://www.adviserinfo.sec.gov), which provides free public access to information that advisers file on Part 1A. As we discuss in more detail in Section II.C below, firms' brochures would be available on the Commission's Web site.

7 The comment letters and a summary of the comments prepared by Commission staff are available for public inspection and photocopying in the Commission's Public Reference Room, 100 F. Street, NE, Washington, DC (File No. S7-10-00). Comments submitted to us electronically are available at http://www.sec.gov/rules/proposed/s71000.shtml. The summary of comments is available at http://www.sec.gov/rules/extra/iardsumm.htm.

8 In addition, we note that Form ADV is used by advisers both to register with the Commission and with state regulatory authorities. In general, this Release discusses the Commission's proposed rules and amendments that would affect advisers registered with the Commission. We understand that the state securities authorities intend to make similar changes that affect advisers registered with the states. The draft form accompanying today's reproposal contains certain proposed items and instructions for Part 2 (proposed Item 20 of Part 2A, proposed Item 11 of Appendix 1 to Part 2A, and proposed Item 7 of Part 2B) that would be applicable only to state-registered advisers. State-registered advisers would be required by state, rather than federal law, to respond to these items. Completion of these items, therefore, would not be an SEC requirement, and these items are not included in this Release as a proposed SEC rule. We will accept any comments and forward them to the North American Securities Administrators Association ("NASAA") for consideration by the state securities authorities. We request that you clearly indicate in your comment letter which of your comments relate to these items. Commenters alternatively may send comments relating to these items directly to NASAA at the following email address: part2comments@nasaa.org.

II. DISCUSSION OF FORM ADV, PART 2

A. Part 2A: The Firm Brochure

1. Proposed Format

We are proposing to require registered advisers to provide prospective and existing clients with a narrative brochure written in plain English.[9] The brochure would describe the adviser's services, fees, business practices, and conflicts of interest with clients. Advisers would file their brochures electronically through the IARD, and the public would benefit by having access to these brochures through the Commission's Web site. We believe that the amendments we are proposing today will greatly improve the ability of clients and prospective clients to evaluate firms offering advisory services and the firms' personnel, and to understand relevant conflicts of interest that the firms and their personnel face and their potential effect on the firms' services.

Commenters supported the narrative format we proposed in 2000 and agreed that it would promote more effective client communications.[10] One stated that it would give an adviser "sufficient flexibility to present and explain its business practices in a meaningful way."[11] Another stated that the new narrative format would eliminate a number of problems identified with the current form.[12]

We request further comment on the proposed narrative format, including comment on whether it is the right approach. Will the flexibility of the form allow

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9 Proposed General Instructions 1 and 2 to Part 2 of Form ADV.

10 *See, e.g.*, Comment Letter of Consumer Federation of America (June 22, 2000) ("CFA Letter"); Comment Letter of Teachers Insurance and Annuity Association and College Retirement Equities Fund (June 13, 2000) ("TIAA-CREF Letter").

11 Comment Letter of Association for Investment Management and Research, Advocacy Advisory Committee (June 13, 2000) ("AIMR Letter").

12 TIAA-CREF Letter.

advisers to present clear and meaningful disclosure to their clients? Will this flexibility minimize the burden on advisers in preparing their brochures? In considering our proposed amendments to Part 2 in their entirety, commenters should consider whether there are disclosures that are best made in a tabular or other non-narrative format and whether our proposal provides sufficient flexibility to permit that type of disclosure.

2. Brochure Items

We are proposing a Part 2A for advisers that would contain nineteen separate items, each covering a different disclosure topic.[13] The topics covered are generally the same as proposed in 2000.[14] Much of the information that would be required in the brochure concerns conflicts between an adviser's own interests and those of its clients and is disclosure the adviser already must make to clients, as a fiduciary, under the Act's

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[13] Part 2A would have a main body and an appendix, Appendix 1. Appendix 1 contains the requirements for a specialized type of firm brochure – a wrap fee program brochure – and would require disclosure similar to current Schedule H of Part 2 of Form ADV. We are reproposing Appendix 1 with changes described below.

[14] Today's proposal does not include an item (which we proposed as Item 17 in 2000) that would have required advisers that advertise or report their investment performance to describe any standards they use to calculate or present that performance. The Securities Industry Association ("SIFMA") argued that the disclosure would be voluminous because many advisers use different types of composites. Comment Letter of the Securities Industry Association (June 13, 2000) ("SIFMA Letter") (the Securities Industry Association has since changed its name to the Securities Industry and Financial Markets Association). The Financial Planning Association ("FPA") argued that the disclosure of calculation standards may not be helpful to investors (Comment Letter of the Financial Planning Association (June 13, 2000) ("FPA Letter")), and the Investment Counsel Association of America ("IAA") argued that clients are not interested in this type of information. Comment Letter of the Investment Counsel Association of America (June 13, 2000) ("June 2000 IAA Letter") (the Investment Counsel Association of America has since changed its name to the Investment Adviser Association). In response to the concerns raised by commenters, we are not reproposing that item. Today's proposal does, however, include a new item on performance fees and side-by-side management (Item 6). Additionally, at the request of state securities regulators, the form we are proposing today includes a separate item containing additional requirements for state-registered advisers (Item 20).

anti-fraud provisions.[15] Thus, many of the proposed disclosure requirements are designed to give advisers guidance on fulfilling their statutory disclosure obligations to clients.[16]

Some commenters applauded our 2000 proposal as appropriately identifying information that advisers should disclose to clients.[17] Others, however, maintained that the proposed form contained too many items and would require too much detailed information, in particular with respect to advisers' policies and procedures.[18] These commenters raised legitimate concerns, which we have addressed in three ways. First, our instructions to Part 2A would clarify that an adviser must respond only to the items that apply to its business.[19] Second, we have incorporated into our proposed Part 2A

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15 Under the Advisers Act, an adviser has an affirmative obligation of utmost good faith and full and fair disclosure of all material facts to its clients, as well as a duty to avoid misleading them. *See SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180 (1963); *In the Matter of Arleen W. Hughes*, Exchange Act Release No. 4048 (Feb. 18, 1948). *See also* Advisers Act section 206 [15 U.S.C. 80b-6].

16 The items in proposed Part 2A will not cover every possible conflict. As a result, delivering a brochure prepared in accordance with Part 2 may not fully satisfy an adviser's disclosure obligations. We make this point clear in both the proposed form and the brochure rule. *See* proposed General Instruction 3 to Part 2; proposed rule 204-3(g).

17 *See, e.g.*, CFA Letter; TIAA-CREF Letter.

18 *See, e.g.*, June 2000 IAA Letter; Comment Letter of the Investment Company Institute (June 13, 2001) ("ICI Letter").

19 Proposed General Instruction 1 to Part 2 of Form ADV. An adviser whose business is solely financial planning, for example, would not need to discuss how it manages client assets in response to Items 4.D and 4.E of Part 2A. An adviser that receives only asset-based fees need not discuss conflicts resulting from commission-based compensation payments in response to Item 5.E of Part 2A. An adviser without disciplinary information would not need to respond to Item 9 of Part 2A. An adviser that does not have custody of client funds or securities would not need to respond to Item 15 of Part 2A.

Additionally, as currently permitted by existing rule 204-3(d), an adviser that offers substantially different types of advisory services to different advisory clients, would retain the option to prepare separate brochures so long as each client receives all information about the services and fees that are applicable to that client. *See* proposed rule 204-3(f) and proposed Instruction 6 to Part 2A. Each brochure may omit

many suggestions from commenters for improving the form, including omitting some information that commenters convinced us is not necessary.[20]

Third, we have re-written several items to require advisers to explain succinctly how they address the conflicts of interest they identify, rather than disclosing their "policies and procedures" as we originally proposed.[21] As commenters noted, requiring disclosure of policies and procedures could result in disclosure that would be lengthy, technical in nature, difficult to read, and that ultimately may not help clients understand how firms address their conflicts.[22] As re-written, we believe these items would give advisers the flexibility to give clients a general understanding of how they address their conflicts. For example, an adviser with an affiliated financial service provider might simply explain that it does not recommend investment products sold by its affiliate, or an adviser with an affiliated broker-dealer might explain that it executes client securities transactions through its affiliated broker-dealer only if it believes that, in doing so, it would obtain best execution of client transactions.[23]

We request comment on whether our revisions to proposed Part 2A adequately respond to commenters' concerns about our 2000 proposal. Specifically, we request comment on our new approach regarding disclosure of policies and procedures that

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information that does not apply to the advisory fees and services it describes. For example, an adviser's brochure describing a particular advisory service need not include the fee schedule for a different advisory service that is not discussed in that particular brochure.

20 For example, in response to comments, we are proposing to omit the requirement that advisers list all the wrap fee programs in which they participate.

21 *See, e.g.*, Proposed Items 5, 6, and 11 of Part 2A.

22 June 2000 IAA Letter; ICI Letter; Comment Letter of Wellington Management Company, LLP (June 22, 2000) ("Wellington Letter").

23 By giving these examples we do not mean to suggest that these are the only ways for an adviser to address these conflicts of interest.

would require advisers to explain generally how they address conflicts of interest, instead of requiring them to describe their policies and procedures. Also, we request comment on our general instructions that clarify that an adviser need not repeat information in its brochure simply because that information is responsive to more than one item. Will our proposed instruction give advisers sufficient flexibility to avoid unnecessary detail while also providing clients and prospective clients with enough information to make an informed decision about whether to hire or retain an adviser or whether to rely on the investment advice provided by the adviser? If not, commenters should suggest alternative approaches.

Below, we discuss each of the items in our proposed form and the more significant changes we have made from our 2000 proposal. In addition to our specific requests for comment detailed below, we also request comment generally on each of the proposed items.

Item 1. Cover Page. We would require an adviser to disclose on the cover page of its brochure the name of the firm, its business address and telephone number, and the date of the brochure. The cover page also would include a statement that the brochure has not been approved by the Commission or any state securities authority.[24] This information already is required by current Part 2 of Form ADV.

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[24] If the adviser holds itself out as being "registered," the cover page also must explain that registration with the SEC does not imply that the adviser possesses a certain level of skill or training. We have observed that the emphasis on SEC registration, in some advisers' marketing materials, appears to suggest that registration either carries some official imprimatur or indicates that the adviser has attained a particular level of skill or ability. Section 208(a) of the Advisers Act [15 U.S.C. 80b-8(a)] makes such suggestions unlawful.

In addition, we would require advisers to disclose on the cover page the name and telephone number of a person or service center that a client or prospective client could contact for further information. At the suggestion of commenters, we revised our 2000 proposal to permit an adviser to identify a service center, rather than only an individual, as a contact for further information.[25] Other commenters suggested that advisers be required to present a home page URL to assist investors using electronic search methods.[26] While we recognize the value of this information, we understand that not all advisers maintain Web sites. Thus, we are proposing to require advisers to disclose a Web site address on the brochure cover page only if they have one.

Item 2. Material Changes. We are proposing a requirement that advisers provide clients with a summary of any material changes to their brochures since the last annual update.[27] This requirement is the same as the one we proposed in 2000, and would help clients identify information that has changed since the prior year's brochure and that may be important to them.[28] The summary would appear on the cover page of the brochure or immediately thereafter, or could be included in a separate communication that would accompany the brochure.[29]

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25 *See* FPA Letter; Securities America Advisors, Inc. and Securities America, Inc. (June 12, 2000) ("Securities America Letter").

26 *See, e.g.*, CFA Letter.

27 As discussed in more detail in Section II.A.3 below, we are proposing to require advisers to deliver an updated brochure annually within 120 days after the end of the adviser's fiscal year.

28 *See* Proposing Release at Section II.D.2.a.

29 An adviser would not be required to provide this information to a client or prospective client who has not received a previous version of the adviser's brochure. *See* proposed Note to Item 2 of Part 2A. Additionally, an adviser would not be required to file the summary with us, and therefore it would not be available on our public disclosure Web site, if the summary is included in a separate communication to clients. This is because

One commenter strongly supported the required summary.[30] Others expressed concern that the summary might be too long.[31] One commenter, the IAA, supported the option of having the summary be a separate letter to existing clients rather than part of the brochure. We request comment on our proposed approach to highlighting material changes to an adviser's brochure. If we do not adopt this approach, how else could clients know of potentially significant changes to the services they receive or the risk of new conflicts? Should we require that it be included in an adviser's brochure? Commenters who believe a summary of material changes would result in disclosure that is too lengthy should suggest other methods for ensuring that clients are made aware of important changes from one year to the next.

Item 3. Table of Contents. We propose to require advisers to include in their brochures a table of contents detailed enough to permit clients and prospective clients to locate topics easily.[32] In response to our 2000 proposal, one commenter, the Consumer Federation of America ("CFA"), supported the use of a table of contents but urged that the Commission mandate a uniform format so that investors could compare brochures of multiple advisers more easily. We are of the initial view that the wide variety of business activities of the large number of advisers registered with us makes it impractical to

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the information contained in such a summary is intended to provide existing clients with means to easily identify changes from one annual brochure update to the next. We do not believe that such a summary would be relevant to persons who do not have the previous version of an adviser's brochure. We are, however, proposing an amendment to our recordkeeping rule that would require the adviser to preserve a copy of the communication, so that our staff has access to such separately provided summaries. *See* proposed rule 204-2(a)(14)(i). *See* Section IV below.

30 CFA Letter.

31 Comment Letter of the Consortium (June 12, 2000) ("Consortium Letter"); Comment Letter of Jane Katz Crist (June 12, 2000) ("Crist Letter"); June 2000 IAA Letter.

32 Current Part 2 of Form ADV also includes a table of contents.

develop a uniform format. We request comment on whether our view is correct. Is there a uniform brochure format that would be useful to clients and prospective clients of all the types of advisers registered with us? If we were to mandate a uniform format, how should it look? For example, should we require advisers to present information in their brochures in a standardized order? Should we adopt standardized titles for each separate section of a brochure? Do commenters have other suggestions for making the brochures easier for clients and prospective clients to compare?

Item 4. Advisory Business. Proposed Item 4 would require an adviser to describe its advisory business, including the types of advisory services offered, whether it holds itself out as specializing in a particular type of advisory service, and the amount of client assets that it manages. In computing the amount of client assets that it manages, an adviser would be permitted, as originally proposed, to use a method that differs from the method used in Part 1A of Form ADV to report "assets under management."[33] We believe that because the Part 1A methodology for calculating assets is designed for a particular purpose (*i.e.*, for making a bright line determination as to whether an adviser should register with the Commission or with the states), permitting a different methodology for Part 2 disclosure may be appropriate to enable advisers to make disclosure that is more indicative to clients about the nature of their business.[34] Although

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[33] One commenter suggested that advisers be required to use the same methodology in their brochures as is required in Part 1A. *See* June 2000 IAA Letter.

[34] For example, in calculating "assets under management," for purposes of Part 1A, an adviser may include the entire value of a managed portfolio, but only if at least 50 percent of the portfolio's total value consists of securities. *See* current Form ADV: Instructions for Part 1A. Thus, for Part 1A purposes an adviser would not include other assets (including securities) that it manages in a "non-securities" portfolio. The Part 1A formula for calculating assets under management was designed based on considerations related to the National Securities Markets Improvement Act of 1996 ("NSMIA") division

we are proposing to permit advisers to choose a different method for their brochure disclosure, we also are proposing to require such advisers to keep records describing the method used.[35] We request comment on this provision and on the proposed recordkeeping requirement. We also request comment as to whether we should require such advisers to disclose why they have elected to use a different method.

Commenters largely supported the proposed item, to which we propose to make two revisions.[36] First, we are not proposing to require advisers to list all wrap fee programs in which they participate. Commenters persuaded us that this requirement likely would lengthen brochures unnecessarily.[37] Second, we are eliminating the proposed requirement that advisers list and describe all periodicals or periodic reports that they issue about securities. While Part 2 currently requires this, we believe that clients and prospective clients should be able to understand the nature of an adviser's services without knowing the names of each of its publications.[38]

Some commenters urged the Commission not to require advisers to make additional disclosure if they hold themselves out as specializing in a particular type of advisory service, asserting that this could mislead clients into believing that advisers who

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of responsibility for regulation of advisers between the Commission and state securities regulatory authorities. Pub. L. No. 104-290, 110 Stat. 3416 (1996) (as a result of NSMIA, advisers with less than $25 million of assets under management generally are regulated by one or more state securities authority, while the Commission generally regulates those advisers with at least $25 million of assets under management).

35 Proposed rule 204-2(a)(14)(ii) and proposed Note to Item 4.E of Part 2A.

36 Current Part 2 presently requires disclosure of similar information to that we are now proposing except in a different format, including information regarding advisory services provided, types of investments that advice is offered on, and investment strategies used. *See* current Form ADV, Part 2, Item 1 and Item 3.

37 *See* Crist Letter; June 2000 IAA Letter.

38 *See* Item 1.D of current Part 2 (requiring all advisers to name any publication or report they issue for a fee or on a subscription basis).

specialize pose a greater risk than other advisers.[39] Our reason for requiring advisers to identify their specialized advisory services, however, is not that we believe that those specialties inherently pose additional risks to clients, although we would expect the adviser to disclose specific risks if a specialized advisory service poses those risks. Instead, our proposal simply acknowledges that a client likely would want to know whether an adviser provides specialized advisory services before engaging that adviser.[40] The proposal was designed to reflect disclosure that we understand most advisers typically provide to prospective clients. The proposal also was intended to recognize the impracticality of having an adviser that offers multiple services describe each one. We request comment on this proposed item generally. Does the item accurately reflect the disclosure most advisers typically provide? Are there other disclosures we should include? Have we included disclosures that are not reflective of those typically provided by most advisers?

Item 5. Fees and Compensation. Item 5 would require an adviser to describe how it is compensated for providing advisory services and to describe the types of other costs, such as brokerage, custody fees, and fund expenses, that clients may pay in connection

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39 *See* Comment Letter of Greenville Capital Management (May 12, 2000) ("Greenville Letter"). *See also* Comment Letter of DE Shaw & Co. (July 6, 2000) ("DE Shaw Letter"); Comment Letter of Thomson Financial (June 22, 2001) ("Thomson Letter").

40 We note that one commenter objected to our characterizing financial planning as a specialized advisory service. Comment Letter of Certified Board of Financial Planners (June 13, 2000) ("CFP Board Letter"). By proposing to include financial planning as an example of a specialized service we are not suggesting in any way that it is a limited service – in fact, we recognize its most marked characteristic is that it seeks to address a wide spectrum of clients' financial needs. However, we note that financial planning has become a distinct profession, and as such, we believe it merits detailed description in the adviser's brochure. *See, e.g.*, Conrad S. Ciccotello *et al.*, *Will Consult For Food! Rethinking Barriers To Professional Entry In The Information Age*, 40 AM. BUS. L. J. 905 (2003) at 921 ("Personal financial planning as a distinct profession is quite new").

with the advisory services provided to them by the adviser.[41] As we proposed in 2000, the adviser would be required to disclose its fee schedule and whether its fees are negotiable, discuss whether the firm bills clients or deducts fees directly from the clients' accounts, and explain how often the firm assesses fees. An adviser charging fees in advance also would be required to explain how it calculates and refunds prepaid fees when a client contract terminates.

We are also proposing in Item 5 a requirement that advisers that receive compensation attributable to the sale of a security or other investment product (*e.g.*, brokerage commissions), or whose personnel receive such compensation, must disclose this practice and the conflict of interest it creates and describe how the adviser addresses this conflict.[42] Such an adviser also would be required to disclose to clients that the client may purchase the same securities or investment products from brokers that are not affiliated with that adviser.[43] Some commenters argued that an adviser that receives commissions or other payments for sales of securities to clients does not necessarily have

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41 Proposed Items 5.A and 5.C of Part 2A. Part 2 currently requires similar disclosure regarding an adviser's fee schedule, how fees are charged, whether fees are negotiable, and when and how compensation is payable. *See* Item 1 of current Form ADV.

42 Proposed Item 5.E of Part 2A. Advisers may engage in practices that would be required to be disclosed under multiple items. For example, an adviser may have a financial interest in securities that it recommends to clients (which would be disclosed in response to proposed Items 5 and 10) or the adviser may receive an economic benefit from a non-client (which would be disclosed in response to proposed Items 5 and 12). As noted above, a brochure would not need to repeat information simply because the information is responsive to more than one item. Proposed General Instruction 1 to Part 2.

43 Proposed Item 5.E.2 of Part 2A. In addition, an adviser that receives more than half of its revenue from commissions and other sales-based compensation would be required to explain that commissions are the firm's primary (or, if applicable, exclusive) form of compensation. Proposed Item 5.E.3 of Part 2A. An adviser that charges *both* advisory fees and commissions would disclose whether it reduces its fees to offset the commissions. Proposed Item 5.E.4 of Part 2A.

a conflict of interest with its clients.[44] This practice, however, gives the adviser and its personnel an incentive to base investment recommendations on the amount of compensation they will receive rather than on the client's best interests.[45] Moreover, disclosure regarding commissions and other similar economic benefits already is required by current Part 2.[46]

We are not proposing a requirement that advisers must disclose the amount or range of mutual fund fees or other third-party fees that clients may pay.[47] Commenters explained that these expenses vary so greatly that attempts to quantify them or describe their range likely would not be useful to clients.[48] Several of these commenters further argued that these fees are typically negotiated directly between the client and the other service providers, the adviser does not always know the amount of the fees, and that the third party often discloses the fees directly to the client.[49] Would our proposed requirement that advisers disclose information about mutual fund or other third-party fees, while not disclosing the range of those fees, adequately inform clients that they will bear other costs in addition to advisory fees?

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44 *E.g.*, Comment Letter of American Express Financial Advisors (June 12, 2000) ("AmEx Letter"); CFP Board Letter; Comment Letter of Richard E. Vodra (Apr. 29, 2000).

45 Because of this conflict of interest, advisers are required by the anti-fraud provisions of the Advisers Act to disclose their receipt of transaction-based compensation to clients. *See* Proposing Release at n. 137-38 and accompanying text.

46 *See* current Form ADV, Part 2, Item 13.

47 The current version of Part 2 does not require disclosure of this information.

48 *E.g.*, AmEx Letter; Consortium Letter; Comment Letter of Davis Polk & Wardwell (June 13, 2000) ("DP&W Letter"); ICI Letter; June 2000 IAA Letter; Comment Letter of National Regulatory Services (June 12, 2000); SIFMA Letter; Comment Letter of T. Rowe Price Associates (June 12, 2000) ("T. Rowe Price Letter").

49 *See* Greenville Letter; DE Shaw Letter; DP&W Letter; June 2000 IAA Letter; ICI Letter; SIFMA Letter.

Item 6. Performance Fees and Side-By-Side Management. New Item 6 would require an adviser that charges performance fees (or who has a supervised person who manages an account that charges such fees) to disclose this fact.[50] If such an adviser also manages accounts that are not charged a performance fee, the item also would require the adviser to discuss the conflicts that arise from its (or its supervised persons') simultaneous management of these accounts, and to describe generally how the adviser addresses those conflicts.[51]

An adviser charging performance fees to some accounts faces a variety of conflicts because the adviser can potentially receive greater fees from its accounts having a performance-based compensation structure than from those accounts it charges a fee unrelated to performance (*e.g.*, an asset-based fee). As a result, the adviser may have an incentive to direct the best investment ideas to, or to allocate or sequence trades in favor of, the account that pays a performance fee. Additionally, conflicts stemming from their clients' differing investment strategies (*e.g.*, clients that pay performance fees who engage in significant short selling) may put an adviser at odds with other clients (*e.g.*,

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50 Proposed Item 6. "Performance fees" would be any fees an adviser receives that are based on a share of the capital gains on, or capital appreciation of, the assets of a client. Current Form ADV, Part 2 does not specifically require similar disclosure of performance fees, although an adviser who offers advisory services in exchange for such fees would be required to respond accordingly by marking "Other" in response to current Form ADV, Part 2, Item 1.C(6).

51 As fiduciaries, advisers must disclose all material information regarding any proposed performance fee arrangements as well as any material conflicts posed by the arrangements. *See Exemption To Allow Investment Advisers To Charge Fees Based Upon a Share of Capital Gains Upon or Capital Appreciation of a Client's Account*, Investment Advisers Act Release No. 1731 at n 13-14 and accompanying text (July 15, 1998) [63 FR 39022 (July 21, 1998)].

clients who hold long positions).[52] The growth in the number of hedge funds, which typically pay performance-based fees to advisers that may have other advisory clients, makes it likely that more advisers today will need to address this conflict.[53] It is important to note that the conflicts of interest that result from the simultaneous management of performance fee accounts and other accounts are not limited to hedge fund advisers. For example, an adviser would face conflicts of interest if it were to manage a proprietary account that paid performance fees side-by-side other client accounts that did not pay performance fees.

We request comment on our approach requiring disclosure of conflicts arising from side-by-side management of accounts that pay performance fees and those that do not. Would our proposed requirement elicit sufficient information to allow a client to understand the conflicts that arise when an adviser manages performance fee accounts alongside accounts that do not charge performance fees? If not, what additional information would be helpful?

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52 "Another concern is the risk that mutual fund [not paying a performance fee] trades may appear to benefit a hedge fund [paying a performance fee], such as where mutual fund long positions in a security are sold after the hedge fund sells the same security short, or where large mutual fund purchases of a security are made after a hedge fund has purchased the same security." Kenneth R. Gerstein, *Alternative Investments in the Mutual Fund World*, Materials prepared for ICI/IBA 2001 Mutual Funds and Investment Management Conference, at XII-8.

53 In a 2003 report, our Division of Investment Management highlighted its concerns regarding disclosure of conflicts of interest by advisers that advise hedge funds at the same time they advise other clients that do not pay a performance fee. *See Implications of the Growth of Hedge Funds*, Staff Report to the United States Securities and Exchange Commission ("Staff Report on the Implications of Hedge Funds"), available at http://www.sec.gov/spotlight/hedgefunds.htm. The staff noted that because performance fees paid to hedge fund advisers are significantly higher than the asset-based fees paid on traditional accounts, advisers have additional incentives to favor their hedge fund clients over other clients by allocating investment opportunities to a hedge fund.

Item 7. Types of Clients. We are proposing Item 7 in the same form as we proposed it in 2000.[54] The one commenter that addressed this item, the FPA, commented favorably on it. As proposed, the brochure would describe the types of advisory clients the firm generally has, as well as the firm's requirements for opening or maintaining an account, such as minimum account size.[55] We request comment on this approach.

Item 8. Methods of Analysis, Investment Strategies and Risk of Loss. We also are proposing Item 8 in the same form as we proposed it in 2000. This item would require advisers to describe their methods of analysis and investment strategies.[56] In addition, proposed Item 8 would require an adviser to discuss the risks clients face in following the adviser's advice or permitting the adviser to manage assets. Advisers that offer a wide variety of advisory services could simply explain that investing in securities involves a risk of loss. Advisers that use primarily a particular method of analysis, strategy, or type of security would be required to explain the specific material risks involved, with more detail if those risks are significant or unusual.

Some commenters supported this proposed disclosure requirement as central to the adviser's fiduciary relationship with the client.[57] Others questioned why multi-

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54 As originally proposed, this was Item 6. Because we have added a new proposed Item 6 (described above), this and subsequent items have been renumbered.

55 Proposed Item 7 of Part 2A. Current Part 2 requires "check-the-box" disclosure regarding types of advisory clients. *See* current Form ADV, Part 2 Item 2. Existing Part 2 currently also requires disclosure regarding whether an adviser providing certain advisory services imposes a minimum dollar value of assets or other conditions for starting or maintaining accounts. *See* current Form ADV, Part 2 Item 10.

56 Presently, Item 4 of current Part 2 requires check-the-box disclosure of similar information regarding methods of analysis and investment strategies used. *See* current Form ADV, Part 2 Item 4.

57 AIMR Letter; CFA Letter.

strategy firms would not be required to make the same level of disclosure.[58] Multi-strategy advisers must already disclose the risks associated with strategies that they recommend to clients, but the brochure may not be the best place to make that disclosure. For example, disclosure of this information may lengthen the brochure unnecessarily given that different clients would be pursuing different strategies, each of which poses specific and different risks, and clients may only need to understand the risks to which they are exposed.[59] Accordingly, we would not require these advisers to list in the brochure the risks involved in each type of security or trading strategy. In such cases, required risk disclosure with respect to particular strategies could be made separately to those clients to whom such disclosure is relevant. We request comment on our approach. Also, we request comment on whether there are particular risks associated with particular strategies, analyses, or securities that warrant specific disclosure, and if so what are they?

Item 8 also would require specific disclosure of how strategies involving frequent trading can affect investment performance. Commenters on this proposal in 2000 noted that an amount of trading that is inappropriately frequent for one type of security or client may be appropriate in the context of a different type of security or client.[60] Does our proposal provide advisers enough flexibility to explain the degree to which frequent trading is appropriate in the context of their business? Also, two commenters recommended that that the Commission define the term "frequent trading of securities."[61] We have not proposed a definition, but instead propose to permit firms some flexibility in

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58 DE Shaw Letter; Greenville Letter.

59 Advisers utilizing multiple strategies would, of course, be free to disclose in their brochures the risks associated with each strategy.

60 June 2000 IAA Letter; T. Rowe Price Letter.

61 June 2000 IAA Letter; T. Rowe Price Letter.

determining whether strategies they employ involve frequent trading. As those commenters pointed out, the term "frequent" is relative both to the client (*i.e.*, an investment strategy involving frequent trading that is inappropriate for one type of client may be appropriate for another), and to the security being traded. We are concerned that a definition of the term "frequent trading" may not be sufficiently flexible to accommodate different types of securities or the different types of advisory clients. We request comment on our concern. Should we define the term "frequent trading"? If so, commenters are invited to submit suggested text for such a definition.

Finally, our proposed Item 8 would require advisers to discuss their practices regarding cash balances in client accounts. The IAA commented that these practices vary depending on the types of accounts and directions from clients and that meaningful disclosure about these practices would be difficult. Our proposal does not require exhaustive disclosure about, for example, all possible directions that all of an adviser's clients may give it. Instead, the proposal would require a concise, general explanation of the adviser's practices with respect to situations in which a particular client has not provided the adviser specific directions for handling cash balances. Does our proposal provide advisers with enough flexibility to explain their practices in a meaningful manner? If not, commenters are invited to suggest how to make the disclosures more meaningful.

Item 9. Disciplinary Information. We are proposing Item 9 to require an adviser to disclose in its brochure material facts about any legal or disciplinary event that is material to a client's evaluation of the integrity of the adviser or its management. These requirements are similar, though as discussed below, not identical to those we proposed

in 2000, and they would continue to incorporate into the brochure the disciplinary disclosure currently required by rule 206(4)-4. Under that rule, advisers can make disciplinary disclosure to clients either orally or in writing. Because of the importance of this information to clients, we proposed in 2000 and now repropose to require advisers to make this disclosure in their brochures.[62]

As proposed (and as currently reflected in rule 206(4)-4), Items 9.A, B, and C would provide a list of disciplinary events that are presumptively material if they occurred in the previous 10 years.[63] The list would include, among other events, any convictions for theft, fraud, bribery, perjury, forgery, and violations of securities laws by the adviser or one of its executives. Disciplinary events such as these reflect the integrity of the adviser and its management persons and therefore are presumptively material to clients.[64] The adviser would be permitted to rebut this presumption, in which case no disclosure to clients would be required. We would, however, require an adviser rebutting a presumption of materiality to document that determination in a memorandum and retain that record in order to better permit our staff to monitor compliance with this important

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62 Current Part 2 of Form ADV does not include an item related to disciplinary issues, however, Item 11 in Part 1A of Form ADV does require disclosure of specified disciplinary events. Such disclosure is filed with the Commission as part of the firm's filing on IARD, but may not in all cases be provided to clients.

63 The list of disciplinary events is similar to the list of events currently presumed material under existing rule 206(4)-4(b). Reproposed Item 9 cautions advisers, however, that the events listed in that item are those that are presumed to be material and do not constitute an exhaustive list of material disciplinary events.

64 *See* Proposing Release at n. 145-150 and accompanying text.

disclosure requirement.[65] A note in Item 9 would explain four factors the adviser should consider when assessing whether the presumption can be rebutted.[66]

We request comment with respect to the list of disciplinary events that are presumptively material. Are there additional types of disciplinary events that we should list? Are there disciplinary events listed that we should remove or modify? Should we expand the list to include disclosure of all cease and desist and censure orders entered against an adviser or its management persons? In addition, we request comment on the terms we use in this item. For example, we propose to state in Item 9 that an adviser must disclose if it (or any of its management persons) has been *involved* in one of the events listed in that item. We propose to continue to define the term "involved" using the same definition that currently exists in Form ADV.[67] We request comment on the proposed use of the term "involved" in this item and our proposed use of the current definition of that term.

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65 Proposed rule 204-2(a)(14)(iii), discussed below in Section IV. Proposed Item 3 of Part 2B, discussed below, requires a brochure supplement to contain disclosure of legal or disciplinary events involving the adviser's supervised persons. Proposed rule 204-2(a)(14)(iii) would require the same memorandum in the event the adviser does not disclose an event described in Item 3 of Part 2B.

66 These factors are: (1) the proximity of the person involved in the disciplinary event to the advisory function; (2) the nature of the infraction that led to the disciplinary event; (3) the severity of the disciplinary sanction; and (4) the time elapsed since the date of the disciplinary event. These are the same factors advisers use to assess materiality under current rule 206(4)-4. *See Financial and Disciplinary Information that Investment Advisers Must Disclose to Clients*, Investment Advisers Act Release No. 1083 (Sept. 25, 1987) [52 FR 36915 (Oct. 2, 1987)] ("Rule 206(4)-4 Adopting Release"). We have removed, as unnecessary, a sentence from the note that was contained in the Proposing Release that explained that an adviser's determination is not binding on us or a court.

67 The current Glossary to Form ADV defines the term "involved" to mean "Engaging in any act or omission, aiding, abetting, counseling, commanding, inducing, conspiring with or failing reasonably to supervise another in doing an act."

As proposed in 2000, this item also would have required advisers subject to a Commission administrative order to provide clients with a copy of that order. Several commenters urged us not to require advisers to deliver copies of Commission administrative orders to all clients, arguing among other things, that not all orders would be material to clients and that rather than imposing a blanket requirement, delivery of orders should remain a subject of settlement negotiation.[68] We are not proposing this requirement because we agree with commenters' suggestion that we are able to require, where appropriate, delivery of orders in individual proceedings. Nonetheless, we request further comment as to whether we should require delivery of all or, alternatively, some specific category of administrative orders. Commenters supporting delivery of orders should explain how clients would benefit from delivery.

In the Proposing Release, we also specifically requested comment about whether we should require disclosure of certain arbitration awards or claims. Several commenters urged us to include arbitration claims or awards in the list of disciplinary events because that information could be useful to the evaluation of an adviser's integrity,[69] while others urged us not to require that disclosure at all, arguing that arbitration claims and awards are not necessarily an indication of wrongdoing.[70] We request further comment on whether we should require disclosure of arbitration awards, settlements, or claims. Also, should we require disclosure of damages in a civil proceeding? Should we require

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68 *E.g.*, AmEx Letter; ICI Letter; Comment Letter of PaineWebber Incorporated and Mitchell Hutchins Asset Management Inc. (June 19, 2000) ("Paine Webber Letter"); T. Rowe Price Letter; Comment Letter of Wilmer, Cutler & Pickering (June 13, 2000) ("Wilmer Letter").

69 AICPA Letter; CFA Letter; Comment Letter of the Pennsylvania Securities Commission (June 12, 2000) ("Penn. Securities Commission Letter").

70 *See, e.g.*, Amex Letter; DP&W Letter; Wilmer Letter.

disclosure of such damages, or arbitration claims, settlements, or awards above a specified amount? If so, would $10,000 be an appropriate amount? If not, what would be an appropriate threshold amount?

Because advisers would include disciplinary disclosures in their advisory brochures if this proposal is adopted, we propose to rescind rule 206(4)-4, which requires disclosure of disciplinary information, but does not specify the means of conveying this disclosure.[71] If we adopt our proposed amendments to Item 9, we would expect to make rescission of rule 206(4)-4 effective on the date by which advisers must deliver their narrative brochures to existing clients and begin delivering their brochures to prospective clients. Some advisers, however, may have clients to whom they are not required to deliver a brochure, for example certain clients receiving impersonal investment advice or registered investment companies and business development companies.[72] For these advisers, their fiduciary duty of full and fair disclosure would require them to continue to disclose to *all* their clients any material disciplinary or legal events or inability to meet contractual commitments.[73] Nonetheless, we request comment about whether we should rescind rule 206(4)-4. Should we retain the rule to clarify the disclosure obligations of advisers in situations in which they have no brochure delivery obligations?

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71 In addition to requiring disclosure of certain disciplinary information, rule 206(4)-4 currently requires an adviser to disclose certain financial information to clients. As with the disciplinary disclosure, this requirement would also be incorporated into the new brochure. Similar to current rule 206(4)-4(a)(1), proposed Item 18.B of Part 2A would require certain advisers to disclose any financial condition that is reasonably likely to impair their ability to meet contractual commitments to clients. *See* note 125 below and accompanying text.

72 Our proposed requirements for which clients an adviser must deliver a brochure are discussed in Section II.A.3 below.

73 *See generally* Rule 206(4)-4 Adopting Release (explaining that rule 206(4)-4 was designed to "remind advisers of their obligation to disclose to clients material facts about precarious financial conditions and certain disciplinary events").

Item 10. Other Financial Industry Activities and Affiliations. We are proposing Item 10 to require advisers to describe material relationships or arrangements the adviser (or any of its management persons) has with related financial industry participants, any material conflict of interest that the relationships or arrangements create, and how they address the conflict.[74] In addition, if an adviser selects or recommends other advisers for clients, proposed Item 10 would require it to disclose any compensation arrangements or other business relationships between the two advisory firms, as well as the conflicts created.[75] The disclosure that Item 10 would require would help clients be more aware of advisers' other financial industry activities and affiliations that can create conflicts of interest and impair the objectivity of investment advice.

One commenter, the CFA, applauded the disclosure required by this proposed item, stating that it would "significantly enhance client understanding of these relationships." Others requested clarification about, among other things, the interaction of the disclosure required by this item and that required by other items, the amount of detail advisers must provide to clients about their internal procedures, and what

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74 Currently, Part 2 of Form ADV requires disclosure regarding an adviser's other financial industry or affiliations, but does not specifically state that an adviser must describe the related conflicts of interest and how they are addressed. *See* current Form ADV, Part 2 Item 8.

75 In 2005, our Office of Compliance Inspections and Examinations issued a report of their targeted exams of pension consultants that highlighted some of the conflicts faced by pension consultants who have business relationships with money managers they recommend to their pension clients: *Staff Report Concerning Examinations Of Select Pension Consultants* (May 16, 2005), available at http://www.sec.gov/news/studies/pensionexamstudy.pdf. The report noted that, for a number of pension consulting firms, compensation received from money managers comprised a significant part of their annual revenue but that pension consultants often did not provide adequate disclosure of the conflicts created by this practice to pension plan clients. Proposed Item 10 recognizes that these potential conflicts of interest are not limited to pension consultants and thus, would require disclosure by any adviser to whom it is relevant.

constitutes a material relationship.[76] Because of the considerable variety among the types of advisers registered with us and the diverse range of their relationships and affiliations in the financial industry, we do not propose to define which relationships or arrangements are material. We request comment on whether, despite the breadth of the financial industry, we should attempt to do so. If so, commenters are invited to provide suggestions of how to craft such a definition so as to capture relationships or arrangements involving material conflicts of interest.

We request further comment on our proposed Item 10. Will the disclosure required by Item 10 be adequate to allow a client to evaluate the conflicts of an adviser, and therefore better manage its relationship with the adviser? If not, what additional or more specific information should an adviser be required to disclose?

Item 11. Code of Ethics, Participation or Interest in Client Transactions and Personal Trading.

Code of Ethics. Proposed Item 11.A would require each adviser to describe briefly its code of ethics and to state that a copy is available upon request. In 2004, we adopted rule 204A-1[77] under the Advisers Act and amended current Item 9, which, as a result, today requires advisers to make this same disclosure.[78] The description of an adviser's code of ethics required by proposed Item 11.A may include matters also

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76 *See, e.g.*, FPA Letter; June 2000 IAA Letter; Thomson Letter. We note that Item 8 of current Part 2 already requires an adviser to disclose certain relationships with a related person "that are material to its advisory business or its clients."

77 17 CFR 275.204A-1.

78 *Investment Adviser Codes of Ethics*, Investment Advisers Act Release No. 2256 (July 2, 2004) [69 FR 41696 (July 9, 2004)] ("Code of Ethics Adopting Release").

responsive to other items, including those discussed below and, in particular, personal trading by advisory personnel. If so, the disclosure need not be repeated.[79]

Participation or Interest in Client Transactions. If the adviser or a related person recommends to clients or buys or sells for clients securities in which the adviser or a related person has a material financial interest, Item 11.B would require the brochure to discuss this practice and the conflicts presented.[80] Conflicts could arise, for example, when an adviser recommends that clients invest in a pooled investment vehicle that the firm advises or serves as the general partner, or when an adviser with a material financial interest in a company recommends that a client buy shares in that company's public offering. An adviser engaging in these practices may have an incentive to base its advice on its own financial interests rather than the interest of clients, and the item is designed to help clients understand that conflict. The item would require advisers to disclose any practices giving rise to these conflicts, the nature of the conflicts presented, and how the adviser addresses the conflicts.[81] The requirements of the proposed item are similar to the disclosures presently required under Item 9 of current Part 2.[82]

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79 Proposed General Instruction 1 to Part 2.

80 Proposed Item 11.B. This item incorporates many of the disclosure requirements of current Item 9 of Part 2 and is identical to the Item 10.B we proposed in 2000. An adviser's related persons are: (1) the adviser's officers, partners, or directors (or any person performing similar functions); (2) all persons directly or indirectly controlling, controlled by, or under common control with the adviser; (3) all of the adviser's current employees; and (4) any person providing investment advice on the adviser's behalf. *See Form ADV: Glossary*.

81 We are not proposing to require an adviser that relies on our recently adopted rule 206(3)-3T under the Advisers Act with respect to its principal trades with its advisory clients to disclose in Part 2 of Form ADV the information required by paragraph (a)(3) of that rule. Rule 206(3)-3T(a)(3) [17 CFR § 275. 206(3)-3T(a)(3)]. *See also Temporary Rule Regarding Principal Trades with Certain Advisory Clients*, Investment Advisers Act Release No. 2653 (Sept. 24, 2007) [72 FR 55022 (Sept. 28, 2007)]. Rule 206(3)-3T sets out an alternative means for advisers that also are registered broker-dealers to comply

We request that commenters consider the proposed item and evaluate whether it would require sufficient disclosure to address our concerns.

Personal Trading. Items 11.C and 11.D would require disclosure regarding personal trading by the adviser and its personnel. Because of the information they have, advisers and their personnel are in a position to abuse clients' positions by, for example, placing their own trades before or after client trades are executed in order to benefit from any price movements due to the clients' trades.[83] These practices not only may affect the objectivity of the adviser's recommendations, but also can harm clients by adversely affecting the prices at which their trades are executed. Item 11.C would require an adviser to disclose whether it or a related person (*e.g.*, advisory personnel) invests – or is permitted to invest – in the same securities that it recommends to clients, or in related securities such as options or other derivatives. If so, the brochure must discuss the conflicts presented and describe how the firm addresses the conflicts. Item 11.D would require a similar discussion, but focuses on the specific conflicts an adviser has when it or a related person trades in the same securities at or about the *same time* as a client.[84] In

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with their obligations under section 206(3) of the Advisers Act with respect to principal trades with their clients. One condition of the rule is that an adviser relying on it must provide its clients with prospective written disclosure to the advisory client explaining (i) the circumstances under which the investment adviser directly or indirectly may engage in principal transactions, (ii) the nature and significance of conflicts with its client's interests as a result of the transactions, and (iii) how the investment adviser addresses those conflicts. Although we do not propose to require advisers to disclose this information in their brochures, they may do so if they wish.

82 *See* current Form ADV, Part 2 Item 9.

83 This practice is known as "front-running." *See Investment Adviser Codes of Ethics*, Investment Advisers Act Release No. 2209 (Jan. 20, 2004) [69 FR 4040 (Jan. 27, 2004)] at n. 18 and accompanying text.

84 Some situations, such as when an adviser owns shares in a company it recommends to clients, may be covered by both proposed Items 11.B and 11.C, as well as others, such as Item 5. Other situations, such as when an adviser sells its holdings of a security it

response to this item, an adviser might explain how its internal controls, including its code of ethics, prevent the firm and its staff from buying or selling securities contemporaneously with client transactions.[85] Similar disclosure is already required under Item 9.E of current Part 2.

We proposed a similar item in 2000 on which we received no comment. Since that time, advisers have adopted codes of ethics that must address personal trading by certain advisory personnel and thus must address, at least in part, the concerns raised by this item. In light of this, should we further revise the item? If so, how?

Item 12. Brokerage Practices. Proposed Item 12 would require advisers to describe how they select brokers for client transactions and determine the reasonableness of brokers' compensation. The item also would require advisers to disclose how they address conflicts arising from their receipt of "soft dollars," *i.e.*, the receipt of benefits such as research in connection with client brokerage.

This item, which we discuss in more detail below, is largely the same as originally proposed, but with two changes urged by commenters. First, we have omitted a proposed requirement that advisers disclose in their brochures whether they negotiate commissions.[86] Commenters informed us that few advisers "negotiate" commission rates

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purchases for clients, would come under proposed Item 11.C, and potentially 11.D. Further, some of these control procedures may be included in the adviser's code of ethics and in the description of the code. A brochure would not need to repeat disclosure simply because it is responsive to more than one item.

85 Advisers would not be required to provide this disclosure with respect to securities that are not "reportable securities" under rule 204A-1, such as shares in unaffiliated mutual funds. *See* rule 204A-1. Such securities are not reportable under rule 204A-1 because they appear to present little opportunity for front-running. *See* Code of Ethics Adopting Release, above note 78, at n. 42 and accompanying text.

86 *See* Proposing Release at n. 178-179 and accompanying text.

in the literal sense suggested by the Proposing Release.[87] Second, we have omitted the proposed requirement that advisers disclose whether they participate in commission recapture programs. We understand that these programs are not typically sponsored or promoted by advisers, but are more likely driven by client demands. We request comment on our understanding of these practices. Should we require brochure disclosure in either instance?

Soft Dollar Practices. Many advisers receive brokerage and research services in reliance on section 28(e) of the Exchange Act, as well as other "soft dollar" products and services, provided by particular brokers in connection with client transactions.[88] As we have previously noted, use of client securities transactions to obtain research and other benefits creates incentives that can result in conflicts of interest between advisers and their clients.[89] Because of these conflicts, we have long required advisers to disclose

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87 June 2000 IAA Letter; SIFMA Letter. Of course, advisers must consider commission rates as part of their duty to seek best execution. *See Interpretive Release Concerning the Scope of Section 28(e) of the Securities Exchange Act of 1934 and Related Matters*, Exchange Act Release No. 23170 (Apr. 23, 1986) [51 FR 16004 (Apr. 30, 1986)] ("1986 Soft Dollar Release") at Section V.

88 Nearly 60 percent of advisers registered with the Commission report on Form ADV, Part 1A, Item 8.E that they or a related person receive soft dollar benefits in connection with client transactions. (IARD Data as of Sept. 30, 2007).

89 *Commission Guidance Regarding Client Commission Practices Under Section 28(e) of the Securities Exchange Act of 1934*, Exchange Act Release No. 54165 (July 18, 2006) [71 FR 41978 (July 24, 2006)] ("2006 Soft Dollar Release") ("[u]se of client commissions to pay for research and brokerage services presents money managers with significant conflicts of interest, and may give incentives for managers to disregard their best execution obligations when directing orders to obtain client commission services as well as to trade client securities inappropriately in order to earn credits for client commission services"). Section 28(e) of the Exchange Act provides a limited "safe harbor" for advisers with discretionary authority in connection with their receipt of soft dollar benefits. Under section 28(e), a person who exercises investment discretion over a client account has not acted unlawfully or breached a fiduciary duty *solely* by causing the account to pay more than the lowest commission rate available, so long as that person determines in good faith that the commission amount is reasonable in relation to the value of the brokerage and research services provided. Advisers must disclose their receipt of

their policies and practices with respect to their receipt of soft dollar benefits in connection with client securities transactions.[90] Some commenters questioned the conflicts we identified and complained that the item would tend to cast aspersions on the use of soft dollar arrangements that are commonplace, such as those that fit within the safe harbor established by section 28(e).[91] Our intent is not to create a negative impression regarding soft dollars arrangements, but rather to require full disclosure of arrangements that we believe involve significant conflicts of interest.

Our 2000 proposal responded to a 1998 report from our Office of Compliance Inspections and Examinations that concluded that advisers' disclosure often failed to provide sufficient information for clients or prospective clients to understand the advisers' soft dollar practices and the conflicts those practices present.[92] In its report, OCIE noted that most advisers' descriptions were simply boilerplate, and urged that we consider amending Form ADV to require better disclosure.[93] We request comment on whether our proposed item would achieve this goal.

Item 12 would require an adviser that receives soft dollar benefits in connection with client securities transactions to disclose its practices.[94] The proposed item would

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soft dollar benefits to clients, regardless of whether the benefits fall inside or outside of the safe harbor. *See* 1986 Soft Dollar Release, above note 87, at n. 33.

90 Item 12 of current Part 2.

91 Comment Letter of the Alliance In Support of Independent Research (June 13, 2000) ("Alliance Letter"); ICI Letter; SIFMA Letter.

92 *Inspection Report on the Soft Dollar Practices of Broker-Dealers, Investment Advisers and Mutual Funds* (Sept. 22, 1998), available at http://www.sec.gov/news/studies/softdolr.htm.

93 *Id*.

94 The soft dollar benefits covered include any research, or other products or services, whether created or developed by the broker-dealer itself or by a third party. *See* note to proposed Item 12.A.1 of Part 2A.

require a brochure's description of soft dollar practices to be specific enough for clients and prospective clients to understand the types of products or services the adviser is acquiring and permit them to evaluate conflicts.[95] Disclosure must be more detailed for products or services that do not qualify for the safe harbor in section 28(e) of the Exchange Act, such as research that does not aid in the adviser's investment decision-making process. Will the proposed disclosure be sufficient to adequately inform clients?

Item 12 also would require an adviser to describe the types of conflicts it has when it accepts soft dollar benefits[96] and to disclose how it addresses those conflicts.[97] The item would require the adviser to explain whether it uses soft dollars to benefit all client accounts or only those accounts whose brokerage "pays" for the benefits, and whether the adviser seeks to allocate the benefits to client accounts proportionately to the soft dollar credits those accounts generate. The item also would require the adviser to explain whether it "pays up" for soft dollar benefits.[98] As we noted above, some

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95 In this regard, the proposed item would incorporate the standard for advisers we set out in our 1986 Soft Dollar Release. Our 2006 Soft Dollar Release preserved this provision of the 1986 Soft Dollar Release. *See* 2006 Soft Dollar Release, above note 89, at n. 68 and accompanying text.

96 An adviser accepting soft dollar benefits would have to explain that (a) the adviser benefits because it does not have to produce or pay for the research or other products or services acquired with soft dollars, and (b) the adviser therefore has an incentive to select or recommend brokers based on the adviser's interest in receiving these benefits, rather than on the client's interest in getting the best execution.

97 *See* proposed Item 12.A.1.f of Part 2A, which is substantively the same as Item 12.B of current Part 2.

98 "Paying up" refers to a manager causing a client account to pay more than the lowest available commission rate in exchange for soft dollar products or services. Item 12 of current Part 2 requires advisers to disclose "whether clients pay commissions higher than those obtainable from other brokers in return for . . . products and services."

commenters to our 2000 proposal questioned our description of the conflicts of interest identified in the item.[99] We ask commenters to consider these descriptions.

Client Referrals. If an adviser uses client brokerage to reward brokers for client referrals, it also would be required to disclose this practice, the conflict it creates, and any procedures the adviser used to direct client brokerage to referring brokers during the last fiscal year, *i.e.*, the system of controls used by the adviser when allocating brokerage.[100] This practice presents advisers with significant conflicts of interest because they may have a bias towards referring brokers.[101] Part 2 currently requires advisers to disclose these arrangements, but does not specifically require that such description discuss the conflicts of interest created.[102]

Proposed Item 12.A.2 is substantially the same as we proposed in 2000. The one commenter that addressed it – CFA – expressed support for the item as proposed, and we request further comment.

Trade Aggregation. Clients engaging an adviser can benefit when the adviser negotiates lower commissions or "bunches" trades to obtain volume discounts on execution costs.[103] Item 12 would require the adviser to describe whether and under what conditions it engages in these practices. If the adviser does not bunch trades when it has the opportunity to obtain discounts, the adviser would be required to explain in the brochure that clients may pay higher brokerage costs. We request comment on this

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99 *See* above note 91 and accompanying text.

100 Proposed Item 12.A.2 of Part 2A.

101 *See* Proposing Release at n. 177 and accompanying text.

102 *See* current Form ADV, Part 2, Item 13.B.

103 Broker-dealers may, for example, offer lower commission costs.

requirement. Should we also require an adviser to discuss whether and under what conditions it *breaks up* large orders to purchase or sell securities (*e.g.*, to mitigate the impact of the transaction on the market value of the securities)?

Directed Brokerage. Clients sometimes instruct their adviser to send transactions to a specific broker-dealer for execution. Clients may initiate this type of arrangement for a variety of reasons, such as favoring a family member or friend or compensating the broker-dealer indirectly for services it provides to the client. But the arrangement may also be initiated by the adviser, who may benefit, for example, when brokerage is directed to its affiliated broker-dealer. In either case, clients directing (or agreeing to direct) brokerage need to understand the consequences of directing brokerage, including the possibility that their accounts will pay higher commissions and receive less favorable execution.[104]

If an adviser *permits* clients to direct brokerage, we would require the brochure to explain that the adviser may be unable to obtain best execution, and that directing brokerage may cost clients more money.[105] If, however, the adviser *routinely recommends, requests or requires* clients to direct brokerage, the adviser also would be required to describe in its brochure the adviser's practice, to disclose that not all advisers require directed brokerage, and to discuss any broker-dealer relationship that creates a material conflict of interest.[106]

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104 1986 Soft Dollar Release, above note 87 at n. 44.

105 Proposed Item 12.A.3.b of Part 2A.

106 Proposed Item 12.A.3.a of Part 2A. Currently, Item 12 of Part 2 requires disclosure of similar information in cases where an adviser or a related person suggests brokers to clients and where an adviser has authority to determine the broker or dealer to be used.

Commenters favored the item.[107] One pointed out, however, that many clients direct brokerage *subject to best execution*.[108] In such situations, the disclosure required by proposed Item 12.A.3.b is not relevant because the adviser *would be required* to seek best execution. To avoid disclosure that may not be helpful to clients, we have modified the item to permit advisers to omit the disclosure if the adviser only permits clients to direct brokerage subject to the adviser's ability to obtain best execution. We request further comment on the proposed disclosures regarding directed brokerage.

Item 13. Review of Accounts. Proposed Item 13 would require an adviser to disclose whether, and how often, it reviews clients' accounts or financial plans, and to identify who conducts the review. An adviser that reviews accounts, but not regularly, would explain what circumstances trigger an account review. This disclosure is similar to that presently required by Item 11 of current Part 2.[109] Commenters who addressed this item supported it as being helpful to clients.[110] We are proposing this item with no change from the 2000 proposal and we request further comment on it.

Item 14. Payment for Client Referrals. Item 14 would require an adviser to describe any cash or other payment that it or a related person makes for client referrals. The brochure also would disclose whether the adviser receives any benefit, including sales awards or prizes, from a non-client for providing advisory services to clients.[111]

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107 CFA Letter; Comment Letter of the Florida State Board of Administration (June 13, 2000) ("Florida Board Letter"); June 2000 IAA Letter.

108 Comment Letter of Frank Russell Securities (June 13, 2000).

109 *See* current Form ADV, Part 2, Item 11.

110 CFA Letter; FPA Letter.

111 Proposed Item 14 would require advisory *firms* to disclose economic benefits they receive. As discussed below in Section II.B.3 of this Release, Part 2B would require advisers to disclose economic benefits a *supervised person* receives.

This item is the same as we proposed it in 2000 and we request further comment on it. Similar disclosure is already required by current Part 2 which requires an adviser to disclose whether it has any arrangements where it directly or indirectly compensates any person for client referrals and to describe such arrangements.[112] Current Part 2 also requires an adviser to disclose whether it receives a cash payment or some economic benefit from non-clients in connection with giving advice to clients.[113] We request further comment on our proposed Item 14.

Item 15. Custody. We have updated this item from our 2000 proposal to reflect subsequent amendments to rule 206(4)-2 (our investment adviser custody rule).[114] The protections afforded clients as a result of compliance with the amended rule reduce the need for much of the disclosure requirements we proposed in 2000. Today, most advisers that have custody of client securities or funds comply with the rule by maintaining these client assets with a qualified custodian (such as a broker-dealer or bank) that directly sends account statements to the adviser's clients.[115] These advisers

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112 *See* current Form ADV, Part 2, Item 13.B.

113 *See* current Form ADV, Part 2, Item 13.A.

114 *See Custody of Funds or Securities of Clients by Investment Advisers*, Investment Advisers Act Release No. 2176 (Sep. 25, 2003) [68 FR 56692 (Oct. 1, 2003)] ("Custody Rule Release"). "Custody" would have the same meaning as it currently has in Form ADV and is based on the term as defined in rule 206(4)-2. *See Form ADV: Glossary*. An adviser has custody if it, directly or indirectly, holds client funds or securities, has any authority to obtain possession of them, or has the ability to appropriate them. For example, an adviser has custody if it has a general power of attorney over a client's account or signatory power over a client's checking account. For a more detailed discussion of what activity constitutes "custody," see Custody Rule Release, at Section II.A.

115 Rule 206(4)-2 defines a "qualified custodian" as a bank, a savings association, a broker-dealer, a futures commission merchant (but only with respect to clients' funds, security futures, and other securities incidental to transactions in futures), or a foreign financial institution that customarily holds financial assets for its customers and segregates the advisory clients' assets from its proprietary assets. Under the rule, a registered adviser

would be required only to explain that clients will receive these account statements from their custodians and should review them carefully. If, however, clients do not receive, from one or more qualified custodians, account statements covering all of the funds and securities over which an adviser has custody, Item 15 would require the adviser to disclose that it has custody and to explain the risks that clients will face as a result.[116]

We request comment on this proposed disclosure item. In particular, we request comment about whether we should further revise this item in light of the amended investment adviser custody rule.

Item 16. Investment Discretion. Item 16 would require advisers with discretionary authority over client accounts to disclose these arrangements in their brochure,[117] and any limitations clients may (or customarily do) place on this authority.[118] This item is the same as originally proposal. Both of the commenters who addressed the proposed item supported it.[119] We request further comment on our proposed Item 16.

Item 17. Voting Client Securities. Item 17 would require advisers to disclose their proxy voting practices. We have revised the item to reflect the adoption of rule

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with custody must either have a reasonable basis for believing that the qualified custodian sends quarterly account statements directly to the client or send its own quarterly account statements to the client, in which case the adviser must also undergo an annual surprise examination by an independent public accountant to verify client funds and securities.

116 We note that current Part 2 of Form ADV does not have an equivalent to Item 15 of reproposed Part 2A.

117 Currently, Items 12.A and 12.B of Part 2 require information about the adviser's investment discretion and any limitations on it. We propose to continue requiring this information but to clarify, through our proposed definitions in Form ADV, that an adviser has "discretionary authority" if it is authorized to make purchase and sale decisions for client accounts. This definition of discretionary authority is derived from section 3(a)(35) of the Exchange Act [15 U.S.C. 78c(a)(35)]. An adviser also has discretionary authority if it is authorized to select other advisers for the client.

118 For example, clients may not understand that they may ask the adviser not to invest in securities of particular issuers.

119 CFA Letter; FPA Letter.

206(4)-6 under the Advisers Act, which, among other things, requires advisers registered with the Commission to disclose certain information about their proxy voting practices.[120] We also have added a new requirement, discussed below, to describe information about an adviser's use of third-party proxy voting services.

Item 17 would require advisers to disclose whether they will accept authority to vote client securities and, if so, to briefly describe the voting policies they adopted under rule 206(4)-6. In addition, each adviser must describe whether (and how) clients can direct the advisers to vote in a particular solicitation, how the adviser addresses conflicts of interest when it votes securities, and how clients can obtain information from the adviser on how the adviser voted their securities. Item 17 also would require an adviser to explain that clients may obtain a copy of the adviser's proxy voting policies and procedures upon request. Advisers that do not have authority to vote securities would have to disclose how clients will receive their proxies and other solicitations.

Finally, we have added a new paragraph B of Item 17. If advisers routinely rely on one or more third-party proxy voting services to advise them in connection with voting client securities, then the advisers would be required to list the proxy voting services that the advisers use and to describe how they select the proxy voting services. The paragraph also would require disclosure of whether these advisers permit clients to direct the use of a particular proxy voting service with respect to the securities held in the clients' accounts. An adviser would not need to identify a proxy voting service that a

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120 *See Proxy Voting by Investment Advisers*, Investment Advisers Act Release No. 2106 (Jan. 31, 2003) [68 FR 6585 (Feb. 7, 2003)]. Rule 206(4)-6 requires advisers to adopt and implement written voting policies and procedures. Advisers are also required to keep certain records relating to their voting. Advisers that exercise voting authority over client securities must describe their voting policies and procedures to clients and furnish clients with a complete copy upon request.

client directs the adviser to use unless the adviser uses the service for the purpose of voting the securities of other clients. Finally, the new paragraph would require advisers to disclose how they pay for proxy voting services.

We believe that clients are interested in knowing whether their adviser is outsourcing its proxy analysis or otherwise using third-party proxy voting services, whether it is doing so in response to direction from another client, and how the adviser is paying for those services. We believe that clients would want to know of potential conflicts of interest that may arise from an adviser's use of proxy voting services, including possibly accommodating one client by hiring a proxy voting service to influence the voting of another client's securities.

Several commenters favored the item when we proposed it in 2000.[121] We request comment on our proposed revisions. Rule 206(4)-6 already requires advisers to disclose much of the information that the proposed item would require. Thus, one principal effect of the item would be to require the rule 206(4)-6 disclosure in the brochure. Should any of that disclosure not be required in the brochure?

Should we require disclosure of the circumstances relating to an adviser's use of third-party proxy voting services? Specifically, would clients be interested in knowing the identity of the proxy voting services that are utilized by their advisers and how these

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[121] *See* Comment Letter of Professor Aaron Brown, Yeshiva University (May 10, 2000); Comment Letter of Council of Institutional Investors (June 12, 2000); Florida Board Letter; Comment Letter of The Corporate Monitoring Project (June 3, 2000); Comment Letter of James McRitchie (May 24, 2000); Comment Letter of Paul Nissenbaum (May 9, 2000). Four commenters were concerned about the length of the disclosure that a description of proxy procedures would entail. *See* AmEx Letter; June IAA 2000 Letter; Comment Letter of Charles Schwab & Co. (June 14, 2000) ("Schwab Letter"); Thomson Letter; Wellington Letter. We note in response to these commenters concerns that the proposed item would only require a brief description of an adviser's policies and procedures and not verbatim incorporation of them.

services are selected? Would clients be interested in knowing whether advisers permit their clients to direct the use of particular proxy voting services? Would clients be interested in knowing the amounts that advisers pay third-party proxy voting services? Would clients be interested in knowing whether their advisers are paying for the services directly or through soft dollars?[122]

Item 18. Financial Information. This item would require disclosure of certain financial information about the adviser when material to clients. Proposed Item 18 of Part 2A would continue to require each adviser that requires prepayment of fees to give clients an audited balance sheet showing the adviser's assets and liabilities at the end of its most recent fiscal year.[123] Prepayment of fees exposes clients to the risk that the firm may become insolvent and unable to refund unearned fees. The proposed item also would require each adviser to disclose any financial condition reasonably likely to impair the adviser's ability to meet contractual commitments to clients if the adviser has discretionary authority over client assets, has custody of client funds or securities, or requires or solicits prepayment of more than $1,200 in fees per client and six months or more in advance.[124] These clients are exposed to the risk that their assets may not be

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122 For a discussion of whether proxy voting services and other proxy services are within the safe harbor under section 28(e) of the Exchange Act, see 2006 Soft Dollar Release, above note 89, at section III.C.5.

123 Currently, Item 14 of existing Part 2 requires (through Schedule G) an audited balance sheet if the adviser requires prepayment of more than $500 in fees per client and six or more months in advance. We would increase the threshold amount from $500 to $1,200 to reflect the effects of inflation, based upon the Personal Consumption Expenditures Chain-Type Price Index as published by the U.S. Department of Commerce, since we adopted Form ADV in 1979. As in the 2000 proposal, we also propose to require an audited balance sheet from advisers that *solicit* clients to prepay fees over $1,200.

124 This disclosure is currently required by rule 206(4)-4. In its release adopting rule 206(4)-4 the Commission noted that a determination about what constitutes financial condition

properly managed if the adviser becomes insolvent and ceases to do business.[125] Finally, proposed Item 18 would require an adviser that has been the subject of a bankruptcy petition during the past ten years to disclose that fact to clients.[126]

This item is largely the same as the one we proposed in 2000, which commenters generally supported.[127] However, we have made revisions to reflect subsequent amendments to Form ADV that were made in conjunction with changes to the adviser custody rule.[128] As a result, Item 18 no longer would require an adviser to supply clients with an audited balance sheet solely because the adviser has custody. Moreover, we now propose to exclude advisers from the balance sheet requirement if they require prepaid fees but are qualified custodians or insurance companies. These firms are subject to capital and regulatory requirements, designed to guard against insolvency, that eliminate the need for an adviser to deliver a balance sheet. Are there other circumstances in which it would be unnecessary for an adviser to deliver a balance sheet to its clients?

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reasonably likely to impair an adviser's ability to meet contractual commitments is inherently factual in nature but would generally include insolvency or bankruptcy. *See* Rule 206(4)-4 Adopting Release, above note 66 at n. 6.

125 As discussed above, we propose to rescind rule 206(4)-4. We caution advisers, however, that their fiduciary duty of full and fair disclosure may require them to continue to disclose any material legal event or precarious financial condition promptly to *all* clients, even clients to whom they may not be required to deliver a brochure or amended brochure. *See* Rule 206(4)-4 Adopting Release, above note 66 at n. 2-3 and accompanying text.

126 This requirement conforms with our already stated position that bankruptcy generally constitutes a 'financial condition reasonably likely to impair the adviser's ability to meet contractual commitments to clients' requiring disclosure under rule 206(4)-4. *See* Rule 206(4)-4 Adopting Release, above note 66 at n. 6.

127 *See, e.g.*, CFA Letter; June 2000 IAA Letter. Although some commenters to our 2000 proposal raised concerns regarding exceptions to delivery of balance sheets, the Commission subsequently considered and addressed this issue in adopting its changes to the custody rule. *See* Custody Rule Release, above note 114.

128 *See* Custody Rule Release, above note 114.

Alternatively, are there additional circumstances in which it would be appropriate for us to require an adviser to deliver a balance sheet?

Item 19. Index. The brochure filed with us would be required to include an index of the items required by Part 2A indicating where in the brochure the adviser addresses each item.[129] This index is intended to facilitate review by our staff for compliance with the requirements of Part 2A. The adviser would not be required to provide the index to its clients. The index would, however, be required to be appended to the brochure as filed through the IARD. We proposed the same index requirement in 2000.[130] We request further comment on our proposal to require advisers to include an index in their brochures.

Part 2A Appendix 1: The Wrap Fee Program Brochure. Advisers that sponsor wrap fee programs[131] would continue to be required to prepare a separate, specialized firm brochure (a "wrap fee program brochure" or "wrap brochure") for clients of the wrap fee program in lieu of the sponsor's standard advisory firm brochure.[132] The items

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129 Although an index is not required by current Part 2 of Form ADV, the requirement in Proposed Item 19 is similar to the index that current Schedule H now requires.

130 In their comments responding to the 2000 proposal, the ICI and IAA opposed this item, arguing that requiring both an index and a table of contents seemed redundant. *See* ICI Letter; June 2000 IAA Letter. The CFA, however, endorsed the requirement. *See* CFA Letter.

131 Under wrap fee programs, which are also sometimes referred to as "separately managed accounts," advisory clients pay a specified fee for investment advisory services and the execution of transactions. The advisory services may include portfolio management and/or advice concerning selection of other advisers, and the fee is not based directly upon transactions in the client's account.

132 We adopted the requirement for a separate brochure for wrap fee clients in 1994. *See Disclosure by Investment Advisers Regarding Wrap Fee Programs*, Investment Advisers Act Release No. 1411 (Apr. 19, 1994) [59 FR 21657 (Apr. 26, 1994)] (adopting rules to require wrap fee sponsors to give wrap fee clients separate brochures). As proposed in 2000, advisers whose entire advisory business is sponsoring wrap fee programs would prepare a wrap brochure but would not be required to prepare a standard advisory firm

in proposed Appendix 1 to Part 2A would contain the requirements for a wrap fee program brochure, and would be substantially similar to those currently in Schedule H. However, as we did in 2000, today we are proposing some changes from current Schedule H to incorporate many of our proposed amendments to the Part 2A firm brochure. We also are proposing an additional disclosure requirement to the wrap fee brochure.

We propose to require an adviser to disclose whether any of its related persons are portfolio managers in the program and to describe the conflicts that may be present.[133] For example, an adviser may have an incentive to select a related person to participate as a portfolio manager based on the person's affiliation with the adviser, rather than based on expertise or performance. The item would require advisers to disclose whether related person portfolio managers are subject to the same selection and review as the other portfolio managers who participate in the wrap fee program and, if they are not, how they are selected and reviewed.

We request comment on this proposed modification to Appendix 1 to Part 2A. Wrap fee programs have evolved in the marketplace, resulting in many different models

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brochure. *See* proposed Instruction 7 to Part 2A of Form ADV. An adviser would have to prepare both a standard firm brochure and a wrap fee brochure if it both sponsors a wrap fee program *and* provides other types of advisory services, and would deliver both a standard and a wrap brochure to a client who receives both types of services. Wrap fee sponsors would, like other advisers, be required to provide brochure supplements to their wrap fee clients.

133 Proposed Item 6.B of Appendix 1. We propose to redesignate the item originally proposed as Item 6.B (requiring additional disclosures if the wrap fee sponsor or any of its employees act as a portfolio manager for a wrap fee program described in the wrap brochure) as new Item 6.C.

that all meet the definition of wrap fee program.[134] As a result of these various structures, are there other disclosures that we should consider including in Appendix 1 that would enhance a client's ability to understand the conflicts of interest in wrap fee programs? Are there disclosure items in proposed Appendix 1 that are unnecessary or would not be useful to clients?

3. Delivery and Updating of Brochures

The Commission also is proposing amendments to rule 204-3, our rule under the Advisers Act that requires registered advisers to update and deliver their brochures to clients and prospective clients.

a. Delivery to Clients

Initial Delivery. Similar to the existing requirements, an adviser would be required to deliver a current firm brochure before or at the time it enters into an advisory contract with the client.[135] As provided under the current rule, advisers would not be required to deliver brochures to certain advisory clients receiving only impersonal investment advice[136] or to clients that are investment companies registered under the

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134 For example, some wrap fee program sponsors have begun to transition from platforms offering a selection of individual portfolio managers to those instead offering a selection of model portfolios.

135 Proposed rule 204-3(b)(1). Rule 204-3 currently requires a registered adviser to furnish each client and prospective client with a written disclosure statement which may be either a copy of the adviser's completed Part 2 or a written document containing the information required by Part 2. Currently, such delivery must occur at least 48 hours before entering into the advisory agreement, *or* at the time of entering into the agreement if the client has the right to terminate the agreement without penalty within five business days thereafter. We are proposing to simply require that the adviser deliver the brochure before or at the time of entering into the agreement.

136 Proposed rule 204-3(c)(1) and proposed Instruction 1 to Part 2A. Advisers would not be required to deliver brochures to advisory clients receiving only impersonal investment advice for which the adviser charges less than $500 per year. Currently, the dollar amount threshold to trigger this exception is $200. *See* rule 204-3. We are proposing to

Investment Company Act of 1940 ("Company Act").[137] We propose expanding the latter exception to cover advisers to business development companies ("BDCs") that are subject to section 15(c) of the Company Act. That section requires the boards of directors to request, and the adviser to furnish, information to enable the board to evaluate the terms of the proposed advisory contract.[138] Because of this safeguard, we believe that proposing a separate obligation for those types of entities to deliver a brochure is not necessary. We note that an adviser would not have to prepare a brochure if it does not have any clients to whom a brochure would have to be delivered, thus saving advisers time and expense.[139]

Annual and Interim Delivery. Currently, rule 204-3 requires advisers to annually deliver, or offer to deliver upon request, a written disclosure statement (either a copy of the adviser's Part 2 or a brochure containing the information required by Part 2) to each of its advisory clients.[140] In 2000, we proposed to require advisers to deliver an updated brochure, or a "sticker" identifying the stale information and including the updated information, whenever information in the brochure became materially incorrect during

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increase this threshold to $500 to reflect the effects of inflation, based upon the Personal Consumption Expenditures Chain-Type Price Index as published by the U.S. Department of Commerce, since rule 204-3 was adopted in 1979.

137 Proposed rule 204-3(c)(1) and proposed Instruction 1 to Part 2A. This does not suggest, however, that investment company directors would no longer receive the disciplinary and financial information that the fund's adviser currently provides under existing rule 206(4)-4, which we are proposing to move into the brochure. Section 15(c) of the Investment Company Act [15 U.S.C. 80a-15(c)] separately requires fund directors to request and evaluate information about the adviser in connection with annual renewal of the advisory contract, and requires the adviser to provide it.

138 *See* note 137 above.

139 Proposed Instruction 5 to Part 2A.

140 Rule 204-3(c). An adviser's offer to deliver the disclosure statement must be in writing.

the year.[141] We expressed concern that few clients requested an updated brochure and were instead relying on "stale" brochures. We analogized our updating proposal to the obligations of mutual funds to update their prospectuses and expressed the view that the additional costs the proposed updating requirements might impose could be reduced by electronic delivery of the updating information. We also pointed out that, as fiduciaries, advisers must already provide their clients with updated information to comply with their obligations under the anti-fraud provisions of the Advisers Act.

Several commenters supported our proposal, particularly the proposal to require advisers to update their brochures throughout the year.[142] Other commenters objected, primarily citing the burden on advisers.[143] Some commenters argued that advisers currently meet their obligations under the anti-fraud provisions through different types of communications with clients, some of which are informal, and urged us not to impose a formal updating requirement.[144] One commenter, the IAA, expressed agreement with our concern that clients may be relying on stale information and urged a compromise approach under which the Commission would require advisers to deliver their brochure to clients annually, but would not specify the means of updating information between the annual updates.[145]

Today, we are proposing an approach similar to the one suggested by the IAA, which we believe may strike an appropriate balance between our concerns and those

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141 *See* Proposing Release at Section II.D.2.

142 *See, e.g.*, AIMR Letter; CFA Letter; Comment Letter of Yasmin Mansoor (May 28, 2000); Penn. Securities Commission Letter; Securities America Letter.

143 *See, e.g.*, AmEx Letter; Crist Letter; DP&W Letter; ICI Letter; SIFMA Letter.

144 *See, e.g.*, Comment Letter of Merrill Lynch, Pierce, Fenner & Smith, Inc. (June 22, 2000) ("Merrill Letter"); Paine Webber Letter; Schwab Letter.

145 Comment Letter of the IAA (May 24, 2001) ("May 2001 IAA Letter").

expressed by commenters. In addition to the initial delivery requirement, the proposed amendments would require each registered adviser to deliver its current brochure to existing clients at least once each year no later than 120 days after the end of the adviser's fiscal year.[146] Thus, clients would receive an updated brochure about the same time each year (identifying changes from the previous year's brochure) shortly after the date by which advisers are already required to file their amended Form ADV with us.[147]

We are proposing to require an adviser to deliver an interim update to clients only when the adviser amends its brochure to add a disciplinary event, or to materially change information already disclosed, in response to Item 9 of Part 2A.[148] We believe that such circumstances warrant a formal delivery requirement because of the importance of disciplinary information to clients.[149] We believe such disciplinary events are important

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146 Proposed amended rule 204-3(b) and proposed Instruction 2 to Part 2A.

147 As discussed below, rule 204-1 requires an adviser registered with the Commission to annually revise its Form ADV, including its brochure, within 90 days of its fiscal year end. Advisers typically provide clients with reports quarterly, and the proposed 120-day period is designed to provide sufficient flexibility to allow advisers to include the updated brochure in a routine quarterly mailing to clients. We expect that permitting an adviser to send the brochure together with these routine mailings could substantially reduce delivery costs. *See* Section VII below. Advisers may, of course, deliver updated brochures electronically with client consent, in which case they would bear significantly lower delivery costs. Proposed Instruction 3 to Part 2A. *See also Use of Electronic Media by Broker-Dealers, Transfer Agents, and Investment Advisers for Delivery of Information*, Investment Advisers Act Release No. 1562 (May 9, 1996) [61 FR 24644 (May 15, 1996)] (publishing Commission interpretive guidance with respect to use of electronic media to fulfill investment advisers' disclosure delivery obligations).

148 Proposed rule 204-3(e). Nonetheless, as fiduciaries advisers have an ongoing obligation to inform their clients of any material information that could affect the advisory relationship. As a result, advisers may be required to disclose material changes to clients between annual updating amendments even if those changes do not trigger delivery of an interim update. *See* Note to Proposed Instruction 2 to Part 2A; *see also* Form ADV: General Instruction 4.

149 Currently, existing rule 206(4)-4 requires disclosure of such disciplinary events. The proposed requirement of interim updates to the brochure would require that such disclosure be written.

because, unlike some of the other disclosure items, they are more likely to reflect directly upon an adviser's integrity and may affect a client's trust and confidence in the adviser.

We request comment generally on our proposed delivery requirement and, in particular, on the proposed requirements regarding delivery of updates. Should we require delivery of interim updates of the brochure in additional circumstances besides those involving disclosure of disciplinary information in response to Item 9? Should we require brochure delivery more frequently than annually? We also request comment with respect to the timing of annual delivery. Is the proposed provision to require annual delivery no later than 120 days after the end of the adviser's fiscal year reasonable? Does it adequately enable advisers to minimize costs by making delivery in conjunction with existing mailings?

b. Updating Part 2 of Form ADV

Similar to the existing requirements, the proposed rules would require advisers to keep the brochures they file with us current by updating them at least annually, and updating them promptly when any information in the brochures becomes materially inaccurate.[150] In the case of both annual and interim updates, advisers will be able to

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150 *See* proposed amended rule 204-3(g), and proposed Instruction 4 to Form ADV, Part 2A. As discussed above, the proposed updating requirement would be similar to the existing standard. *See* current rule 204-1 and Form ADV: General Instruction 4. Additionally, proposed Instruction 4 to Part 2A and a proposed Note to Item 4.E would state that an adviser does not need to update its brochure solely because the amount of its client assets has materially changed. This proposed instruction reflects our understanding that in most cases the amount of an adviser's assets under management will likely continually change over the course of a year due to market fluctuations, and that requiring advisers to update their brochure in each instance would be burdensome and of limited value. This approach is similar to that we currently take with respect to advisers' obligations to update assets under management reported in Item 5 of Form ADV, Part 1A. *See* Form ADV: General Instruction 4. For similar reasons, proposed Instruction 4 to Part 2A also would state that an adviser does not need to update its brochure solely because its fee schedule has changed. Advisers would, however, be required to update their brochure to

make changes to their brochures using their own computers and then simply submit the revised versions of their brochures through IARD.[151] In some cases, an adviser will be required to submit an annual updating amendment, but may not have any changes to make to its brochure (because the currently filed brochure does not contain any materially inaccurate information). The IARD system will give the adviser the option of indicating on IARD that its current brochure does not contain any materially inaccurate information and that the adviser is not attaching another brochure. Although previously-filed versions of an adviser's brochures will remain stored as Commission records in the IARD system, as with an adviser's Part 1A filings, only the most recent version of an adviser's brochure will be available through the Commission's public disclosure Web site.[152] The purpose of the public disclosure Web site is to provide the public with current information about advisers, rather than historic information.[153]

We request comment generally with respect to our proposed requirements for updating brochures. We request comment specifically about the proposal to require ongoing updating. Should we develop different updating requirements for the different disclosure items of the brochure in a manner similar to the updating requirements for Form ADV, Part 1A (*e.g.*, require more frequent updating with respect to changes to an adviser's listed fee schedule)? We also request comment about whether we should make

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reflect material changes with respect to listed assets and fee schedules if they are otherwise updating their brochure for a separate reason.

151 Proposed rule 204-1(b).

152 *See* note 6 above. In the case of an adviser that prepares, files and delivers to clients separate brochures for the various different advisory services it offers, the most recent version of *each* of its brochures would be available via the public disclosure Web site.

153 Advisers' historic brochure filings would be available for public inspection and copying in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549.

advisers' historical brochure filings available via the Commission's public disclosure Web site.

B. Part 2B: The Brochure Supplement

In 2000, we expressed our concern that, because the information in current Part 2 concerns the advisory *firm*, clients may not receive information they want and need about the firm's employees with whom they have contact and on whom they rely for investment advice.[154] In the case of smaller advisers, the current disclosure requirements, which focus on the senior executives of the advisory firm, may be adequate. But in large advisory firms, which account for a significant number of SEC-registered advisers, clients may never meet the firm's senior executives, who may be located in a different city and may have only an indirect effect on the advice given to the client.[155] We believe clients of these firms also are interested in the background, disciplinary record (if any), and qualifications of the individuals with whom they are dealing.

Therefore, we proposed in 2000, and are today reproposing, a requirement that adviser brochures be accompanied by brochure supplements that provide information about the advisory personnel on whom clients rely for investment advice. A brochure supplement ordinarily would be less than a page long and would contain information

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154 For example, current Part 2 requires background information only on firm executives and members of the firm's "investment committee." Item 6 of Part 2 of Form ADV.

155 Based on advisers' responses to questions on Part 1A of Form ADV as of September 30, 2007, more than 475 of the investment advisers registered with the Commission report on Part 1A of their Form ADV that they have more than 50 employees who perform investment advisory functions on behalf of the firm. (IARD Data as of Sept. 30, 2007).

about the educational background, business experience, and disciplinary history (if any) of the supervised person who provides advisory services to that client.[156]

We received a large number of comments on the brochure supplement proposal. Several commenters, including those representing financial planners, investment consultants, and consumer groups, praised the supplement as a highly practical and beneficial tool for informing clients about the qualifications and background of the individuals on whom they rely for investment advice.[157] Several others, including a number of investment advisers, argued that ensuring proper distribution of supplements at large firms would be costly and burdensome.[158] Some maintained that clients do not want the information that would be contained in a supplement.[159] Another commenter, the IAA, acknowledged that consumers hiring professionals in any field often inquire about the individuals' credentials in addition to the firm's reputation, but urged that we narrow the rule so as not to require advisers to deliver the supplement to institutional clients.[160]

We continue to believe that information contained in the brochure supplement may be very important to clients. In response to commenters' concerns, however, we have made a number of changes that are intended to reduce burdens on advisers subject

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156 Proposed rule 204-3(b)(2).

157 *E.g.*, AIMR Letter; CFA Letter; Consortium Letter; FPA Letter; Comment Letter of the Investment Management Consultants Association (June 12, 2000).

158 *E.g.*, AmEx Letter; June 2000 IAA Letter; ICI Letter; Comment Letter of Legg Mason, Inc. (June 13, 2000) ("Legg Mason Letter"); Merrill Letter; Paine Webber Letter; Comment Letter of Salomon Smith Barney Inc. (June 13, 2000) ("Salomon Letter"); Schwab Letter; SIFMA Letter; TIAA-CREF Letter; T. Rowe Price Letter; Comment Letter of United Services Planning Association, Inc. and Independent Research Agency for Life Insurance, Inc. (June 12, 2000) ("USPA Letter"); Wellington Letter.

159 Merrill Letter; Salomon Letter; Schwab Letter; SIFMA Letter.

160 May 2001 IAA Letter.

to the rule. As discussed in more detail below, we would modify the delivery requirement, reduce the number of types of clients to whom advisers would be required to provide supplements, clarify the format of the supplements to maximize the amount of flexibility advisers have in preparing a supplement, and limit the information that would have to be included in the supplement.

1. Delivery and Updating

We originally proposed to require that each adviser provide its clients with a brochure supplement for each supervised person who provides advisory services to that client.[161] In response to comments, we are limiting the circumstances in which an adviser would be required to deliver the supplement.[162]

The proposed amendments would require that a client be given a brochure supplement for each supervised person who (i) formulates investment advice for that client and has direct client contact,[163] or (ii) makes discretionary investment decisions for that client's assets, even if the supervised person has no direct client contact.[164] We

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161 *See* Proposing Release at Section II.D.2.

162 *See* note 158 above. A number of commenters argued that advisers should only be required to deliver brochure supplements of supervised persons who actually formulated investment advice. Crist Letter; June 2000 IAA Letter; ICI Letter; TIAA-CREF Letter; T. Rowe Price Letter. Nine commenters argued that brochure supplements should not be required of supervised persons who act as solicitors. Crist Letter; DP&W Letter; Comment Letter of Federated Investors Inc. (June 13, 2000) ("Federated Letter"); FPA Letter; June 2000 IAA Letter; ICI Letter; TIAA-CREF Letter; T. Rowe Price Letter; USPA Letter. Some commenters urged limiting delivery to certain types of clients, such as "retail" clients, but not to sophisticated or institutional clients.

163 An adviser would not have to provide a supplement for a third-party solicitor because solicitors already must deliver a disclosure document to potential advisory clients. Rule 206(4)-3 [17 CFR 275.206(4)-3].

164 An adviser would not, however, have to provide a supplement for a supervised person who provides discretionary advice only as part of a team and has no direct client contact as we believe that when investment advice is formulated by a team, specific information

believe that requiring supplements for these categories of supervised persons would provide clients with the information they want and need about the particular individuals on whom they will rely for investment advice. We originally proposed, but have eliminated, a provision requiring delivery of a supplement for a supervised person who merely communicates investment advice. Commenters pointed out that our original proposal would have required disclosure of the backgrounds of client service representatives who transmit investment advice to clients, but who have no influence on the advice given. To limit disclosure about employees with whom a client may have no contact or about employees who do not influence the advice given to the client, we have more narrowly tailored the proposed supplement delivery requirements so that a particular client would receive disclosure specifically about those persons on whom he relies for investment advice.

As reproposed, an adviser generally would be required to provide its clients with a brochure supplement for each supervised person who provides advisory services as described above. However, advisers would not be required to deliver supplements to four types of clients: (i) clients to whom an adviser is not required to deliver a firm brochure (*e.g.*, registered investment companies and business development companies);

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about each individual team member takes on less importance. Proposed Instruction 1 to Part 2B.

The supervised person's supplement must be given to the client at or before the time *that* supervised person begins to provide advisory services to *that* client. Proposed rule 204-3(b)(2) and proposed Instruction 3 to Part 2B. Although the amendments we are proposing today would require the advisory firm to deliver the brochure supplement, we recognize that in most cases advisers' supervised persons will actually deliver the required supplements to clients on behalf of the advisory firm.

(ii) clients who receive only impersonal investment advice;[165] (iii) clients who are "qualified purchasers;"[166] and (iv) certain "qualified clients" who also are officers, directors, employees and other persons related to the adviser.[167] An adviser that does not have any clients to whom a supplement would have to be delivered would not have to prepare any supplements. Similarly, an adviser would not have to prepare a supplement for any supervised person who does not have clients to whom the adviser must deliver a supplement.

The first two categories of clients were included in our 2000 proposal. Commenters did not address these exceptions to the supplement delivery requirement. We propose to add the latter two exceptions in response to several commenters' arguments that certain institutional and sophisticated clients do not need the protections of the brochure supplement requirement because they are in a position to obtain, and

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165 This exception from the supplement delivery requirement differs slightly from the exception from the brochure delivery requirement, in that it does not depend on the cost of the impersonal advisory services involved. This is because in situations involving impersonal advisory services, the nature of the services are such that supervised persons of the adviser are unlikely to be directly providing advisory services to clients. As a result, we believe that in such situations requiring supplement delivery would result in an unnecessary expense with little appreciable benefit. We believe, however, that delivery of a firm brochure would be useful where the cost of the impersonal advisory services is significant, that is $500 or above.

166 "Qualified purchasers," as defined under section 2(a)(51)(A) of the Investment Company Act of 1940 [15 USC 80a-2(a)(51)(A)], include, among others, natural persons who own $5 million or more in investments and persons who manage $25 million or more in investments for their account or other accounts of other qualified purchasers.

167 Rule 205-3(d)(1)(iii) defines certain related persons of an adviser as "qualified clients," including: (i) any executive officers, directors, trustees, general partners, or persons serving in a similar capacity, of the advisory firm; and (ii) any employees of the advisory firm (other than employees performing solely clerical, secretarial or administrative functions) who, in connection with their regular functions or duties, participate in the investment activities of the firm and have been performing such functions or duties for at least 12 months.

frequently do obtain, information about the advisory personnel on whom they rely for investment advice.[168]

We request comment on our assumption that some clients do not need the protections afforded by a requirement that an adviser deliver a brochure supplement even though we would continue to require delivery of the brochure. Should we use a higher threshold to exclude clients, such as "Qualified Institutional Buyers?"[169] Should we use a lower one, and exclude all clients who are "qualified clients" under rule 205-3, rather than just those qualified clients that are officers, directors and employees of the adviser?[170] In December 2006, the Commission proposed, but has not adopted, new rules 509 and 216 under the Securities Act of 1933, that would define the term "accredited natural person."[171] We ask for comment on whether we should create an exclusion from supplement delivery for accredited natural persons. In particular, with respect to natural persons, we request comment on whether "accredited natural person" or "qualified

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168 *See* DE Shaw; Federated Letter; June 2000 IAA Letter; T. Rowe Price Letter; Wellington Letter.

169 "Qualified Institutional Buyer," as defined under rule 144a of the Securities Act of 1933 [17 CFR 230.144a], includes entities that own and invest on a discretionary basis at least $100 million in securities.

170 "Qualified client," as defined under rule 205-3 of the Advisers Act [17 CFR 275.205-3], includes natural persons with $750,000 under management with the adviser and individuals who have a net worth of $1.5 million.

171 Proposed new rules 509 and 216 under the Securities Act of 1933 would add to the existing definition of "accredited investor" and apply to private offerings of certain unregistered investment pools. As proposed, these rules would define the term "accredited natural person" under Regulation D and Section 4(6) of the Securities Act. "Accredited natural person" would be any natural person who meets either the net worth or income test specified in rule 501(a) or rule 215, as applicable, and who owns at least $2.5 million in investments. *See Prohibition of Fraud by Advisers to Certain Pooled Investment Vehicles; Accredited Investors in Certain Private Investment Vehicles*, Investment Advisers Act Release No. 2576 (Dec. 27, 2006) [72 FR 400 (Jan. 4, 2007)]. In August 2007, we proposed further general amendments to the definition of accredited investor. *See Revisions of Limited Offering Exemptions in Regulation D*, Securities Act Release No. 8828 (Aug. 3, 2007) [72 FR 45116 (Aug. 10, 2007)].

client" is the appropriate standard to use or whether it would be more appropriate to use the higher "qualified purchaser" standard.[172]

In 2000, we proposed to require that advisers promptly deliver to existing clients a revised supplement (or a sticker) whenever information in the supplement became materially inaccurate.[173] Today, we propose to reduce the frequency with which advisers would have to deliver clients an updated supplement so that they would only deliver them to existing clients when new disclosure of a disciplinary event, or a material change to disciplinary information already disclosed, in response to proposed Part 2B, Item 3, which we believe is critical information for clients. As we noted above, we believe disciplinary information is important because it reflects upon the supervised person's integrity and may affect a client's trust and confidence in that person.

As with the brochure, advisers would have to amend a brochure supplement promptly if information in it becomes materially inaccurate, and any new clients who would be required to receive that supplement must be given the amended version (or the "old" supplement and a sticker). Supplements, like brochures, could be delivered on paper or electronically.[174] However, unlike the delivery requirement for firm brochures, and because we believe most information in the supplement is less likely to become materially inaccurate over time, advisers would not be required to deliver supplements to existing clients annually. We request comment generally on the proposed updating and delivery requirements for brochure supplements. We also request comment on our proposal to require advisers to deliver updated supplements to clients describing changes

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172 *See* note 166 above.

173 Proposing Release at n. 215.

174 Proposed Instruction 4 to Part 2B.

to disciplinary information. Should we also require updated supplements to be delivered if other information changes?

2. Format

The proposed amendments would require advisers to write their supplements in plain English, but would give advisers considerable flexibility in presenting information in a format that best suits their firms.[175] This flexibility is designed to reduce the cost of preparing and delivering supplements. Advisers would be permitted to include supplement information in the firm's brochure, an approach that may be attractive to smaller firms with few persons for whom they would be required to prepare supplements.[176] Advisers could also elect to prepare a supplement for each supervised person, or alternatively, they could prepare separate supplements for different groups of supervised persons (*e.g.*, all supervised persons in a particular office or work group). We request comment generally on the proposed format for brochure supplements.

3. Supplement Items

Most commenters who addressed the proposed items supported the proposed content of the brochure supplements.[177] As we are proposing it today, Part 2B would consist of six items. We are proposing to omit two that we originally proposed in 2000. We would omit originally proposed Item 7, which would have required disclosure if the supervised person had been the subject of a bankruptcy petition during the past 10

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175 *See* Proposed Instruction 6 to Part 2B.

176 IARD data as of September 30, 2007 indicate that nearly 82 percent of advisers registered with us have 10 or fewer employees performing investment advisory functions on their behalf. Over 67 percent have five or fewer employees performing advisory functions.

177 *E.g.*, AIMR Letter; CFA Letter; CFP Board Letter.

years.[178] Commenters asserted that a personal bankruptcy is not necessarily indicative of a supervised person's investment advisory skills and thus need not be disclosed in the brochure supplement. In light of these comments, we have eliminated this item. Should we require disclosure of personal bankruptcies in supplements and, if so, why? We are proposing most of the other items, each of which we discuss below, as originally proposed. In addition to our specific requests for comment, we request comment generally on each of these items.

Item 1. Cover Page. The supplement's cover page would include information identifying the supervised person and the advisory firm.

Item 2. Educational Background and Business Experience. Item 2 would require the supplement to describe the supervised person's formal education and his or her business background for the past five years.[179] If the supervised person either has no formal education after high school or has no business background, the adviser would have to disclose this fact in the supplement.

We are not, as originally proposed, including the requirement to describe professional designations or attainments. Advisers would be permitted, however, to include information about professional designations and attainments in the supplement if they so choose.[180] We are concerned that in light of the already large number and variety

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178 In 2000, we proposed disclosure of bankruptcy filings of supervised persons. We are, as discussed above, proposing Item 18 of Part 2A, which would require the firm's brochure to disclose whether the *advisory firm* has been the subject of a bankruptcy petition during the past 10 years.

179 Currently, Item 6 of Part 2 of Form ADV requires this information about the adviser's principal executive officers and about individuals who determine general investment advice on behalf of the adviser.

180 Some commenters, however, supported disclosure of professional designations (AIMR Letter; CFP Board Letter; FPA Letter).

of existing designations, requiring such information may encourage the proliferation of fictitious and meaningless designations. In addition, our staff and other securities regulators have warned that investors may be confused by some professional designations, such as those that imply expertise in providing services to seniors.[181] We request comment about this approach. Should we require disclosure about professional designations and attainments? Are there additional items related to educational background and business experience that we should include? Have we included disclosure items that are not relevant?

Item 3. Disciplinary Information. Item 3 would require disclosure of any legal or disciplinary event that is material to a client's evaluation of the supervised person's integrity. Many commenters supported our 2000 proposal.[182] One commenter, the United Services Planning Association, opposed it, saying that such disclosure would be punitive and unnecessary. Some others suggested that the scope of the required disciplinary disclosure be narrowed, or that advisers might not have the information about their supervised persons' disciplinary history.[183] Two commenters, SIFMA and the FPA, recommended limiting the disclosure to events that are the subject of a final order or judgment, and not requiring disclosure if the supervised person is named in a pending

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181 *See Protecting Senior Investors: Report of Securities Firms Providing "Free Lunch" Sales Seminars*, Joint Report by the Staff of the Commission's Office of Compliance Inspections and Examinations, NASAA, and FINRA (available at http://www.sec.gov/spotlight/seniors/freelunchreport.pdf); Staff Update, *"Senior" Specialists and Advisors: What You Should Know About Professional Designations* (available at http://www.sec.gov/investor/pubs/senior-profdes.htm). While we acknowledge that a number of well-regarded professional designations and attainments exist, the required credentials, training, and experience associated with different designations varies widely.

182 AIMR Letter; CFA Letter; CFP Board Letter; FPA Letter.

183 *E.g.*, AmEx Letter; ICI Letter; Greenville Letter; Legg Mason Letter; Securities America Letter.

criminal proceeding. Four commenters supported our proposal to require disclosure if a supervised person's professional designations are suspended or revoked, arguing that consumers would benefit from having full disclosure of all relevant information.[184] Three commenters opposed that disclosure, arguing among other things, that suspension or revocation proceedings do not "guarantee due process" and could occur for "mundane" reasons (*e.g.*, failure to pay dues).[185]

In general, we believe that advisory clients would consider the listed disciplinary events critically important in determining whether to hire or retain an adviser or any specific supervised person of that adviser. We believe it is important that clients have information concerning disciplinary events that involve the persons who are substantially responsible for the investment advice that clients receive. Thus, we are proposing Item 3 largely as we proposed it in 2000 to require substantially the same disclosure requirements for the supervised person's disciplinary history as we are proposing for the firm's disciplinary history.[186]

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184 AIMR Letter; CFA Letter; CFP Board Letter; FPA Letter.

185 AmEx Letter; June 2000 IAA Letter; T. Rowe Price Letter.

186 As in proposed Item 9 of Part 2A, proposed Item 3 of Part 2B would include a list of events that are presumptively material if they occurred in the prior 10 years. The list parallels the proposed list of legal and disciplinary events in Item 9 of Part 2A that must be disclosed in the firm brochure and which are derived from the existing disclosure requirements set out in rule 206(4)-4. The list also is substantially similar to the list of disciplinary events advisers are already required to disclose in response to Item 11 of Form ADV, Part 1A. With respect to commenter's concerns regarding the burdens of requiring disclosure of "pending criminal proceedings," the required disclosure is narrow, as it would not include other investigations, or arrests or similar charges effected in the absence of a formal criminal indictment or information (or equivalent formal charge). *See* Form ADV: Glossary.

As under proposed Item 9 of Part 2A, proposed Item 3 of Part 2B would permit an adviser to rebut the presumption with respect to a particular event, in which case no disclosure to clients about the event would be required. We would, however, require an adviser rebutting a presumption of materiality to document that determination in a

In response to comments, we have clarified that an adviser would be required to disclose a proceeding that revoked or suspended the supervised person's professional attainment, designation, or license only if the action was a result of a violation of rules relating to professional conduct.[187] We also added a proposed requirement that the supplement describe any event over which the supervised person has ever resigned or otherwise relinquished a professional attainment, designation or license in anticipation of it being suspended or revoked (other than for suspensions or revocations for failure to pay membership dues). We believe clients would wish to know about these kinds of events as they may reflect on the integrity of the supervised person.

We believe our proposal strikes an appropriate balance among the concerns raised by commenters. We request comment on whether it does. Are there listed disciplinary events that we should remove or modify? Are there additional types of disciplinary events that we should list? For example, should we require disclosure of all cease and desist and censure orders? Are there other events, such as arbitration claims or awards, which could be characterized as disciplinary and should be disclosed in a supplement? If we were to require advisers to make disclosure regarding arbitration claims or awards, should we require such disclosure only if the award or claim exceeds a specified amount?

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memorandum and retain that record in order to better permit our staff to monitor compliance with this important disclosure requirement. The same standard as under Item 9 would apply, and similarly, a note in Item 3 would explain four factors the adviser should consider when assessing whether the presumption can be rebutted.

187 *See* CFP Board Letter; T. Rowe Price Letter.

If so, what should that amount be?[188] Is any of the proposed information not useful to advisory clients?

Item 4. Other Business Activities. Item 4 would require an adviser to describe other business activities of its supervised person. The item specifically would require disclosure with respect to other capacities in which the supervised person participates in any investment-related business and any conflicts of interest such participation may create.[189] In addition, we would require the supplement to include information about any compensation, including bonuses and non-cash compensation, the supervised person receives based on the sales of securities as well as an explanation of the incentives this type of compensation creates.[190] As we noted in the Proposing Release, this practice creates an incentive for the supervised person to base investment recommendations on his own compensation rather than on clients' best interests.[191] We are also proposing, with some revisions, a requirement to disclose *other* business activities or occupations that the supervised person engages in for pay.[192] Clients may have different expectations of an individual whose sole business is providing investment advice than of an individual who is engaged in other substantial business activities.

One commenter, the CFA, enthusiastically supported our proposal, stating that clients would benefit greatly from disclosures about a supervised person's other business activities. Two others, T.Rowe and the IAA, argued that disclosure of other business

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188 Determining whether to include disclosure of arbitration proceedings in brochure supplements raises the same issues as would be involved in requiring such disclosure in firm brochures. *See* discussion above at notes 69-70 and accompanying text.

189 Proposed Item 4.A of Part 2B.

190 Proposed Item 4.A.2 of Part 2B.

191 *See* Proposing Release at n. 219 and accompanying text.

192 Proposed Item 4.B of Part 2B.

activities should be limited to substantial investment-related activities that provide a major source of that person's income. We would continue to require disclosure of other business activities because we believe that, as reflected in the CFA's comments, investors would find this information helpful in assessing the conflicts created by those activities. We are not limiting the proposed disclosure of other investment-related activities to those characterized as "substantial," because we believe the client is in the best position to assess the significance of any other business activities and the impact that they may have on their advisory relationship.

We are, however, proposing to require disclosure about only those non-investment-related business activities or occupations that provide a substantial source of the supervised person's income or that involve a substantial amount of the supervised person's time. We believe this responds to commenters' concerns by eliminating unnecessary disclosure about relatively insignificant other business activities, while still requiring important disclosures that inform clients of the supervised person's primary business activities. We request comment as to this approach. We request comment specifically with regard to whether this information would be useful to a client's evaluation of a supervised person's competence. Further, we have not defined "substantial" for purposes of this item, preferring instead to leave some flexibility for advisers to determine whether their supervised persons' non-investment related business provides a substantial source of income or involves a substantial amount of time. Is our approach appropriate?

Item 5. Additional Compensation. This proposed item would require that the supplement describe arrangements in which someone other than a client gives the

supervised person an economic benefit (such as a sales award or other prize) for providing advisory services.[193] The proposed item would specify that regular salary need not be disclosed.

One commenter, the CFA, strongly supported this proposed item, while two others objected, arguing that it would require disclosure of confidential and proprietary business information of the adviser.[194] While we understand that firms may wish to keep sales awards or prizes, and similar incentive structures, confidential, these types of arrangements can create significant and material conflicts of interest that may bias the advice being presented. We believe clients need to know about these arrangements in order to assess the advisory services of a firm's supervised person. Are we correct? In addition, we request comment on alternatives that might strike a different balance between concerns about disclosure of advisers' confidential and proprietary business information with clients' need to be informed of material conflicts of interest.

Item 6. Supervision. This item would require an adviser to explain how the firm monitors the advice provided by its supervised person.[195] It also would require a firm to provide the client with the name, title and telephone number of the person responsible for supervising the advisory activities of the supervised person. This information would permit the client to contact other advisory personnel when necessary to address any problems in the advisory relationship. We are proposing this item in the same form as we

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193 Bonuses based (in part or whole) on sales, client referrals or new accounts would trigger required disclosure, but other bonuses would not.

194 DE Shaw Letter; DP&W Letter.

195 As we discuss in more detail above in Section II.B.1of this Release, we have narrowed the scope of supervised persons who would need a supplement. As a result, we do not believe it is necessary to propose, as we did in 2000, to require the supplement to discuss who formulates the advice a supervised person gives to clients.

proposed it in 2000. Commenters who addressed the item supported disclosure of information on the supervision of the individual that is the subject of the supplement.[196]

C. Filing Requirements, Public Availability, and Transition

We propose to amend our rules to require advisers to file their new brochures with us electronically through the IARD system, which would permit us to make them publicly available through our Web site.[197] Part 1 of Form ADV has been filed electronically and the information contained in it publicly available since 2001. At the time we adopted the amendments to Part 1, we exempted advisers from submitting Part 2 to us because the IARD was not ready to accept those filings.[198] The required system functionality is now available, and we therefore propose to reinstate the filing requirement so that we, and members of the public, may have ready access to adviser brochures.

The IARD is able to accept brochure filings using the Adobe Portable Document Format ("PDF"), which would allow advisers to capture information from any application on any computer system.[199] Utilizing PDF format would promote accessibility to brochure filings by enabling users of our public disclosure Web site to access and read brochures filed on IARD without having to possess the particular

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196 *See* AIMR Letter; CFA Letter.

197 Proposed rule 204-1(b). In some cases an adviser will not have to file a brochure because it is not required to deliver one. *See* above Section II.A.3 of this Release. When an adviser has not submitted a brochure as part of its Form ADV filing, the IARD system will generate an automated message asking an adviser that has not attached a brochure to its filing to confirm that it is not required to prepare a brochure.

198 *See* Note to current rule 204-1(c).

199 IARD system functionality for electronic filing of brochures is currently operational and the state securities regulators have been running a voluntary pilot program for advisers to file the current version of Part 2 using PDF.

software used by each adviser to prepare its brochure.[200] The PDF format, which limits transferability of computer viruses, also permits full-text search features that make it easy to locate words, bookmarks, and data fields within a brochure, and it permits the IARD to accept brochures that include graphics and charts, so that advisers who choose to use more elaborate brochures need not also prepare a plain text version solely for purposes of filing it with the Commission. We believe that the ability to accept PDF filings presents the most flexible and cost-efficient approach.[201] We request comment about whether advisers currently have access to PDF conversion software. We also request comment, however, on whether we should permit advisers to file their brochures in other electronic formats. If so, which ones and why? Should we consider requiring advisers to file brochure information that makes use of data tagging technologies and taxonomies such as eXtensible Business Reporting Language ("XBRL")?[202]

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200 PDF reader software is widely available and is a standard feature on most word processing software. Additionally, users may download this software for free from the Internet.

201 PDF converter software is already widely available and in many cases comes as a standard feature on word processing software. We anticipate that most, if not all, investment advisers will have access to such software, and thus would not need to incur additional expense associated with filing their brochure in PDF format were we to adopt this proposal. We are currently exploring options with the FINRA for making PDF converter software available to those investment advisers that do not already have it.

202 Data tagging uses standard definitions (or data tags) to translate text-based information into data that is interactive, *i.e.*, data that can be retrieved, searched, and analyzed through automated means. XBRL is a language for the electronic communication of business and financial data that was developed as an open source specification that describes a standard format for tagging financial and other information to facilitate the preparation, publication, and analysis of that information by software applications. In 2005 we adopted rules instituting a program that permits certain filers, on a voluntary basis, to submit specified, supplemental disclosure tagged in XBRL format as an exhibit to certain filings on the Commission's Electronic Data Gathering, Analysis and Retrieval System ("EDGAR"). *See XBRL Voluntary Financial Reporting Program on the EDGAR System*, Securities Act Release No. 8529 (Feb. 3, 2005) [70 FR 6556 (Feb. 8, 2005)]. In July 2007, we extended the voluntary reporting program to enable mutual funds to submit supplemental tagged information contained in the risk/return summary section of their

The IARD will provide advisers with access to the Part 2 Items and instructions. Instead of completing Part 2 on-line, advisers will create their brochure on their own computers and then attach the completed document to their filing on IARD, much like attaching a document to an e-mail. To update brochures, advisers will make the necessary changes on their own computers and then attach the revised versions to an IARD filing. The IARD will not accept an annual updating amendment without an updated brochure. However, if no changes are necessary when an adviser is submitting its annual updating amendment, an adviser will have the option of indicating on IARD that its current brochure does not contain any materially inaccurate information. If an adviser ceases to use a particular brochure, it will be able to eliminate it from its current filing. Our Web site will make only the firm's current filings publicly available because that filing should contain the most up-to-date information about the adviser.[203]

As proposed, advisers would not be required to file brochure supplements or supplement amendments with the Commission and therefore they will not be available on the Commission's public disclosure Web site.[204] We are not proposing to require filing of supplements so as to reduce the potential burdens on advisers and because the supplement disclosure requirement is designed primarily to provide advisers' clients with

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prospectuses. *Extension Of Interactive Data Voluntary Reporting Program On The Edgar System To Include Mutual Fund Risk/Return Summary Information*, Securities Act Release No. 8823 (July 11, 2007) [72 FR 39290 (July 17, 2007)].

203 As discussed above, historical filings would nonetheless be available for public inspection and copying in the Commission's Public Reference Room. *See* above note 153.

204 Proposed rules 203-1(b) and 204-1(c) and proposed Instruction 8 to Part 2B of Form ADV. Because brochure supplements would not be filed with us, they would not be required as part of any state notice filing. Section 307(a) of the National Securities Market Improvement Act of 1996, Pub. L. No. 104-290, 110 Stat. 3416 (1996) (state securities authorities may only require SEC-registered advisers to file with the states copies of those documents advisers have filed with the Commission).

background information about the particular supervised persons with whom they are dealing. We believe this information is less likely to be of interest to the general investing public.[205] Advisers would be required, however, to maintain copies of all supplements and amendments in their files.[206] We request comment on our approach. Should we require brochure supplements and amendments to brochure supplements to be filed with us through the IARD system and be made to available to the public through our Web site?

To provide adequate notice and opportunity to comply with the proposed brochure filing requirements, new applicants for registration with us as investment advisers would not be required to include their brochures as part of their initial application for registration until the date six months after the effective date of the amendments. After that date, however, the Commission would not accept any initial application for registration as an investment adviser that does not include a brochure that satisfies the requirements of Part 2A of Form ADV.[207]

Similarly, we believe it would be helpful to provide sufficient time for advisers already registered with us to prepare the new brochure and brochure supplements. Accordingly, we propose to implement a transition schedule requiring advisers to comply with the new Part 2 requirements by the date they must make their next annual updating amendment to Form ADV following the date the revised form becomes effective. In no

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205 We note that the disciplinary history of an adviser's supervised persons is required to be reported as part of the adviser's filing of Part 1 of Form ADV, and is available to the Commission through the IARD and to the public via the Commission's public disclosure Web site.

206 Proposed rules 203-1(b) and 204-1(c) and proposed Instruction 8 to Part 2B of Form ADV.

207 Proposed rule 203-1(a)(2).

case, however, would any adviser be required to comply with the new requirements earlier than six months after they become effective.[208] We request comment on our proposed implementation plan. Would a six-month period from the effective date of the revised form provide enough time for advisers to complete their new brochures? If not, please explain why and how much time advisers would need to complete their new brochures. Should implementation of the brochure requirements be on a separate timetable from implementation of the brochure supplement requirements?

III. AMENDMENTS TO FORM ADV INSTRUCTIONS AND GLOSSARY

In conjunction with the proposed Part 2 amendments, we are also proposing to make conforming amendments to the General Instructions and the Glossary of Terms for Form ADV. We propose amending the General Instructions to Form ADV to include instructions regarding brochure filing requirements. Similarly, we would amend the Glossary of Terms to add the following five terms that are used in proposed Part 2: (i) "brochure;"[209] (ii) "brochure supplement;"[210] (iii) "investment adviser representative;"[211] (iv) "supervised person;"[212] and (v) "wrap brochure or wrap fee

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208 Proposed rule 204-1(b)(2).

209 "Brochure" would mean: "A written disclosure statement that your firm is required to provide to clients and prospective clients." *See Form ADV: Glossary.*

210 "Brochure supplement" would mean: "A written disclosure statement containing information about certain of your supervised persons that your firm is required by Part 2B of Form ADV to provide to clients and prospective clients." *See Form ADV: Glossary*.

211 "Investment adviser representative" would mean:

> Any of your firm's supervised persons (except those that provide only impersonal investment advice) is an investment adviser representative, if --
>
> - the supervised person regularly solicits, meets with, or otherwise communicates with your firm's clients,
> - the supervised person has more than five clients who are natural persons and not high net worth individuals, and

program brochure."[213] We also would update the Glossary to reflect cross-references to these new terms, and cross-references to existing Glossary entries used in the revised portions of the Form.

We also are proposing to update the Glossary to correct a discrepancy in the definition of "Non-Resident" to make it consistent with the definition in rule 0-2, the Advisers Act rule related to the procedures for serving process, pleadings, and other papers on non-resident investment advisers, and advisers' non-resident general partners and managing agents. This proposed revision would properly effect the Commission's intent at the time the Glossary was originally adopted, that the definition of "Non-Resident" in the Glossary be the same as that in rule 0-2.[214] Although technical in nature, this amendment may potentially result in an increased number of corporate entities qualifying as non-resident general partners or managing agents of SEC-registered advisers. Certain entities would be required to file Form ADV-NR with the Commission

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- more than ten percent of the supervised person's clients are natural persons and not high net worth individuals. *See Form ADV: Glossary*.

212 "Supervised person" would mean: "Any of your officers, partners, directors (or other persons occupying a similar status or performing similar functions), or employees, or any other person who provides investment advice on your behalf and is subject to your supervision or control." *See Form ADV: Glossary*.

213 "Wrap brochure or wrap fee program brochure" would mean: "The written disclosure statement that sponsors of wrap fee programs are required to provide to each of their wrap fee program clients." *See Form ADV: Glossary*.

214 This proposed amendment would change the definition of "Non-Resident" to include "a corporation incorporated in *or* having its principal place of business in any place not subject to the jurisdiction of the United States." (Emphasis added). *See* rule 0-2(b)(2) [17 CFR 275.0-3(b)(2)]. The current Glossary definition includes a "corporation incorporated in *and* having its principal place of business in any place not subject to the jurisdiction of the United States." (Emphasis added). *See Form ADV: Glossary*. Inclusion in the current Glossary definition of the conjunctive "and" rather than the disjunctive "or" was unintentional.

to appoint agents for service of process because they relied on the glossary definition and did not previously file the form.

We request comment on these proposed amendments.

IV. AMENDMENTS TO RULE 204-2

We also are proposing conforming amendments to Advisers Act rule 204-2, the rule that sets forth the requirements for maintaining and preserving specified books and records, to require SEC-registered investment advisers to retain copies of each brochure, brochure supplement, and each amendment to the brochure and supplements that are prepared as required under the rule 204-3.[215] This proposed change is designed to update the books and records rule in light of our proposed changes to Part 2.[216] Additionally, the proposed amendments would require SEC-registered advisers to prepare and preserve documentation of the method they use to compute managed assets for purposes of Item 4.E in Part 2A of Form ADV, if that method differs from the method used to calculate "assets under management" in Part 1A of Form ADV.[217] The amendments also would require advisers to prepare and preserve a memorandum describing any legal or disciplinary event listed in Item 9 in Part 2A and Item 3 in Part 2B of Form ADV for the period the event is presumed material, if the event is not disclosed in the adviser's

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215 Proposed rule 204-2(a)(14)(i). The proposed rule also would require advisers to keep and maintain a copy of any summary of material changes that is not included in the brochure or brochure supplements, as well as a record of the dates that each brochure, supplement, amendment, and summary of material change was given to any client. *See* discussion above at notes 27-29 and accompanying text.

216 Currently, rule 204-2(a)(14) requires advisers to maintain copies of written statements and amendments given or delivered to any client or prospective client under existing rule 204-3. Thus, advisers already are required to maintain copies of their brochures.

217 *See* discussion above at note 33.

brochure or the relevant brochure supplement.[218] These records would be required to be maintained in the same manner, and for the same period of time, as other books and records required to be maintained under rule 204-2(a). We request comment on these proposed amendments.

V. GENERAL REQUEST FOR COMMENT

The Commission requests comment on the amendments proposed in this Release, suggestions for other additions to the amendments, and comment on other matters that might have an effect on the proposals contained in this Release. For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996, the Commission also requests information regarding the potential impact of the proposed amendments on the economy on an annual basis. Commenters should provide empirical data to support their views.

VI. PAPERWORK REDUCTION ACT

Certain provisions of the rule and form amendments that we are proposing today contain "collection of information" requirements within the meaning of the Paperwork Reduction Act of 1995 ("PRA").[219] The Commission is submitting these proposed amendments to the Office of Management and Budget ("OMB") for review in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. The titles for these collections of information are "Form ADV," "Rule 204-2," "Rule 204-3," and "Rule 206(4)-4," all under the Advisers Act. These rules and forms contain currently approved collection of information numbers under OMB control numbers 3235-0049, 3235-0278, 3235-0047,

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218 *See* discussion above at notes 65-66 and accompanying text, and note 186.

219 44 U.S.C. 3501 *et seq*.

and 3235-0345, respectively. An agency may not sponsor, conduct, or require response to an information collection unless it displays a currently valid OMB number.

The respondents to the collections of information are investment advisers registered or applying for registration with us. We use the information to determine eligibility for registration with us and to manage our regulatory and examination programs. Clients use certain of the information to determine whether to hire or retain an adviser.

The amendments to Form ADV we are proposing involve three distinct "collections of information" for purposes of the Paperwork Reduction Act. The first is the collection of information connected with Form ADV itself, specifically our proposed amendments to Part 2 of Form ADV. The second collection of information involved is that under the proposed amendment to rule 204-2, which requires advisers to maintain and preserve specified books and records. The third collection involved is that related to a proposed amendment to rule 204-3, which requires advisers to deliver certain of the information required under Form ADV to their clients.

In addition, we are proposing to withdraw rule 206(4)-4, the rule requiring advisers to disclose certain disciplinary and financial information, because that rule will become duplicative if the amendments to Part 2 of Form ADV are adopted. We incorporate the discussion of our proposed withdrawal of rule 206(4)-4 into the discussion of Part 2 of Form ADV below.

A. Amendments to Form ADV (17 CFR 275.203-1, 275.204-1, and 279.1)

We are proposing amendments to Part 2 of Form ADV to provide advisory clients with clear, current, and more meaningful disclosure in a narrative, plain English format.

Rules 203-1 and 204-1 already require every applicant for investment adviser registration with us to file Form ADV through the IARD and require every investment adviser registered with us to file amendments to Form ADV through the IARD at least annually.[220] As proposed, the amendments to rules 203-1 and 204-1 and to Part 2 of Form ADV also would require advisers registered with us to prepare and electronically file firm brochures required by Part 2A, and to maintain copies of brochure supplements that they deliver to clients.

The information required by the proposed amendments to Form ADV is mandatory. Responses are not kept confidential. Under section 204 of the Advisers Act, investment advisers required to register with the Commission must make and keep certain records, including those related to Form ADV, for prescribed periods, generally for a period of at least five years, and must make and disseminate certain reports. In 2000, when we originally proposed revisions to Form ADV (including Part 2), we sought OMB approval of the increased burden stemming from the revised form.[221] The collection of information was approved and has subsequently been amended. The currently approved total annual burden for all advisers completing, amending, and filing revised Form ADV (Parts 1 and 2) with us, is 109,678 hours.[222] Because of the passage

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220 Presently, advisers must submit Part 1 of Form ADV to us through the IARD system, but are not required to submit a copy of current Part 2 of Form ADV to the Commission if they maintain in their files a copy of their Part 2 (and of any brochure they deliver to clients). The copy they maintain in their files is considered filed with the Commission.

221 *See* Proposing Release, above note 5.

222 The paperwork burdens associated with rules 203-1 and 204-1 are included in the approved annual burden associated with Form ADV and thus, do not entail a separate collection of information.

of time and modifications to the original proposal, we intend to resubmit the collection of information under Form ADV to OMB for approval.

1. Part 2 of Form ADV

In the Proposing Release, we acknowledged that the proposed amendments to Form ADV (including those to Part 2) would at first increase the then-current paperwork burden because most advisers would have to redraft and disseminate a narrative brochure and brochure supplements. We noted that most of the new paperwork burden would be incurred in this initial preparation, specifically in drafting the narrative text. We further observed that once the adviser has redrafted its narrative brochure, proposed Parts 2A and 2B were not expected to result in any significant burden increase over time (except for changes to the brochure that are necessitated by changes in the adviser's business). We continue to believe that the initial paperwork burden will be higher and that the efficiencies of filing through IARD, over time, are expected to reduce the initial burdens associated with completing the revised Form ADV.

The Commission staff previously estimated that during the first year that an adviser responds to Form ADV, including amended Part 2, an average investment adviser's total collection of information burden would be 22.25 hours per adviser.[223] We estimated that this average annual burden per adviser would apply to both new registrants applying for registration with us, as well as to current registrants required to amend their

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223 In the Proposing Release we estimated that during the first year, advisers' use of the revised form would result in an average annual collection burden of 22 hours per adviser. *See* Section IV of the Proposing Release. In conjunction with adoption of our rule requiring advisers to adopt codes of ethics, we amended this estimated burden by adding 0.25 hours to reflect the requirement that an adviser's Part 2 contain a description of its code of ethics and a statement that a copy of the code is available upon request. *See* Code of Ethics Adopting Release above note 78.

Form ADVs as a result of the proposed revisions. This estimate included time for preparation of brochures and brochure supplements in addition to the burden of preparing Part 1A. A few commenters, particularly those representing large advisory firms, disagreed with the Commission staff's estimate, arguing that it would take advisers much more time to complete and distribute their new narrative brochure and brochure supplements.[224] Large firms asserted that they would have "thousands" of employees for whom supplements would have to be prepared.

We appreciate the different costs that small versus large firms may experience, and so we have made it clear that our estimate is an average that takes into consideration the thousands of advisers that have a small number of employees as well as the few advisers that have thousands of employees. As of September 30, 2007, there were 10,817 investment advisers registered with the Commission, and nearly 82 percent of these advisers have 10 or fewer employees performing advisory functions on their behalf compared to less than one third of one percent of advisers who have more than 1,000 employees.[225] Moreover, the paperwork burden of preparing a narrative firm brochure is likely to vary substantially among advisers, in part because proposed Part 2A would give an adviser considerable flexibility in structuring its disclosure, and also because the amount of disclosure required would vary among advisers.[226] The burdens associated

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224 *See, e.g.*, Crist Letter; SIFMA Letter; Comment Letter Dechert Price and Rhoads (June 14, 2000).

225 *See* note 176 above.

226 Additionally, since the 2000 proposal, we have made certain revisions to the proposed form that scale back the types of clients for whom brochures and supplements must be delivered. These revisions should actually have the effect of reducing the number of advisers who are required to prepare and update brochures, and thus may actually reduce somewhat the burden of the revised Form ADV from what was originally proposed.

with preparing the new brochures will depend on the size of the adviser, the complexity of its operations, and the extent to which its operations present conflicts of interest with clients. Many of the new items imposing the most rigorous disclosure requirements may not apply to certain small advisers because, for example, those advisers may not have soft dollar or directed brokerage arrangements, or may not have custody of client assets. Accordingly, based on our consultations with industry representatives, we estimate that the average initial annual burden associated with Form ADV may range from as little as 5 hours for smaller advisers, to approximately 50 hours for medium-sized advisers, to as much as nearly 3,300 hours for larger advisers.[227] Based on IARD data, we estimate that there are approximately 8,835 small advisers, 1,952 medium-sized advisers, and 30 large advisers.[228] As such, we believe that 22.25 hours remains an accurate reflection of the time that it will take the *average* adviser to complete revised Form ADV (including both Parts 1 and 2).[229]

As under the currently approved collection, the estimated initial burdens associated with using the revised form would be amortized over the estimated period that advisers would use their revised brochure. Thus, we have amortized the paperwork burdens of the revised form over a three-year period.[230] Respondents under this

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227 For purposes of this estimate, we have categorized small advisers as those with 10 or fewer employees, medium-sized advisers as those with between 11 and 999 employees, and large advisers as those with 1,000 or more employees.

228 Unless otherwise noted, the IARD data cited below is based on advisers' responses to questions on Part 1A of Form ADV as of September 30, 2007.

229 [8,835 small advisers x an estimated 5 hours/adviser] + [1,952 medium-sized advisers x an estimated 50 hours/adviser] + [30 large advisers x an estimated 3,296 hours/adviser] = 240,655 hours total. 240,655 hours / 10,817 total advisers = 22.25 hours/adviser.

230 In the Proposing Release, the Commission staff chose a fifteen-year amortization period to reflect the anticipated period of time that advisers would use the revised form.

collection of information would be advisers currently registered with the Commission as well as new applicants for investment adviser registration with the Commission. We estimate that approximately 1,000 new applicants apply for registration as investment advisers each year. Thus, in combination with the approximately 10,817 existing investment advisers registered with the Commission, we estimate that the total number of respondents under this collection of information would be 11,817 advisers. Based on the estimated average collection of information burden of 22.25 hours per adviser, the total initial collection of information would amount to 22,250 hours for new registrants and 240,678.25 hours for currently registered advisers that re-file Form ADV (including Part 2) through the IARD system, for a total of 262,928.25 hours.[231] Amortizing this total burden imposed by Form ADV over a three-year period would result in an average burden of an estimated 87,643 hours per year,[232] or of 7.42 hours per year for each new applicant and for each adviser currently registered with the Commission that would re-file through the IARD.[233]

We further estimate that some advisers may incur a one-time initial cost including outside legal fees in connection with preparation of Form ADV (including preparation of Part 2). As we discuss above, advisers subject to the Form ADV requirements vary widely in terms of the size, complexity and nature of their advisory business, and thus,

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However, for purposes of our current proposal, we are amortizing the estimated burden over a shorter period of time – three years – and have submitted to OMB an amendment to this collection of information to reflect this approach.

231 Based on historic IARD registration data, we estimate that approximately 1,000 new applicants for registration with the Commission each year. (10,817 current registrants x 22.25 hours) + (1,000 new applicants x 22.25 hours) = 240,678.25 hours + 22,250 hours = 262,928.25 hours.

232 262,928.25 hours / 3 years = 87,642.75 hours/year.

233 87,643 hours / 11,817 advisers = 7.42 hours/adviser.

the amount of disclosure required, would vary substantially among advisers. Accordingly, the amount of time, and thus cost, required for outside legal review is likely to vary substantially among those advisers who elect to obtain outside legal assistance. We estimate that the initial per adviser cost related to preparation of Form ADV may range from as little as $1,200 for smaller advisers, to $4,400 for medium-sized advisers, to as much as $10,400 for larger advisers.[234] Similarly, whether an adviser even seeks outside legal services in drafting their Form ADV will depend on the size, complexity and nature of their advisory business. We believe that a substantial percentage of advisers, particularly smaller advisers, are unlikely to seek such outside legal services. We estimate that only a quarter of smaller advisers, or about 2,209 advisers, are likely to seek outside legal services. Similarly, we estimate that approximately half of medium-sized advisers, or 976 advisers, are likely to seek such services.[235] On the other hand, advisers with more significant conflicts are more likely to engage outside legal services to assist in preparation of Form ADV. On this basis we estimate that all of the 30 larger advisers registered with the Commission are likely to incur costs related to such outside legal services. Thus, we estimate that approximately 3,215 advisers, will elect to obtain outside legal assistance, for a total cost among all respondents of $7,257,200.[236]

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234 Outside legal fees are in addition to the projected hourly per adviser burden discussed above. $400 per hour for legal services x 3.0 hours per small adviser = $1,200. $400 per hour for legal services x 11 hours per medium-sized adviser = $4,400. $400 per hour for legal services x 26 hours per large adviser = $10,400. The hourly cost estimate of $400 is based on our consultation with advisers and law firms who regularly assist them in compliance matters.

235 8,835 small advisers x 0.25 = 2,208.75. 1,952 medium-sized advisers x 0.5 = 976.

236 ($1,200 x 2,209 advisers) + ($4,400 x 976 advisers) + ($10,400 x 30 advisers) = $7,257,200.

In addition to the burdens associated with initial completion and filing of the revised form, we estimate that on average, each adviser filing Form ADV through the IARD system will likely amend its form 1.5 times during the year.[237] We estimate that the collection of information burden for amendments would be 0.75 hours per amendment. Thus, we estimate that advisers will file an estimated total of 17,725.5 amendments per year for an estimated total paperwork burden of 13,294 hours per year.[238]

Therefore the total annual collection of information burden for advisers to file and complete the revised Form ADV (Parts 1 and 2), including the initial burden for both existing and anticipated new registrants plus the burden associated with amendments to the form, is estimated to be approximately 100,976 hours per year.[239] In addition to these estimated burdens, under this collection of information there is also a burden of 11,971 hours associated with advisers' obligations to deliver to clients copies of their adviser codes of ethics.[240] Thus, the estimated revised total annual hourly burden under this

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237 This estimate is based on IARD system data regarding the number of filings of Form ADV amendments.

238 11,817 advisers x 1.5 amendments per year = 17,725.5 amendments per year. 17,725.5 amendments x 0.75 hours = 13,294.125 hours.

239 13,294 hours per year attributable to amendments + (1,000 new registrants each year x 7.42 hours) + (10,817 currently-registered advisers x 7.42 hours) = 13,294 hours + 7,420 hours + 80,262.14 hours = 100,976.14 hours.

240 *See* Code of Ethics Adopting Release, above note 78. The current approval of this collection estimates that ten percent of an adviser's clients would make such requests, however, subsequently obtained information based on discussions with the industry regarding actual practice indicates that such requests occur significantly less frequently than previously estimated, thus, we have modified our estimate. We now estimate that only one percent of an adviser's clients actually request a copy the adviser's code of ethics. 0.01 x 1,013 (the estimated average number of clients per adviser) = 10.13 requests per registrant. *See* note 258 below regarding the estimated average number of clients. We continue to estimate that responding to each such request involves a burden of 0.10 hours, amounting to an annual burden of 1.013 hours for each adviser stemming

collection of information would be 112,947 hours.[241] This represents an increase of 3,269 hours per year from the currently approved burden.[242]

2. Rule 206(4)-4

Rule 206(4)-4 currently requires advisers to disclose certain disciplinary and financial information to clients. We are proposing to rescind rule 206(4)-4 and to incorporate its substantive provisions into Part 2A of Form ADV. The collection of information burden associated with the requirements of rule 206(4)-4 has been incorporated into the collection of information requirements for Form ADV, discussed above. Thus, the currently approved burden estimate for Form ADV already includes an estimate of the burdens associated with the disclosure of disciplinary and financial information connected with proposed Part 2.

B. Rule 204-2

This requirement is found at 17 CFR 275.204-2 and is mandatory. The Commission staff uses the collection of information in its examination and oversight program, and the information generally is kept confidential.[243] The likely respondents to this collection of information requirement are all of the approximately 10,817 advisers currently registered with the Commission.

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from the obligation to deliver copies of their codes of ethics to clients. 10.13 requests per adviser x 0.10 hours = 1.013 hours/adviser. This obligation applies to both currently-registered (10,817 respondents) and newly-registered advisers (1,000 respondents), for a total annual burden of 11,971 hours. 11,817 respondents x 1.013 hours = 11,970.621 hours.

241 11,971 hours + 100,976 hours = 112,947 hours.

242 Revised burden 112,947 hours - currently approved burden of 109,678 hours = 3,269 hours. As discussed above, the currently approved burden includes the estimated paperwork burdens associated with all the revisions to Form ADV that were proposed in 2000.

243 *See* section 210(b) of the Advisers Act (15 U.S.C. 80b-10(b)).

Under section 204 of the Advisers Act, investment advisers required to register with the Commission must make and keep certain records for prescribed periods, generally for a period of at least five years, and must make and disseminate certain reports. Rule 204-2 sets forth the requirements for maintaining and preserving specified books and records.

The amendments to rule 204-2 that we are proposing today would require SEC-registered advisers to prepare and preserve a memorandum describing any legal or disciplinary event listed in Item 9 in Part 2A and Item 3 in Part 2B of Form ADV, if the event is not disclosed in the adviser's brochure or the relevant brochure supplement. This revision is the same as originally proposed. Additionally, the amendments would also require SEC-registered investment advisers to prepare and preserve documentation of the method they use to compute managed assets for purposes of Item 4.E. in Part 2 of Form ADV, if that method differs from the method used to calculate "assets under management" in Part 1A of Form ADV. These records would be required to be maintained in the same manner, and for the same period of time, as other books and records required to be maintained under rule 204-2(a).

As discussed in the Proposing Release, Commission staff had estimated that the proposed amendments to rule 204-2 would result in a burden increase of four hours for each of the then estimated 110 Commission-registered advisers that would be required to prepare and preserve additional records as a result of the amendments. We continue to

believe that the proposed amendments to rule 204-2 will result in an increased burden of four hours for each adviser subject to the additional requirements.[244]

We estimate that 325 advisers will use a method for computing managed assets in Part 2 that differs from the method used to compute assets under management in Part 1A and thus would be required to prepare and preserve documentation describing the method used in Part 2.[245] We also estimate that 162 advisers will conclude that the materiality presumption in Part 2 is overcome with respect to a legal or disciplinary event, will determine not to disclose that event, and therefore would be required to prepare and preserve a memorandum describing the event.[246]

As discussed earlier, in the Proposing Release Commission staff had estimated that 110 advisers would have to prepare and preserve additional records in accordance with the amendments to rule 204-2. However, we now estimate that a total of 487 advisers will have to prepare and preserve additional records in accordance with

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244 The proposed rule did not require documentation for Item 4.E computations that differed from Part 1A, Item 5.F of Form ADV. We estimate that the additional recordkeeping requirement applicable to advisers who use an alternative method of asset calculation will take approximately the same amount of time (4.0 hrs) as that required by advisers who compose memoranda with respect to undisclosed legal/disciplinary events.

245 Based on the Commission staff's conversations with industry professionals, we anticipate that approximately three percent of the 10,817 advisers registered with us as of September 30, 2007 will use a method for computing managed assets in Part 2 of Form ADV that differs from the method used to compute assets under management in Part 1A of Form ADV. 10,817 advisers x 0.03 = 324.51 advisers.

246 Approximately 1,620 advisers registered with the Commission report disciplinary information in Part 1A of their Form ADV as of September 30, 2007. We anticipate that most of these advisers will include all disciplinary information in their brochures and supplements, but that approximately 10 percent of these advisers, or 162, will need to prepare and preserve a memorandum explaining their basis for not disclosing a legal or disciplinary event listed in Part 2 that is not disclosed in their brochures and supplements. 1,620 advisers x 0.10 = 162 advisers.

amendments to rule 204-2.[247] Only 110 of these are already accounted for in the currently approved burden estimate. We estimate that the additional 377 advisers whom we anticipate will be subject to the amended provisions of rule 204-2, will yield a 1,508 hour burden increase under rule.[248]

The approved annual aggregate burden for rule 204-2 is currently 1,762,267 hours based on an estimate of 9,728 registered advisers, or 181.15 per registered adviser.[249] Taking into account the estimated increased burden of 1,508 hours as discussed above, as well as an increase of 1,089 registered advisers,[250] the revised annual aggregate burden for all respondents to the recordkeeping requirements under rule 204-2 is therefore estimated to be 1,961,048 total hours.[251]

We further estimate that some advisers may incur a one-time cost including outside legal fees in connection with preparation of a memorandum explaining their basis for not disclosing a legal event listed in Part 2 in their brochures or supplements. We estimate this one-time cost would include fees for approximately three hours of outside

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247 325 advisers that we estimate would prepare memoranda regarding alternative method for calculating assets under management + 162 advisers that we estimate would prepare memoranda regarding unreported nonmaterial disciplinary events = 487 advisers.

248 487 advisers – 110 advisers = 377 advisers. 377 advisers x 4.0 hours = 1,508 hours.

249 1,762,267 hours / 9,728 registered advisers = 181.15 hours per adviser.

250 As stated above, our IARD data show that as of September 30, 2007 there were 10,817 advisers registered with the SEC. 10,817 – 9,728 = 1,089.

251 1,762,267 current burden hours + 1,508 hours due to an increase in the estimated number of registered advisers subject to additional recordkeeping under the amendments + (1,089 due to an increase of total number of registered advisers x 181.15 hours per adviser) = 1,961,048. The annual average burden per SEC-registered adviser is therefore 181.29 hours. 1,961,048 total hours / 10,817 advisers = 181.29 hours per adviser.

legal review and would amount on average to approximately $1,200 per adviser.[252] We believe that approximately 80 percent of the advisers preparing such memoranda would likely to engage outside legal services to assist in their preparation. Thus, we estimate that approximately 130 advisers, will incur these costs, for a total cost among all respondents of $156,000.[253]

C. Rule 204-3

Rule 204-3 contains a collection of information requirement. This collection of information is found at 17 CFR 275.204-3 and is mandatory. Responses are not kept confidential. The likely respondents to this information collection are the approximately 10,817 investment advisers registered with the Commission.

Rule 204-3 currently requires an investment adviser to deliver to clients, at the start of an advisory relationship, a copy of Part 2 of Form ADV or a written document containing at least the information required by Part 2 of Form ADV. The rule currently requires no further brochure delivery unless the client accepts the adviser's required annual offer. The brochure assists the client in determining whether to hire or retain an adviser.

The amendments to rule 204-3 would require advisers registered with us to deliver their brochures and brochure supplements at the start of an advisory relationship and to deliver their firm brochure annually thereafter.[254] The amendments also would

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252 Outside legal fees are in addition to the projected hourly per adviser burden discussed above. $400 per hour for legal services x 3 hours per adviser = $1,200. The hourly cost estimate is based on our consultation with advisers and law firms who regularly assist them in compliance matters.

253 162 advisers x 0.80 = 129.6. $1,200 x 130 = $156,000.

254 Proposed rule 204-3(b).

require that advisers deliver updates of the brochure and brochure supplements to clients only when disciplinary information in the brochure or supplements becomes materially inaccurate.[255] The updates could take the form of a revised brochure (or supplement) or a "sticker" containing the updated information. This represents a departure from the originally proposed requirements which would have required an ongoing obligation to deliver updates involving any material information in the brochure or supplement, not just disciplinary information.

The total annual burden currently approved by OMB for rule 204-3 is 6,902,278 hours and is based on the requirements of the rule as proposed in 2000.[256] This currently approved burden is based on each adviser having, on average, an estimated 670 clients.[257] Our records now currently indicate that the 10,817 advisers registered with the Commission have, on average, 1,013 clients.[258] These changes, along with our proposal

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255 Proposed rule 204-3(e). We received comments that were critical of that proposal and that also suggested alternative approaches. In response to those comments, we are now proposing a narrower scope of the updating requirement.

256 Following issuance of the Proposing Release, OMB approved a burden of 411,075 hours. That estimate assumed, in part, that approximately 8,100 advisers were registered with us and that each adviser had, on average, 49 clients. OMB subsequently approved an increase in the annual burden to 6,902,278 hours to reflect assumptions regarding an increased number of SEC-registered advisory firms and an increased estimate with respect to the average number of clients per adviser. This currently approved burden is based on the proposed delivery requirements (initial delivery plus interim stickering) and assumptions (an initial bulk mailing at 0.25 hours and 2 stickers per year for each SEC-registered firm at 0.5 hours per sticker) that were discussed in the Proposing Release.

257 This average was based on advisers' responses to Item 5.C of Part 1A of Form ADV as of October 5, 2001.

258 This average is based on advisers' responses to Item 5.C of Part 1A of Form ADV as of September 30, 2007, excluding the two advisers that reported the largest number of clients. Those advisers account for over 43 percent of all advisory clients of SEC registrants and not excluding them would raise the average client count to 1,778 clients. These two firms provide advisory services primarily over the Internet and currently meet their brochure obligations electronically, thus essentially entirely eliminating for these advisers any PRA burden associated with delivery under this rule. Therefore, we believe

to require annual brochure delivery along with interim delivery only of brochure and supplement updates that involve disciplinary information (in lieu of the originally proposed ongoing delivery obligation) alter the collection of information burden from that currently approved.

We expect that advisers will send their brochures annually in a "bulk mailing" to clients. We estimate that, with a bulk mailing, an adviser will require no more than 0.25 hours to send the adviser's firm brochure to each client, or an annual burden of 253.25 hours per adviser.[259] Thus, we estimate the total burden hours for 10,817 advisers to distribute their firm brochure to existing clients initially and annually thereafter to be 2,739,405 hours per year.[260]

Advisers also will be required to distribute interim updates disclosing new or revised disciplinary information in their brochure or supplements. We anticipate that in any given year, the number of such interim updates that advisers will be required to

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that it is appropriate to exclude these firms from our calculations. Even removing these advisers discussed above, the "typical" adviser registered with the Commission, has far fewer clients than suggested by this average. The average is still heavily weighted by the responses received from the few largest advisers. We note that the next five advisory firms with the largest numbers of clients account for more than an additional 15 percent of all clients. In contrast, the majority (over 60 percent) of advisers registered with us have 100 or fewer clients, and the vast majority (over 90 percent) have 500 or fewer. Based on a median, we estimate that the "typical" adviser registered with us has approximately 63 clients – that is, half of Commission-registered advisers have more than 63 clients and half have fewer. This median is consistent with advisers' modal response (the most common response) to Item 5.C of Part 1A, which was "26 to 100 clients."

259 (0.25 hours per client x 1,013 clients per adviser) = 253.25 hours per adviser. This is the same estimate we made in the 2000 proposal and for which we received no comment. We note that the burden for *preparing* brochures is already incorporated into the burden estimate for Form ADV discussed above. We anticipate that most advisers will make their annual delivery of their brochure as part of the annual bulk mailings they already make to clients.

260 (0.25 hours per client x 1,013 clients per adviser) x 10,817 advisers = 2,739,405.25 hours.

deliver is approximately 541.[261] We further estimate that an adviser will require no more than 0.5 hours per client for delivery of each such update.[262] This represents about 507 hours per interim update.[263] Thus, the aggregate annual hour burden for affected advisers to deliver interim updates to their brochures and supplements will be approximately 274,287 hours per year.[264]

Thus, the rule amendments requiring annual delivery and interim updating of advisers' brochures and supplements yields a total collection of information burden for rule 204-3 of 3,013,692 hours per year, or 279 hours per respondent.[265] This represents a decrease of 3,888,586 hours from the currently approved PRA burden.[266] The reduced burden results primarily from our proposal to replace the originally proposed requirement to deliver brochure and supplement updates on an ongoing basis, with a requirement to only deliver brochure updates once annually and interim amendments to brochures and supplements only when such updates involve disciplinary information. This change thus

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261 Just under fifteen percent of the advisers currently registered with the Commission report any disciplinary events at all on their Form ADVs (as of September 30, 2007, only 1,620 of all 10,817 registered advisers indicated at least one "yes" answer to a question related to disciplinary events in Form ADV, Part 1A, Item 11). Thus, we anticipate that a correspondingly small number of advisers will be required to disclose new or updated disciplinary information. The Commission staff estimates that in any given year, five percent of advisers, will be required to deliver a single interim update to each of their clients, resulting in a total of approximately 522 interim updates per year. 0.05 x 10,817 x 1 update = 540.85 updates.

262 This burden estimate relates only to the amount of time it will take advisers to *deliver* interim updates to clients, as required by the rule amendments. The burden for *preparing* interim updates is already incorporated into the burden estimate for Form ADV discussed above.

263 0.5 hours per client x 1,013 clients per adviser = 506.5 hours per update.

264 541 updates x 507 hours = 274,287 hours.

265 2,739,405 hours (initial and annual delivery) + 274,287 hours (interim delivery of updates to disciplinary information) = 3,013,692 hours. 3,013,692 hours / 10,817 advisers = 278.61 hours per adviser.

266 6,902,278 hours - 3,013,692 hours = 3,888,586 hours.

significantly reduces the estimated total number of updates advisers will be required to deliver annually.[267]

D. Request for Comment

With respect to the above-described collections of information and pursuant to 44 U.S.C. 3506(c)(2)(B), the Commission solicits comments to: (i) evaluate whether the proposed collections of information is necessary for the proper performance of the functions of the agency, including whether the information shall have practical utility; (ii) evaluate the accuracy of the Commission's estimates of the burdens of the proposed collections of information; (iii) determine whether there are ways to enhance the quality, utility, and clarity of the information to be collected; and (iv) evaluate whether there are ways to minimize the burdens of the collections of information on those who are to respond, including through the use of automated collection techniques or other forms of information technology.

Persons submitting comments on these collections of information requirements should direct them to the Office of Management and Budget, Attention: Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington, DC 20503, and should also send a copy of their comments to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090, with reference to File No. S7-10-00. Requests for materials submitted to OMB by the Commission with regard to these collections of information should be in writing, with reference to File No. S7-10-00, and be submitted to the Securities and

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[267] This reduction in hours is offset somewhat by the fact that we have increased the estimated number of clients per adviser who will receive brochures and supplements and interim updates to these.

Exchange Commission, Records Management, Office of Filings and Information Services, 100 F Street, NE, Washington, DC 20549-1090. As OMB is required to make a decision concerning the collections of information between 30 and 60 days after publication, a comment to OMB is best assured of having its full effect if OMB receives it within 30 days of publication.

VII. COST-BENEFIT ANALYSIS

A. Background

The Commission is sensitive to the costs and benefits of its rules. As proposed, this rulemaking would revise Part 2 of Form ADV to require advisers to prepare plain English narrative brochures discussing their business practices and conflicts of interest and to prepare brochure supplements discussing the background and disciplinary history of certain supervised persons who formulate investment advice or exercise investment discretion for clients. The revisions to the form would essentially move into the form itself existing rule provisions that require advisers to disclose certain disciplinary and financial information. In conjunction with these revisions the Commission is proposing to withdraw rule 206(4)-4 as duplicative.

The proposed rulemaking would require advisers to deliver the narrative brochures to clients at the outset of the advisory relationship and annually thereafter, and to deliver to each client an initial brochure supplement for each supervised person who provides advisory services to that client. Advisers would be required to deliver to clients interim updates to their brochure and brochure supplements that involve a change to certain disciplinary information required by Part 2. The rules would provide exceptions to the brochure and supplement delivery requirements for certain types of clients, and

would excuse the adviser from preparing a brochure or supplement if there is no client to whom it must be delivered. The proposed rule amendments would also require advisers to file their narrative brochures electronically through the IARD, and to keep certain records relating to the brochures and supplements.

We have identified certain costs and benefits, discussed below, that may result from the proposed rule and form amendments. In the Proposing Release,[268] we analyzed costs and benefits of the proposed amendments to Part 2 and the related rules and requested comment and data on the effect they would have on individual investment advisers and on the advisory industry as a whole. We are now able to make more detailed estimates of costs, based on data available through the IARD system, and we provide those below.[269] We request comment on the costs and benefits of the proposed amendments. We encourage commenters to identify, discuss, analyze, and supply relevant data regarding these or any additional costs and benefits.

B. Form ADV Part 2 and IARD Filing

As discussed above, the proposed revisions to Part 2 would require most advisers to prepare plain English narrative brochures.[270] Advisers would file their brochures electronically through the IARD in a process much like attaching a file to an email.

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268 *See* above note 5.

269 As discussed above in note 2 of this Release and unless otherwise noted, the IARD data cited below is based on advisers' responses to questions on Part 1A of Form ADV as of September 30, 2007.

270 Under the amendments, advisers that are not required to deliver a brochure to clients would not be required to prepare one. Advisers that provide only impersonal advice costing less than $500 per year per client, and advisers only to registered investment companies, would therefore not be required to prepare a brochure. We estimate, based on information filed with us on Form ADV, that approximately 295 advisers provide their services only to registered investment companies and therefore would not need to prepare a brochure. Based on Form ADV filings, we estimate that less than 10 advisers offer

The new narrative brochures and electronic filing would provide substantial benefits to advisory clients. The brochures would present clients with critically important information they need to determine whether to hire or continue the services of a particular adviser. This information would be presented in a format easy for most investors to understand. Investors searching for an adviser would be able to access the firm's brochures through our public disclosure Web site even before contacting the firm, and thus would be in a better position to know whether they wish to inquire further about the services the firm is offering. We believe these benefits to advisory clients will be a significant enhancement to the adviser disclosure regime. These benefits, while substantial, are difficult to quantify. Most commenters strongly supported the narrative, plain English format, and viewed it as an improvement over the current form. They agreed that the new brochures would greatly benefit clients by requiring advisers to present important information about their firms in a clear and more meaningful way. They observed that the enhanced disclosure required by the revised form would benefit clients by better equipping them with the knowledge to make informed decisions about whether to hire or retain a particular adviser.

Advisers themselves would also benefit from the flexibility the new narrative brochures would give them. Advisers would be able to organize their brochures in the manner that they believe best communicates the required disclosure to their clients. Advisers would also only be required to respond to items that apply to their business,

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advisory services only by publishing periodicals and newsletters; we estimate that approximately half of these charge less than $500 per year per client and would not need to prepare a brochure. Moreover, because advisers need not deliver supplements to clients that do not receive a brochure, these advisers would also be excused from preparing any brochure supplements.

thus substantially enhancing the efficiency and minimizing the costs of preparing brochures and supplements. Moreover, the new amendments provide significant guidance to advisers in terms of highlighting the types of disclosures they, as fiduciaries, are already required to make. We believe the flexibility created by the revisions, as well as the enhanced clarity the new form provides will yield substantial benefits for advisers.

We recognize, however, that revised Part 2 would also impose costs on advisers. Advisers would be required to replace their current Part 2 with the new narrative brochure and supplements, and would be required to file their brochures with us. In addition, the disclosure in the new brochure may be more complete than that existing Form ADV Part 2 currently requires. Thus, drafting the new narrative brochure will likely entail additional expenses. As discussed in the Proposing Release, we believe that most of the costs that advisers will incur in connection with preparation of the new narrative firm brochure and brochure supplements will be in the initial drafting of these documents.[271] We do not expect that revised Part 2 would result in a significant cost increase on a long-term basis.

The cost of preparing a narrative brochure likely would vary significantly among advisers, depending on the complexity of their operations and because Part 2 would give advisers considerable flexibility in structuring their disclosure. Some firms may choose to prepare multiple brochures for several different services. These firms likely would

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[271] Proposing Release at Section III.B.2. We do not, however, expect advisers to face substantial costs in *gathering* the required disclosure. Advisers already are required to provide us and/or their clients with much of the information required in the new narrative brochure. In addition, much of the information needed for the brochure supplements can be found in an adviser's current Form ADV or an investment adviser representative's registration application (*i.e.*, Form U-4) filed with state securities authorities.

face only incrementally higher drafting costs than an advisory firm that uses a single brochure to make the required disclosure about the services it provides.

Similarly, the costs of preparing brochure supplements would vary from one adviser to the next. Costs would vary most significantly depending on the number of supervised persons for whom an adviser must provide disclosure.[272] An adviser with very few supervised persons for whom a supplement must be prepared would incur lower costs than a large adviser. Costs associated with preparing supplements also would vary greatly depending on the amount of disciplinary information, if any, required to be disclosed about a particular supervised person. The preparation of brochure supplements would be most demanding for those few advisers whose supervised persons have lengthy disciplinary records that must be disclosed, and less taxing for the vast majority of advisers, whose supervised persons have no disciplinary records and whose supplements would therefore likely be a page or less in length.[273]

We expect that only a few advisers would incur substantial costs in preparing supplements. Although some commenters representing large advisers argued that the supplement proposal would unduly burden advisers that have "thousands" of employees, IARD data indicate that fewer than one third of one percent of advisers registered with us have over 1,000 employees performing investment advisory functions on their behalf.[274]

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272 In response to comments we received, we narrowed the scope of supervised persons for whom a brochure supplement must be delivered. In addition, an adviser that is not required to *deliver* a brochure supplement for a particular supervised person is not required to *prepare* a supplement for that individual. *See* Section II.B of this Release.

273 IARD data indicate that in response to Item 11 in Part 1A of Form ADV, only 1,620, or just under 15 percent, of the 10,817 advisers registered with us report any disciplinary information about their firms or advisory affiliates, including their advisory employees.

274 Moreover, it may not be necessary to prepare a brochure supplement for all of these employees.

Indeed, less than five percent of our registrants have over 50 employees performing investment advisory functions. The vast majority of SEC-registered advisers – nearly 82 percent – have 10 or fewer employees performing advisory functions on their behalf. We believe most, if not all, of these firms may choose to incorporate required information about their supervised persons into their firm brochures instead of preparing separate brochure supplements, thus reducing costs of preparation. We request comment on the number of supplements that advisers of varying sizes would need to prepare, and how that number compares to the number of advisory employees at the firm.

For purposes of the Paperwork Reduction Act and taking into account the widely varying numbers of advisory employees among the thousands of different advisory firms registered with us, we have estimated the number of hours the *average* adviser would spend in the initial preparation of their brochures and supplements.[275] Based on those estimates, we estimate that advisers would incur costs of approximately $14,723,982 in drafting these documents in the first year.[276] Furthermore, for Paperwork Reduction Act purposes we also have estimated that advisers may incur approximately costs of $7,257,200 in connection with their use of outside legal services to assist in preparation of their Form ADV.

Advisers would incur annual expenses in addition to the initial costs of preparing firm brochures and brochure supplements, but we believe these costs would be modest and similar to current costs. The rule amendments, similar to the current requirements,

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275 *See* Section VI.A of this Release.

276 We expect that this function will most likely be performed by compliance professionals. Data from SIFMA's *Report on Office Salaries in the Securities Industry 2006*, modified to account for an 1,800-hour work-year and multiplied by 2.93 to account for bonuses, firm size, employee benefits and overhead, suggest that cost for a Compliance Clerk is approximately $56 per hour. 262,928.25 hours x $56 per hour = $14,723,982.

would require advisers to revise their disclosure documents promptly when any information in them becomes materially inaccurate, and would require advisers to update their brochures and brochure supplements each year at the time of their required annual updating amendment. For Paperwork Reduction Act purposes, we have estimated that advisers would need to prepare brochure amendments, on average, one and one half times per year, and spend three quarters of an hour on each amendment. We estimate that advisers would incur annual costs of $744,471 in meeting these requirements.[277]

Finally, advisers would incur some costs in filing their brochures with us through the IARD. Advisers would prepare their brochures on their own computers, and as noted earlier, the filing of a brochure would be similar to attaching a file to an email.[278] We believe conversion of an adviser's brochure to PDF format and filing of that brochure through the IARD would impose minimal costs on advisers.

C. Brochure and Supplement Delivery

Advisers would be required to deliver their revised brochures to existing clients annually.[279] The amended rules would require that, between annual deliveries, advisers deliver brochure and supplement amendments to existing clients only if there is an addition or change to disciplinary disclosure. Advisers already are required to deliver a copy of Part 2 to new clients. Thus, this requirement should present no new costs to

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277 Similarly, we expect that amendments to Part 2 will also most likely be performed by compliance professionals at an estimated cost for a Compliance Clerk of $56 per hour. 17,725.5 amendments x 0.75 hours per amendment x $56 = $744,471.

278 We note that all advisers registered with the Commission currently file Form ADV electronically via the IARD system and that since implementation of the electronic filing requirements in 2000 no adviser has applied for a permanent hardship exemption available to advisers for whom filing electronically would constitute an undue hardship. *See* rule 203-3(b) [17 CFR 275.203-3(b)].

279 Currently, an adviser must *offer* its brochure to clients annually, and must deliver a revised brochure only if the client accepts the adviser's offer.

advisers. Moreover, we believe that because advisers must deliver brochures to new clients, the cost of delivering brochure supplements to new clients should increase the existing cost of delivery only incrementally. New clients would receive brochures and supplements that are current as of the time of delivery.

Annual brochure delivery would benefit advisory clients by ensuring that they are kept apprised of their advisers' business practices and procedures for managing conflicts and enable clients to make decisions with respect to the adviser with the most currently available information. Changes to disciplinary information disclosed in the brochure and supplement are of such importance to clients that we believe interim delivery of these amendments is necessary. Moreover, advisers currently are already required to make disclosures regarding disciplinary information under existing rule 206(4)-4. Based on the experiences of examination staff, we believe that most advisers likely already make these disclosures in writing so that they can demonstrate compliance with the requirements of rule 206(4)-4. Thus, we believe that it is unlikely that there will be any new costs associated with delivery of this information.

As discussed above, delivery of the new narrative brochures would provide substantial benefits to advisory clients. The brochures would present clients with important information they need to determine whether to hire or continue the services of a particular adviser. Currently, advisers must annually offer to deliver their brochure to existing clients, however, clients who never request a brochure may not necessarily see important amendments. Under the proposed approach, each year clients would automatically receive advisers' brochures and the valuable in information contained

therein. Although we believe these benefits to advisory clients will be substantial, they are difficult to quantify.

Although advisers are already currently required to deliver a revised brochure to clients upon request, advisers would incur additional delivery costs under the amended rule (particularly in connection with the initial and annual delivery obligations). We expect these additional costs, however, to be less than under the original proposal.[280] Certain commenters raised particular concerns about the scope of the brochure supplement and its delivery, and the costs associated with ensuring proper distribution of supplements. In response to comments, we have both proposed to narrow the group of supervised persons who would need a brochure supplement, and to eliminate the need to send supplements to certain institutional or sophisticated clients. For Paperwork Reduction Act Purposes, we have estimated that the total annual paperwork burden associated with annual and interim delivery of brochures and supplements is approximately 3,013,692 hours. We estimate this would represent an annual cost of $168,766,752.[281]

Advisers may significantly minimize the costs associated with annual delivery of their brochures and supplements by arranging to deliver their brochures and supplements

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280 We are proposing the annual brochure delivery requirement (and the requirement that advisers deliver any interim amendments that disclose additional or revised disciplinary information) in lieu of our original proposal, which would have required advisers to deliver all brochure and supplement updates to clients on a continuous basis whenever any information in their brochures or supplements became materially inaccurate.

281 We expect that delivery of amendments to Part 2 will also most likely be performed by compliance professionals at an estimated cost for a Compliance Clerk of $56 per hour. 3,013,692 hours x $56 = $168,766,752.

to some or all clients by electronic media.[282] Advisers also may minimize delivery costs by mailing their brochures and supplements along with quarterly statements or other routine mailings they already send to clients.[283] The extent to which advisers will take advantage of these and other techniques to reduce costs is difficult to predict but we believe it will be significant. We request comment about the percentage of clients to whom advisers are likely to make electronic delivery. We also request comment about the extent to which advisers may minimize delivery costs by mailing their brochures and supplements along with quarterly statements or other routine mailings.

D. Amendments to Rule 204-2

The proposed amendments to rule 204-2 would require SEC-registered advisers to retain certain records relating to brochures and supplements. One of the proposed revisions to the rule would require advisers to retain copies of brochures and supplements prepared as required by Part 2. This provision is designed to conform that rule to our proposed changes to Form ADV and generally would impose no additional costs because advisers are already currently required to retain records relating to materials they distribute to their clients. Other proposed revisions to the rule would require advisers to maintain certain records in the event they use an alternative method to calculate assets under management in response to Item 4.E of Part 2A and if they do not disclose in their brochure any legal or disciplinary event listed in Part 2. These provisions would benefit advisers by permitting them flexibility in drafting their firm brochures while providing

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282 Proposed Instruction 3 for Part 2A of Form ADV expressly notes that Commission interpretive guidance permits advisers to deliver their brochures electronically upon client consent.

283 As noted above, annual brochure delivery must be made within 120 days of the adviser's fiscal year end. We have designed this deadline so that advisers can include the brochure in a routine mailing to clients.

for maintenance of records needed by our examination staff. Moreover, because we anticipate that only a relatively small number of advisers would be subject to these provisions we expect that the cost of maintaining these records will be relatively minimal.[284]

E. Total Estimated Costs and Benefits of this Rulemaking

As discussed above, the proposed rule and form amendments are expected to have both benefits and costs for investors and the advisory industry as a whole. We believe the benefits to advisory clients in the form of significant enhancements to the adviser disclosure regime will be quite substantial, but are difficult to quantify. Similarly difficult to quantify are the expected benefits to the advisory industry that we believe would result from the proposed rules in the form of enhanced flexibility with respect to their obligations to prepare and deliver brochures and supplements. Moreover, not all of the costs we anticipate to result from this rulemaking are quantifiable. Based on the figures discussed above, however, we estimate that the first year quantifiable costs related to this proposed rulemaking to be approximately $191,492,405.[285]

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284 For Paperwork Reduction Act purposes we estimate that only 487 advisers would be required to prepare additional records in accordance with the amendment to rule 204-2 and that each adviser would spend approximately four hours to satisfy the obligation for a total burden of 1,948 hours per year.

285 Estimated costs related to initial preparation of Form ADV (including Part 2) of $14,723,982 + estimated one-time outside legal costs associated with this initial preparation of $7,257,200 + estimated costs of $744,471 related to annual updating of Form ADV (including Part 2) + estimated costs associated with delivery of brochures and supplements of $168,766,752 = $191,492,405.

VIII. INITIAL REGULATORY FLEXIBILITY ANALYSIS

We have prepared this Initial Regulatory Flexibility Analysis (IRFA) in accordance with section 3(a) of the Regulatory Flexibility Act (RFA).[286] It relates to proposed amendments to rules 203-1, 204-1, 204-2, 204-3, and 206(4)-4, and Form ADV under the Advisers Act. The rule and form amendments are designed to improve the disclosure that investment advisers provide to their clients. These proposed amendments would also revise the instructions for updating and filing Form ADV (including adviser brochures). We also are proposing conforming rule amendments that would revise the recordkeeping requirements relating to Part 2 of Form ADV.

We prepared an IRFA in conjunction with the release proposing amendments to Part 2 of Form ADV in April 2000, and made it available to the public. A summary of that IRFA was published with the Proposing Release.[287] We received no comments specifically on that IRFA.

A. Need for the Rule and Form Amendments

The proposed rule and form amendments are necessary to improve the quality of disclosure that advisers provide to their clients.[288] Form ADV was adopted by the Commission in 1985[289] and advisers currently use it to register with the Commission (Part 1) and to provide clients disclosure about their advisory firm and personnel (Part 2). Over the years, however, experience has shown that the format and content of current

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286 5 U.S.C. 603(a).

287 *See* above note 5.

288 Sections I through IV, above, of this Release, describe in more detail the reasons for the proposed amendments.

289 *Uniform Investment Adviser Registration Application Form*, Investment Advisers Act Release No. 991 (Oct. 15, 1985) [50 FR 42903 (Oct. 23, 1985)].

Part 2 of Form ADV do not lend themselves to disclosure that is easy for clients to understand. Clients need clearer information about an adviser's services, fees, business practices, and conflicts of interests to be able to make an informed decision about whether to hire or retain that adviser.

B. Objectives and Legal Basis

The primary objective of the proposed form and rule amendments is to provide advisory clients and prospective clients with access to meaningful and up-to-date disclosure, as well as to provide for filing of this disclosure with the Commission.[290] By requiring advisers to provide current narrative brochures and brochure supplements written in plain English, the amendments are intended to improve the quality of information investors receive from advisers about their services, fees, business practices and conflicts of interest. Also, by requiring advisers to file their brochures (and any amendments) with the Commission electronically using IARD, the proposal would make full use of existing and new information technologies to aid the Commission staff in its oversight efforts and provide ready public access to advisers' brochures.

We are proposing these amendments under section 19(a) of the Securities Act of 1933 [15 U.S.C. 77s(a)], sections 23(a) and 28(e)(2) of the Securities Exchange Act of 1934 [15 U.S.C. 78w(a) and 78bb(e)(2)], section 319(a) of the Trust Indenture Act of 1939 [15 U.S.C. 77sss(a)], section 38(a) of the Investment Company Act of 1940 [15 U.S.C. 78a-37(a)], and sections 203(c)(1), 204, 206(4), and 211(a) of the Investment Advisers Act of 1940 [15 U.S.C. 80b-3(c)(1), 80b-4, 80b-6(4), and 80b-11(a)].

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290 Sections I through IV, above, of this Release, describe in more detail the objectives of the proposed amendments.

C. Small Entities Subject to the Rules

In developing the proposals, we have considered their potential impact on small entities that may be affected. The proposed rule and form amendments would affect all advisers registered with the Commission, including small entities. Under Commission rules, for purposes of the Regulatory Flexibility Act, an investment adviser generally is a small entity if it: (i) has assets under management having a total value of less than $25 million; (ii) did not have total assets of $5 million or more on the last day of its most recent fiscal year; and (iii) does not control, is not controlled by, and is not under common control with another investment adviser that has assets under management of $25 million or more, or any person (other than a natural person) that had $5 million or more on the last day of its most recent fiscal year.[291]

Our rule and form amendments would not affect most advisers that are small entities ("small advisers") because they are generally registered with one or more state securities authorities and not with us. Under section 203A of the Advisers Act, most small advisers are prohibited from registering with the Commission and are regulated by state regulators.[292] Those small advisers that register with us are located in Wyoming (which does not have an investment adviser statute), or are eligible for an exemption that permits SEC registration. The Commission estimates that as of September 30, 2007, of the 10,449 registered with us, there were approximately 634 that were small entities that

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291 Rule 0-7 [17 CFR 275.0-7].

292 National Securities Markets Improvement Act of 1996 (Pub. L. No. 104-290, 110 Stat. 3438) (1996) ("NSMIA"). As a result of NSMIA, advisers with less than $25 million of assets under management generally are regulated by one or more state securities authority, while the Commission generally regulates those advisers with at least $25 million of assets under management. *See* section 203A of the Advisers Act [15 USC 80b-3a].

would be affected by the proposed amendments.[293] We request comment on the effect and costs of the proposed amendments on small entities.

D. Reporting, Recordkeeping, and Other Compliance Requirements

The proposed rule and form amendments would impose certain reporting and compliance requirements on small advisers, requiring them to create and update narrative brochures containing certain information regarding their advisory business. The amendments also would require advisers to deliver their brochures to clients and to file them electronically through the IARD. The proposals would also impose new recordkeeping requirements. These requirements and the burdens on small advisers are discussed below.[294]

1. Amendments to Part 2 of Form ADV

The amendments to Part 2, because they require registered advisers to prepare and disseminate narrative brochures, would impose additional costs on all registered advisers, including small advisers. We assume that all small advisers currently distribute Part 2 of Form ADV and would have to redraft their brochures completely to comply with the proposed new format, although some information in current Part 2 may be transferable to the new narrative brochures.

The costs associated with preparing the new brochures will depend on the size of the adviser, the complexity of its operations, and the extent to which its operations present conflicts of interest with clients. Many of the new items imposing the most rigorous disclosure requirements may not apply to certain small advisers because, for

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293 This estimate is based on information advisers have filed with the Commission on Part 1A of Form ADV.

294 Sections I through IV, above, of this Release, describe these requirements in more detail.

example, those advisers may not have soft dollar or directed brokerage arrangements, or may not have custody of client assets. To the extent that some of the new disclosure burdens would apply to small advisers, these advisers are already obligated to make the disclosures to clients under the Advisers Act's anti-fraud provisions, although the disclosure is not required to be in the firm's written brochure.

For the first time, advisers also would be required to prepare and disseminate brochure supplements for certain supervised persons of their firm. To reduce the burdens on small advisers, however, we have drafted the new supplement rules so that firms with few employees would be permitted to include supplement information in their firm brochures and avoid preparing and distributing separate brochure supplements. We believe many small advisers would take advantage of this option and reduce their compliance burden.

2. Updating and Delivery Requirements

The amended rules, like the current rules, would require advisers to update their brochures whenever information in them becomes materially inaccurate. The proposed amendments would also implement the same updating requirements for supplements. In updating its brochure and supplements, an adviser may minimize its burden by using a "sticker" containing the updated information instead of reprinting its entire brochure and supplements.

The amendments would require advisers to deliver a current brochure to clients annually and to deliver interim updates of the brochure and supplements to clients to disclose new or revised disciplinary information. These delivery requirements would replace the current requirement that advisers offer clients a revised brochure annually.

To minimize the burden of delivery, advisers would be permitted with client consent to deliver brochures and supplements, as well as updates, electronically. To the extent that small advisers are more likely to have fewer advisory clients (and fewer supervised persons) than larger advisers, the proposed delivery requirements should impose lower variable costs on small advisers than on larger firms.

3. Recordkeeping Requirements

The proposed amendments would impose new recordkeeping requirements on advisers, including small advisers. As under the current rules, advisers would be required to maintain copies of their brochures. The proposed amendments would also require all advisers to maintain copies of their brochure supplements. In addition, the proposed amendments would require advisers, including small advisers, to maintain certain records if they determine that a disciplinary event that is presumptively material does not have to be disclosed, or if they calculate their managed assets for purpose of their brochures differently than in Part 1A of Form ADV.

E. Duplicative, Overlapping, or Conflicting Federal Rules

The Commission believes that there are no rules that duplicate or conflict with the proposed rule.[295]

F. Significant Alternatives

We have considered various alternatives in connection with the proposed rule and form amendments that might minimize their effect on small advisers, including: (i) establishing different compliance or reporting requirements or timetables that take into account the resources available to small advisers; (ii) clarifying, consolidating, or

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[295] As discussed above, the Commission is proposing to withdraw as duplicative current rule 206(4)-4.

simplifying compliance and reporting requirements under the proposed amendments for small advisers; (iii) using performance rather than design standards; and (iv) exempting small advisers from coverage of all or part of the proposed amendments.

Regarding the first alternative, the Commission believes that establishing different compliance or reporting requirements for small advisers would be inappropriate under these circumstances. The amendments are designed to improve the quality and timeliness of critically important disclosure that advisory clients receive from their advisers. To establish different disclosure requirements for small entities would diminish this investor protection for clients of small advisers. We note, however, that small advisers, by the nature of their business, likely would spend fewer resources in completing their brochures and any brochure supplements. Moreover, certain rule and form amendments were designed specifically to reduce the burden on small advisers. For example, the proposed Part 2 instructions would give advisers the flexibility to incorporate required information about their supervised persons into their firm brochures rather than presenting it in separate brochure supplements, thereby saving additional printing and mailing costs.

Regarding the second alternative, the proposed amendments would clarify requirements for all advisers, including small advisers. The proposed Part 2 instructions are designed to present requirements for advisers' brochures and supplements clearly and simply to all advisers, including small entities.

Regarding the third alternative, the Commission believes that the proposed amendments already appropriately use performance rather than design standards in many instances. The amendments would permit advisers considerable flexibility in designing their brochures and supplements so as best to communicate the required information to

clients. In preparing brochure supplements, advisers would also have the flexibility of adapting the format of the supplements to best suit their firm: an adviser may: (i) prepare a separate supplement for each supervised person; (ii) prepare a single supplement containing the required information for all of its supervised persons; (iii) prepare multiple supplements for groups of supervised persons (*e.g.*, all supervised persons in a particular office or work group); or (iv) include all information about supervised persons in the firm brochure and prepare no separate supplements.[296] The proposed amendments clarify that advisers may, with client consent, deliver their brochures and supplements, along with any updates, to clients electronically.

Regarding the fourth alternative, it would be inconsistent with the purposes of the Advisers Act to exempt small advisers from the proposed rule and form amendments. The information in an adviser's brochure is necessary for the client to evaluate the adviser's services, fees, and business practices, and to apprise the client of potential conflicts of interest and, when necessary, of the adviser's financial condition. Since we view the protections of the Advisers Act to apply equally to clients of both large and small advisers, it would be inconsistent with the purposes of the Act to specify different requirements for small entities.

G. Solicitation of Comment

The Commission encourages the submission of comments on matters discussed in the IRFA. Comment is requested particularly on the number of small advisers that would be affected by the proposals, the burdens the proposals would impose on small advisers, and whether the effects of the proposed rule and form amendments on small advisers

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296 *See* Section II.B of this Release.

would be economically significant. Commenters are asked to describe the nature of any effect and provide empirical data supporting the extent of the effect. These comments will be placed in the same public comment file as comments on the proposals.

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996, the Commission is also requesting information regarding the potential impact of the proposals on the economy on an annual basis. Commenters should provide empirical data to support their views.

IX. EFFICIENCY, COMPETITION, AND CAPITAL FORMATION

Section 202(c) of the Advisers Act requires the Commission, when engaging in rulemaking that requires it to consider or determine whether an action is necessary or appropriate in the public interest, to consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.[297] Today the Commission is proposing amendments to Part 2 of Form ADV and related Advisers Act rules that would require investment advisers registered with us to deliver to clients and prospective clients, brochures and brochure supplements written in plain English.

The brochure rule and form amendments that we are proposing today would promote efficiency and competition in the marketplace by improving the disclosure that advisers must provide to clients.[298] These amendments are designed to require advisers

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297 15 U.S.C. 80b-2(c).

298 Along with the proposed brochure amendments, the Commission also is proposing conforming amendments to the General Instructions and Glossary of Form ADV to include instructions regarding brochure filing requirements and to add glossary terms and definitions that are used in Part 2. Additionally, the Commission also is proposing conforming amendments to the Advisers Act books and records rule. These proposed amendments would require advisers to maintain copies of their brochures, supplements, and amendments, and are intended to update the books and records rule in light of our proposed changes to Part 2. None of these proposed conforming amendments are

to provide clients and prospective clients with clear, current, and more meaningful disclosure of the business practices, conflicts of interest, and background of investment advisers and their advisory personnel. Advisers would file their brochures with us electronically, and we would make them available to the public through our Web site. With the public availability of more thorough and current disclosure of advisers' services, fees, business practices and conflicts of interests, investors will be able to make more informed decisions about whether to hire or retain a particular adviser. A more informed investing public will create a more efficient marketplace and strengthen competition among advisers. Moreover, the electronic filing requirements are expected to expedite and simplify the process of filing firm brochures and amendments for the advisory firms, thus further improving efficiency. We believe, however, that the proposed brochure amendments are unrelated to and will have little or no effect on capital formation.

The Commission requests comment whether the above proposals, if adopted, would promote efficiency, competition, and capital formation. Commenters are requested to provide empirical data to support their views.

X. STATUTORY AUTHORITY

We are proposing amendments to rule 203-1 under sections 203(c)(1), 204, and 211(a) of the Investment Advisers Act of 1940 [15 U.S.C. 80b-3(c)(1), 80b-4, and 80b-11(a)].

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expected to have an independent impact on efficiency, competition, or capital formation. To the extent that they facilitate the purposes of the proposed brochure amendments, the conforming amendments may, however, contribute to the expected effects on efficiency, competition and capital formation that would stem from the proposed brochure amendments and which are discussed below.

We are proposing amendments to rule 204-1 under sections 203(c)(1) and 204 of the Investment Advisers Act of 1940 [15 U.S.C. 80b-3(c)(1) and 80b-4].

We are proposing amendments to rule 204-2 under section 204 and 206(4) of the Investment Advisers Act of 1940 [15 U.S.C. 80b-4 and 80b-6(4)].

We are proposing amendments to rule 204-3 under section 204, 206(4), and 211(a) of the Investment Advisers Act of 1940 [15 U.S.C. 80b-4, 80b-6(4), and 80b-11(a)].

We are proposing amendments to rule 279.1, Form ADV, under section 19(a) of the Securities Act of 1933 [15 U.S.C. 77s(a)], sections 23(a) and 28(e)(2) of the Securities Exchange Act of 1934 [15 U.S.C. 78w(a) and 78bb(e)(2)], section 319(a) of the Trust Indenture Act of 1939 [15 U.S.C. 77sss(a)], section 38(a) of the Investment Company Act of 1940 [15 U.S.C. 78a-37(a)], and sections 203(c)(1), 204, and 211(a) of the Investment Advisers Act of 1940 [15 U.S.C. 80b-3(c)(1), 80b-4, and 80b-11(a)].

We are proposing to remove and reserve rule 206(4)-4 under section 206(4) of the Investment Advisers Act of 1940 [15 U.S.C. 80b-6(4)].

List of Subjects in 17 CFR Parts 275 and 279

Reporting and recordkeeping requirements; Securities

TEXT OF RULE AND FORM AMENDMENTS

For the reasons set out in the preamble, Title 17, Chapter II of the Code of Federal Regulations is proposed to be amended as follows:

PART 275 -- RULES AND REGULATIONS, INVESTMENT ADVISERS ACT OF 1940

1. The general authority citation for Part 275 continues to read as follows:

Authority: 15 U.S.C. 80b-2(a)(11)(G), 80b-2(a)(17), 80b-3, 80b-4, 80b-4a, 80b-6(4), 80b-6a, and 80b-11, unless otherwise noted.

2. Section 275.203-1 is amended by revising paragraphs (a) and (b) to read as follows:

§ 275.203-1 Application for investment adviser registration.

(a) Electronic Filing of Form ADV. (1) To apply for registration with the Commission as an investment adviser, you must complete Form ADV [17 CFR 279.1] by following the instructions in the form and you must file Part 1A of Form ADV and the firm brochure(s) required by Part 2A of Form ADV electronically with the Investment Adviser Registration Depository (IARD) unless you have received a hardship exemption under § 275.203-3.

Note to paragraph (a)(1): Information on how to file with the IARD is available on the Commission's Web site at www.sec.gov/iard.

(2) After [INSERT DATE SIX MONTHS AFTER EFFECTIVE DATE OF RULES/FORM] the Commission will not accept any initial application for registration as an investment adviser that does not include a brochure that satisfies the requirements of Part 2A of Form ADV.

(b) Special rule for Part 2B. You are not required to file with the Commission the brochure supplements required by Part 2B of Form ADV.

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3. Section 275.204-1 is amended by removing the notes to paragraphs (a) and (c) and revising paragraphs (b) and (c) to read as follows:

§ 275.204-1 Amendments to application for registration.

* * * * *

(b) Electronic filing of amendments. (1) Subject to paragraph (b)(2) of this rule, you must file all amendments to Part 1A of your Form ADV and all your amended firm brochure(s) required by Part 2A of Form ADV electronically with the Investment Adviser Registration Depository (IARD), unless you have received a continuing hardship exemption under § 275.203-3.

(2) Transition to electronic filing. You must amend your Form ADV by electronically filing with the IARD one or more brochures that satisfy the requirements of Part 2A of Form ADV (as amended effective [INSERT EFFECTIVE DATE OF RULES/FORM]) as part of the next annual updating amendment you are required to file after [INSERT DATE SIX MONTHS AFTER EFFECTIVE DATE OF RULES/FORM].

Note to paragraphs (a) and (b): Information on how to file with the IARD is available on our Web site at www.sec.gov/iard.

(c) Special rule for Part 2B. You are not required to file with the Commission amendments to brochure supplements required by Part 2B of Form ADV.

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4. Section 275.204-2(a)(14) is revised to read as follows:

§ 275.204-2 Books and records to be maintained by investment advisers.

(a) * * *

(14)(i) A copy of each brochure and brochure supplement, and each amendment or revision to the brochure and brochure supplements, required by Part 2 of Form ADV [17 CFR 279.1]; any summary of material changes that is required by Part 2 of Form ADV but is not contained in the brochure or brochure supplements; and a record of the dates that each brochure and brochure supplement, each amendment or revision thereto, and each summary of material changes was given to any client or to any prospective client who subsequently becomes a client.

(ii) Documentation describing the method used to compute managed assets for purposes of Item 4.E of Part 2A of Form ADV, if the method differs from the method used to compute assets under management in Item 5.F of Part 1A of Form ADV.

(iii) A memorandum describing any legal or disciplinary event listed in Item 9 of Part 2A or Item 3 of Part 2B of Form ADV (Disciplinary Information) and presumed to be material, if the event involved the investment adviser or any of its supervised persons and is not disclosed in the brochure or brochure supplements described in paragraph (a)(14)(i) of this section. The memorandum must explain the investment adviser's determination that the presumption of materiality is overcome, and must discuss the factors described in Item 9 of Part 2A or Item 3 of Part 2B of Form ADV.

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5. Section 275.204-3 is revised to read as follows:

§ 275.204-3 Delivery of firm brochures and brochure supplements.

(a) General requirements. If you are registered under the Act as an investment adviser, you must deliver a firm brochure and one or more supplements to each client or prospective client as required by this section. The brochure and supplement(s) must contain all information required by Part 2 of Form ADV [17 CFR 279.1].

(b) Delivery requirements. You (or a supervised person acting on your behalf) must deliver to a client or prospective client:

(1) Your current brochure before or at the time you enter into an investment advisory contract with the client and, after that, an updated brochure annually within 120 days after the end of your fiscal year;

(2) A current brochure supplement for a supervised person before or at the time that supervised person begins to provide advisory services to the client. For purposes of this section, a supervised person will provide advisory services to a client if that supervised person will:

(i) Formulate investment advice for the client and have direct client contact; or

(ii) Make discretionary investment decisions for the client, even if the supervised person will have no direct client contact.

(c) Exceptions to delivery requirements.

(1) You are not required to deliver a brochure to a client:

(i) that is an investment company registered under the Investment Company Act of 1940 [15 U.S.C. 80a-1 to 80a-64] or a business development company as defined in that

Act, provided that the advisory contract with that client meets the requirements of section 15(c) of that Act [15 U.S.C. 80a-15(c)]; or

(ii) who receives only impersonal investment advice for which you charge less than $500 per year.

(2) You are not required to deliver a brochure supplement to a client:

(i) to whom you are not required to deliver a brochure under subparagraph (c)(1) of this section;

(ii) who receives only impersonal investment advice;

(iii) who would be a "qualified purchaser" under section 2(a)(51)(A) of the Investment Company Act of 1940 [15 U.S.C. 80a-2(a)(51)(A)]; or

(iv) who would be a "qualified client" of your firm under § 275.205-3(d)(1)(iii).

(d) Wrap fee program brochures.

(1) If you are a sponsor of a wrap fee program, then the brochure that paragraph (b)(1) of this section requires you to deliver to a client or prospective client of the wrap fee program must be a wrap fee brochure containing all information required by Part 2A Appendix 1 of Form ADV. Any additional information in a wrap fee brochure must be limited to information applicable to wrap fee programs that you sponsor.

(2) You do not have to deliver a wrap fee brochure if another sponsor of the wrap fee program delivers, to the client or prospective client of the wrap fee program, a wrap fee program brochure containing all the information your wrap fee program brochure must contain.

Note to paragraph (d): A wrap fee brochure does not take the place of any brochure supplements that you are required to deliver under paragraph (b)(2) of this section.

(e) Amendments. Section 275.204-1 and instructions to Form ADV contain instructions that you must follow to amend your brochure and brochure supplements. You must provide a current brochure and current brochure supplements to any new clients or prospective clients. If an amendment adds disclosure of an event, or materially revises information already disclosed about an event, in response to Item 9 of Part 2A or Item 3 of Part 2B of Form ADV (Disciplinary Information), then you must provide the current brochure or current brochure supplements (or the amendment), as applicable, to all existing clients to whom you are required to deliver a brochure or brochure supplement under this section.

(f) Multiple brochures. If you provide substantially different advisory services to different clients, you may provide them with different brochures, so long as each client receives all information about the services and fees that are applicable to that client. The brochure you deliver to a client may omit any information required by Part 2A of Form ADV if the information does not apply to the advisory services or fees that you will provide or charge, or that you propose to provide or charge, to that client.

(g) Other disclosure obligations. Delivering a brochure or supplement in compliance with this section does not relieve you of any other disclosure obligations you have to your advisory clients or prospective clients under any federal or state laws or regulations.

(h) Transition rule.

(1) Within 30 days after the date by which you are first required by § 275.204-1(b)(2) to electronically file your brochure with the Commission, you must deliver to each

of your existing clients your current brochure and all current brochure supplements as required by Part 2 of Form ADV.

(2) As of the date by which you are first required to electronically file your brochure with the Commission, you must begin using your current brochure and current brochure supplements as required by Part 2 of Form ADV to comply with the requirements of this section pertaining to initial delivery to new and prospective clients.

(i) Definitions. For purposes of this section:

(1) Impersonal investment advice means investment advisory services that do not purport to meet the objectives or needs of specific individuals or accounts.

(2) Current brochure and current brochure supplement mean the most recent revision of the brochure or brochure supplement, including all amendments to date.

(3) Sponsor of a wrap fee program means an investment adviser that is compensated under a wrap fee program for sponsoring, organizing, or administering the program, or for selecting, or providing advice to clients regarding the selection of, other investment advisers in the program.

(4) Supervised person means any of your officers, partners or directors (or other persons occupying a similar status or performing similar functions) or employees, or any other person who provides investment advice on your behalf.

(5) Wrap fee program means an advisory program under which a specified fee or fees not based directly upon transactions in a client's account is charged for investment advisory services (which may include portfolio management or advice concerning the selection of other investment advisers) and the execution of client transactions.

6. Section 275.206(4)-4 is removed and reserved.

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PART 279 -- FORMS PRESCRIBED UNDER THE INVESTMENT ADVISERS ACT OF 1940

7. The authority citation for Part 279 continues to read as follows:

Authority: 15 U.S.C. 80b-1, *et seq.*

8. Form ADV [referenced in § 279.1] is amended by:

a. In the instructions to the form, revising the section entitled "Form ADV: General Instructions." The revised version of Form ADV: General Instructions is attached as Appendix A;

b. In the instructions to the form, revising the section entitled "Glossary of Terms." The revised version of Form ADV: Glossary of Terms is attached as Appendix B; and

c. Removing Form ADV, Part II, and adding Form ADV, Part 2. Form ADV, Part 2 is attached as Appendix C.

Note: The text of Form ADV does not and the amendments will not appear in the Code of Federal Regulations.

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By the Commission.

Florence E. Harmon
Deputy Secretary

March 3, 2008

FORM ADV (Paper Version)
UNIFORM APPLICATION FOR INVESTMENT ADVISER REGISTRATION

Form ADV: General Instructions

Read these instructions carefully before filing Form ADV. Failure to follow these instructions, properly complete the form, and pay all required fees may result in your application being delayed or rejected.

In these instructions and in Form ADV, "you" means the investment adviser (i.e., the advisory firm) applying for registration or amending its registration. If you are a "separately identifiable department or division" (SID) of a bank, "you" means the SID, rather than your bank, unless the instructions or the form provide otherwise. Terms that appear in *italics* are defined in the Glossary of Terms to Form ADV.

1. Where can I get more information on Form ADV, electronic filing, and the IARD?

The SEC provides information about its rules and the Advisers Act on its website: <http://www.sec.gov/iard>.

NASAA provides information about state investment adviser laws and state rules, and how to contact a *state securities authority*, on its website: <http://www.nasaa.org>.

FINRA provides information about the IARD and electronic filing on the IARD website: <http://www.iard.com>.

2. What is Form ADV used for?

Investment advisers use Form ADV to:

- Register with the Securities and Exchange Commission
- Register with one or more *state securities authorities*
- Amend those registrations

3. How is Form ADV organized?

Form ADV contains four parts:

- Part 1A asks a number of questions about you, your business practices, the *persons* who own and *control* you, and the *persons* who provide investment advice on your behalf. All advisers registering with the SEC or any of the *state securities authorities* must complete Part 1A.

  Part 1A also contains several supplemental schedules. The items of Part 1A let you know which schedules you must complete.

- Schedule A asks for information about your direct owners and executive officers.
- Schedule B asks for information about your indirect owners.
- Schedule C is used by paper filers to update the information required by Schedules A and B (see Instruction 14).
- Schedule D asks for additional information for certain items in Part 1A.
- Disclosure Reporting Pages (or "DRPs") are schedules that ask for details about disciplinary events involving you or *persons* affiliated with you.

- Part 1B asks additional questions required by *state securities authorities*. Part 1B contains three additional DRPs. If you are applying for registration or are registered only with the SEC, you do not have to complete Part 1B. (If you are filing electronically and you do not have to complete Part 1B, you will not see Part 1B.)

- Part 2A requires advisers to create narrative *brochures* containing information about the advisory firm. The requirements in Part 2A apply to all investment advisers registered with or applying for registration with the SEC. If you are registered with or applying for registration with one or more of the *state securities authorities*, you should contact the appropriate *state securities authorities* to determine whether the requirements in Part 2A apply to you.

- Part 2B requires advisers to create *brochure supplements* containing information about certain *supervised persons*. The requirements in Part 2B apply to all investment advisers registered with or applying for registration with the SEC. If you are registered with or applying for registration with one or more of the *state securities authorities*, you should contact the appropriate *state securities authorities* to determine whether the requirements in Part 2B apply to you.

4. When am I required to update my Form ADV?

You must amend your Form ADV each year by filing an *annual updating amendment* within 90 days after the end of your fiscal year. When you submit your *annual updating amendment*, you must update your responses to all items.

In addition to your *annual updating amendment*, you must amend your Form ADV by filing additional amendments (other-than-annual amendments) promptly if:

- information you provided in response to Items 1, 3, 9, or 11 of Part 1A or Items 1, 2.A. through 2.F., or 2.I. of Part 1B, becomes inaccurate in any way;

- information you provided in response to Items 4, 8, or 10 of Part 1A or Item 2.G. of Part 1B becomes materially inaccurate; or

- information you provided in your brochure becomes materially inaccurate.

If you are submitting an other-than-annual amendment, you are not required to update your responses to Items 2, 5, 6, 7, or 12 of Part 1A or Items 2.H. or 2.J. of Part 1B, even if your responses to those items have become inaccurate.

Note: You must amend your *brochure supplements* (see Form ADV, Part 2B) promptly if any information in them becomes materially inaccurate.

- If you are an SEC-registered adviser, you are required to file your *brochure* amendments electronically through IARD. You are not required to file amendments to your *brochure supplements* with the SEC, but you must maintain a copy of them in your files.

- If you are a state-registered adviser, you may be required to file your *brochure* amendments and *brochure supplement* amendments with the appropriate *state securities authorities*. You should contact the appropriate *state securities authorities* to determine whether the states in which you have a filing obligation require filing of your *brochure* amendments and *brochure supplement* amendments, and if so, whether these should be filed electronically through IARD.

Failure to update your Form ADV, as required by this instruction, is a violation of SEC rule 204-1 or similar state rules and could lead to your registration being revoked.

5. Part 2 of Form ADV was amended recently. When do I have to comply with the new requirements?

If you are applying for registration with the SEC:

- Beginning [ ], your application for registration must include a narrative *brochure* prepared in accordance with the requirements of (amended) Part 2 of Form ADV. See SEC rule 203-1. After that date, the SEC will not accept any application that does not meet this requirement.

- Until that date, you may (but are not required to) include in your application a narrative *brochure* that meets the requirements of (amended) Part 2 of Form ADV. If you do not do this, you must comply with the requirements for preparing, delivering, and offering "old" Part II of Form ADV.

If you already are registered with or have submitted an application for registration with the SEC by [ ]:

- When you make the next annual updating amendment to your Form ADV after [ ], you must submit a narrative *brochure* that meets the requirements of (amended) Part 2 of Form ADV. See SEC Rule 204-1(b).

- Until that date, you may (but are not required to) submit a narrative *brochure* that meets the requirements of (amended) Part 2 of Form ADV. If you do not do this, you must comply with the requirements for preparing, delivering, and offering "old" Part II of Form ADV.

Note: Until the amendments to Part 2 are effective, you can satisfy the requirements related to "old" Part II by updating the information in your Part II whenever it becomes materially inaccurate. You must deliver Part II or a brochure containing at least the information contained in Part II to prospective *clients* and annually offer it to current *clients*. You are not required to file "old" Part II with the SEC, but you must keep a copy in your files, and provide it to the SEC staff upon request.

If you are applying for registration or are registered with one or more *state securities authorities*:

- Contact the appropriate *state securities authorities* for more information about the compliance transition schedule applicable to you.

6. Where do I sign my Form ADV application or amendment?

You must sign the appropriate Execution Page. There are three Execution Pages at the end of the form. Your initial application and all amendments to Form ADV must include at least one Execution Page.

- If you are applying for or are amending your SEC registration, you must sign and submit either a:
    - Domestic Investment Adviser Execution Page, if you (the advisory firm) are a resident of the United States; or
    - *Non-Resident* Investment Adviser Execution Page, if you (the advisory firm) are not a resident of the United States.
- If you are applying for or are amending your registration with a *state securities authority*, you must sign and submit the State-Registered Investment Adviser Execution Page.

7. Who must sign my Form ADV or amendment?

The individual who signs the form depends upon your form of organization:

- For a sole proprietorship, the sole proprietor.
- For a partnership, a general partner.
- For a corporation, an authorized principal officer.
- For a "separately identifiable department or division" (SID) of a bank, a principal officer of your bank who is directly engaged in the management, direction or supervision of your investment advisory activities.

- For all others, an authorized individual who participates in managing or directing your affairs.

The signature does not have to be notarized, and in the case of an electronic filing, should be a typed name.

8. How do I file my Form ADV?

Complete Form ADV electronically using the Investment Adviser Registration Depository (IARD) if:

- You are filing with the SEC (and submitting *notice filings* to any of the *state securities authorities*), or

- You are filing with a *state securities authority* that requires or permits advisers to submit Form ADV through the IARD.

  Note: SEC rules require advisers that are registered or applying for registration with the SEC to file electronically through the IARD system. See SEC rule 203-1. Check with the *state securities authorities* of each state in which you have a filing obligation to determine whether you can or must file Form ADV electronically through the IARD.

To file electronically, go to the IARD website (<www.iard.com>), which contains detailed instructions for advisers to follow when filing through the IARD.

Complete Form ADV (Paper Version) on paper if:

- You are filing with the SEC or a *state securities authority* that requires electronic filing, but you have been granted a continuing hardship exemption. Hardship exemptions are described in Instruction 14.

- You are filing with a *state securities authority* that permits (but does not require) electronic filing and you do not file electronically.

9. How do I get started filing electronically?

- First, get a copy of the IARD Entitlement Package from the following web site: <http://www.iard.com>. Second, request access to the IARD system for your firm by completing and submitting the IARD Entitlement Package. The IARD Entitlement Package must be submitted on paper. Mail the forms to: IARD Entitlement Requests, FINRA, P.O. Box 9495, Gaithersburg, MD 20898-9495.

- When FINRA receives your Entitlement Package, they will assign a *CRD* number (identification number for your firm) and a user I.D. code and password (identification number and system password for the individual(s) who will submit Form ADV filings for

your firm). Your firm may request an I.D. code and password for more than one individual. FINRA also will create a financial account for you from which the IARD will deduct filing fees and any state fees you are required to pay. If you already have a *CRD* account with FINRA, it will also serve as your IARD account; a separate account will not be established.

- Once you receive your *CRD* number, user I.D. code and password, and you have funded your account, you are ready to file electronically.

- Questions regarding the Entitlement Process should be addressed to FINRA at 240.386.4848.

10. If I am applying for registration with the SEC, or amending my SEC registration, how do I make *notice filings* with the *state securities authorities*?

If you are applying for registration with the SEC or are amending your SEC registration, one or more *state securities authorities* may require you to provide them with copies of your SEC filings. We call these filings "*notice filings*." Your *notice filings* will be sent electronically to the states that you check on Item 2.B. of Part 1A. The *state securities authorities* to which you send *notice filings* may charge fees, which will be deducted from the account you establish with FINRA. To determine which *state securities authorities* require SEC-registered advisers to submit *notice filings* and to pay fees, consult the relevant state investment adviser law or *state securities authority*. See General Instruction 1.

If you are granted a continuing hardship exemption to file Form ADV on paper, FINRA will enter your filing into the IARD and your *notice filings* will be sent electronically to the *state securities authorities* that you check on Item 2.B. of Part 1A.

11. I am registered with a state. When must I switch to SEC registration?

If you report on your *annual updating amendment* that your assets under management have increased to $30 million or more, you must register with the SEC within 90 days after you file that *annual updating amendment*. If your assets under management increase to $25 million or more but not $30 million, you may, but are not required to, register with the SEC (assuming you are not otherwise required to register with the SEC). Once you register with the SEC, you are subject to SEC regulation, regardless of whether you remain registered with one or more states. Each of your *investment adviser representatives*, however, may be subject to registration in those states in which the representative has a place of business. See SEC rule 203A-1(b). For additional information, consult the investment adviser laws or the *state securities authority* for the particular state in which you are "doing business." See General Instruction 1.

12. I am registered with the SEC. When must I switch to registration with a *state securities authority*?

If you report on your *annual updating amendment* that you have assets under management of less than $25 million and you are not otherwise eligible to register with the SEC, you must

withdraw from SEC registration within 180 days after the end of your fiscal year by filing Form ADV-W. You should consult state law in the states that you are doing business to determine if you are required to register in these states. See General Instruction 1. Until you file your Form ADV-W with the SEC, you will remain subject to SEC regulation, and you also will be subject to regulation in any states where you register. See SEC rule 203A-1(b).

13. Are there filing fees?

Yes. These fees go to support and maintain the IARD. The IARD filing fees are in addition to any registration or other fee that may be required by state law. You must pay an IARD filing fee for your initial application and each *annual updating amendment***.** There is no filing fee for an other-than-annual amendment or Form ADV-W. The IARD filing fee schedule is published at <http://www.sec.gov/iard>; <http://www.nasaa.org>; and <http://www.iard.com>.

If you are submitting a paper filing under a continuing hardship exemption (see Instruction 14), you are required to pay an additional fee. The amount of the additional fee depends on whether you are filing Form ADV or Form ADV-W. (There is no additional fee for filings made on Form ADV-W.) The hardship filing fee schedule is available by contacting FINRA at 240.386.4848.

14. What if I am not able to file electronically?

If you are required to file electronically but cannot do so, you may be eligible for one of two types of hardship exemptions from the electronic filing requirements.

- A **temporary hardship exemption** is available if you file electronically, but you encounter unexpected difficulties that prevent you from making a timely filing with the IARD, such as a computer malfunction or electrical outage. This exemption does not permit you to file on paper; instead, it extends the deadline for an electronic filing for seven business days. See SEC rule 203-3(a).

- A **continuing hardship exemption** may be granted if you are a small business and you can demonstrate that filing electronically would impose an undue hardship. You are a small business, and may be eligible for a continuing hardship exemption, if you are required to answer Item 12 of Part 1A (because you have assets under management of less than $25 million) and you are able to respond "no" to each question in Item 12. See SEC rule 0-7.

  If you have been granted a continuing hardship exemption, you must complete and submit the paper version of Form ADV to FINRA. FINRA will enter your responses into the IARD. As discussed in General Instruction 13, FINRA will charge you a fee to reimburse it for the expense of data entry.

  Before applying for a continuing hardship exemption, consider engaging a firm that assists investment advisers in making filings with the IARD. Check the SEC's web site

(<http://www.sec.gov/iard>) to obtain a list of firms that provide these services.

15. I am eligible to file on paper. How do I make a paper filing?

When filing on paper, you must:

- Type all of your responses.
- Include your name (the same name you provide in response to Item 1.A. of Part 1A) and the date on every page.
- If you are amending your Form ADV:
  - complete page 1 and circle the number of any item for which you are changing your response.
  - include your SEC 801-number (if you have one) and your *CRD* number (if you have one) on every page.
  - complete the amended item in full and circle the number of the item for which you are changing your response.
  - to amend Schedule A or Schedule B, complete and submit Schedule C.

Where you submit your paper filing depends on why you are eligible to file on paper:

- If you are filing on paper because you have been granted a continuing hardship exemption, submit one manually signed Form ADV and one copy to: IARD Document Processing, FINRA, P.O. Box 9495, Gaithersburg, MD 20898-9495.

  If you complete Form ADV on paper and submit it to FINRA but you do not have a continuing hardship exemption, the submission will be returned to you.

- If you are filing on paper because a state in which you are registered or in which you are applying for registration allows you to submit paper instead of electronic filings, submit one manually signed Form ADV and one copy to the appropriate *state securities authorities*.

16. Who is required to file Form ADV-NR?

Every *non-resident* general partner and *managing agent* of <u>all</u> SEC-registered advisers, whether or not the adviser is resident in the United States, must file Form ADV-NR in connection with the adviser's initial application. A general partner or *managing agent* of an SEC-registered adviser who becomes a *non-resident* after the adviser's initial application has been submitted must file Form ADV-NR within 30 days. Form ADV-NR must be filed on paper (it cannot be filed electronically).

Submit Form ADV-NR to the SEC at the following address:

Securities and Exchange Commission, 100 F Street, NE, Mail Stop 8031, Washington, DC 20549; Attn: The Registrations Branch

Failure to file Form ADV-NR promptly may delay SEC consideration of your initial application.

Federal Information Law and Requirements

Sections 203(c) and 204 of the Advisers Act [15 U.S.C. §§ 80b-3(c) and 80b-4] authorize the SEC to collect the information required by Form ADV. The SEC collects the information for regulatory purposes, such as deciding whether to grant registration. Filing Form ADV is mandatory for advisers who are required to register with the SEC. The SEC maintains the information submitted on this form and makes it publicly available. The SEC may return forms that do not include required information. Intentional misstatements or omissions constitute federal criminal violations under 18 U.S.C. § 1001 and 15 U.S.C. § 80b-17.

SEC's Collection of Information

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number. The Advisers Act authorizes the SEC to collect the information on Form ADV from applicants. See 15 U.S.C. §§ 80b-3(c)(1) and 80b-4. Filing the form is mandatory.

The main purpose of this form is to enable the SEC to register investment advisers. Every applicant for registration with the SEC as an adviser must file the form. See 17 C.F.R. § 275.203-1. By accepting a form, however, the SEC does not make a finding that it has been completed or submitted correctly. The form is filed annually by every adviser, no later than 90 days after the end of its fiscal year, to amend its registration. It is also filed promptly during the year to reflect material changes. See 17 C.F.R. § 275.204-1. The SEC maintains the information on the form and makes it publicly available through the IARD.

Anyone may send the SEC comments on the accuracy of the burden estimate on page 1 of the form, as well as suggestions for reducing the burden. The Office of Management and Budget has reviewed this collection of information under 44 U.S.C. § 3507.

The information contained in the form is part of a system of records subject to the Privacy Act of 1974, as amended. The SEC has published in the Federal Register the Privacy Act System of Records Notice for these records.

Appendix B

GLOSSARY OF TERMS

1. **Advisory Affiliate:** Your advisory affiliates are (1) all of your officers, partners, or directors (or any ***person*** performing similar functions); (2) all ***persons*** directly or indirectly ***controlling*** or ***controlled*** by you; and (3) all of your current ***employees*** (other than ***employees*** performing only clerical, administrative, support or similar functions).

   If you are a "separately identifiable department or division" (SID) of a bank, your ***advisory affiliates*** are: (1) all of your bank's ***employees*** who perform your investment advisory activities (other than clerical or administrative ***employees***); (2) all ***persons*** designated by your bank's board of directors as responsible for the day-to-day conduct of your investment advisory activities (including supervising the ***employees*** who perform investment advisory activities); (3) all ***persons*** who directly or indirectly ***control*** your bank, and all ***persons*** whom you ***control*** in connection with your investment advisory activities; and (4) all other ***persons*** who directly manage any of your investment advisory activities (including directing, supervising or performing your advisory activities), all ***persons*** who directly or indirectly ***control*** those management functions, and all ***persons*** whom you ***control*** in connection with those management functions. *[Used in: Part 1A, Item 11; Part 1B, Item 2]*

2. **Annual Updating Amendment:** Within 90 days after your firm's fiscal year end, your firm must file an "annual updating amendment," which is an amendment to your firm's Form ADV that reaffirms the eligibility information contained in Item 2 of Part 1A and updates the responses to any other item for which the information is no longer accurate. *[Used in: General Instructions; Part 1A Instructions, Introductory Text, Item 2; Part 2A, Instructions, Appendix 1 Instructions; Part 2B, Instructions]*

3. **Brochure:** A written disclosure statement that your firm is required to provide to ***clients*** and prospective ***clients***. See SEC rule 204-3; Form ADV, Part 2A. *[Used in: General Instructions; Used throughout Part 2 General Instructions; Part 2A, Instructions, Appendix 1 Instructions; Part 2B, Instructions]*

4. **Brochure Supplement:** A written disclosure statement containing information about certain of your supervised persons that your firm is required by Part 2B of Form ADV to provide to clients and prospective clients. See SEC rule 204-3; Form ADV, Part 2B. *[Used in: General Instructions; Used throughout Part 2 General Instructions; Part 2A, Instructions, Appendix 1 Instructions; Part 2B, Instructions]*

5. **Charged:** Being accused of a crime in a formal complaint, information, or indictment (or equivalent formal charge). *[Used in: Part 1A, Item 11; DRPs]*

6. **Client:** Any of your firm's investment advisory clients. This term includes clients from which your firm receives no compensation, such as members of your family. If your firm also provides other services (e.g., accounting services), this term does not include clients that are not investment advisory clients. *[Used throughout Form ADV and Form ADV-W]*

7. **Control:** Control means the power, directly or indirectly, to direct the management or policies of a ***person***, whether through ownership of securities, by contract, or otherwise.

   - Each of your firm's officers, partners, or directors exercising executive responsibility (or ***persons*** having similar status or functions) is presumed to control your firm.

   - A ***person*** is presumed to control a corporation if the ***person***: (i) directly or indirectly has the right to vote 25 percent or more of a class of the corporation's voting securities; or (ii) has the power to sell or direct the sale of 25 percent or more of a class of the corporation's voting securities.

   - A ***person*** is presumed to control a partnership if the ***person*** has the right to receive upon dissolution, or has contributed, 25 percent or more of the capital of the partnership.

   - A ***person*** is presumed to control a limited liability company ("LLC") if the ***person***: (i) directly or indirectly has the right to vote 25 percent or more of a class of the interests of the LLC; (ii) has the right to receive upon dissolution, or has contributed, 25 percent or more of the capital of the LLC; or (iii) is an elected manager of the LLC.

   - A ***person*** is presumed to control a trust if the ***person*** is a trustee or ***managing agent*** of the trust.

   [Used in: General Instructions; Part 1A, Instructions, Items 2, 7, 10, 11, 12, Schedules A, B, C, D; Regulatory DRP]

8. **Custody:** Your firm has custody if it directly or indirectly holds ***client*** funds or securities, has any authority to obtain possession of them, or has the ability to appropriate them. Your firm has custody, for example, if it has a general power of attorney over a ***client's*** account or signatory power over a ***client's*** checking account. See SEC rule 206(4)-2. *[Used in: Part 1A, Item 9; Part 1B, Instructions, Item 2; Part 2A, Items 15, 18]*

9. **Discretionary Authority or Discretionary Basis:** Your firm has discretionary authority or manages assets on a discretionary basis if it has the authority to decide which securities to purchase and sell for the ***client***. Your firm also has discretionary authority if it has the authority to decide which investment advisers to retain on behalf of the ***client***. *[Used in: Part 1A, Instructions, Item 8; Part 1B, Instructions; Part 2A, Items 4, 16, 18; Part 2B, Instructions]*

10. **Employee:** This term includes an independent contractor who performs advisory functions on your behalf. *[Used in: Part 1A, Instructions, Items 1, 5, 7, 11]*

11. **Enjoined:** This term includes being subject to a mandatory injunction, prohibitory injunction, preliminary injunction, or a temporary restraining ***order***. *[Used in: Part 1A, Item 11; DRPs]*

12. **Felony:** For jurisdictions that do not differentiate between a felony and a ***misdemeanor***, a felony is an offense punishable by a sentence of at least one year imprisonment and/or a fine of at least $1,000. The term also includes a general court martial. *[Used in: Part 1A, Item 11; DRPs; Part 2A, Item 9; Part 2B, Item 3]*

13. **FINRA CRD** or **CRD:** The Web Central Registration Depository ("CRD") system operated by FINRA for the registration of broker-dealers and broker-dealer representatives. *[Used in: Part 1A, Item 1; Form ADV-W, Item 1]*

14. **Foreign Financial Regulatory Authority:** This term includes (1) a foreign securities authority; (2) another governmental body or foreign equivalent of a ***self-regulatory organization*** empowered by a foreign government to administer or enforce its laws relating to the regulation of ***investment-related*** activities; and (3) a foreign membership organization, a function of which is to regulate the participation of its members in the activities listed above. *[Used in: Part 1A, Items 1, 11; DRPs; Part 2A, Item 9; Part 2B, Item 3]*

15. **Found:** This term includes adverse final actions, including consent decrees in which the respondent has neither admitted nor denied the findings, but does not include agreements, deficiency letters, examination reports, memoranda of understanding, letters of caution, admonishments, and similar informal resolutions of matters. *[Used in: Part 1A, Item 11; Part 1B, Item 2; Part 2A, Item 9; Part 2B, Item 3]*

16. **Government Entity:** Any state or political subdivision of a state, including (i) any agency, authority, or instrumentality of the state or political subdivision; (ii) a plan or pool of assets ***controlled*** by the state or political subdivision or any agency, authority or instrumentality thereof; and (iii) any officer, agent, or employee of the state or political subdivision or any agency, authority or instrumentality thereof, acting in their official capacity. *[Used in: Part 1A, Item 5]*

17. **High Net Worth Individual:** An individual with at least $750,000 managed by you, or whose net worth your firm reasonably believes exceeds $1,500,000, or who is a "qualified purchaser" as defined in section 2(a)(51)(A) of the Investment Company Act of 1940. The net worth of an individual may include assets held jointly with his or her spouse. *[Used in: Part 1A, Item 5]*

18. **Home State:** If your firm is registered with a ***state securities authority***, your firm's "home state" is the state where it maintains its ***principal office and place of business***. *[Used in: Part 1B, Instructions]*

19. **Impersonal Investment Advice:** Investment advisory services that do not purport to meet the objectives or needs of specific individuals or accounts. *[Used in: Part 1A, Instructions; Part 2A, Instructions; Part 2B, Instructions]*

20. **Investment Adviser Representative:** Investment adviser representatives of SEC-registered advisers are subject to state registration in each state in which they have a ***place of business.*** Any of your firm's ***supervised persons*** (except those that provide only ***impersonal investment advice***) is an investment adviser representative, if --

    - the ***supervised person*** regularly solicits, meets with, or otherwise communicates with your firm's ***clients***,
    - the ***supervised person*** has more than five ***clients*** who are natural persons and not ***high net worth individuals***, and
    - more than ten percent of the ***supervised person's*** clients are natural persons and not ***high net worth individuals*.**

    NOTE: If your firm is registered with the ***state securities authorities*** and not the SEC, your firm may be subject to a different state definition of "investment adviser representative."

[Used in: Part 2, General Instructions; Part 2A, Item 14; Part 2B, Item 1]

21. **Investment-Related:** Activities that pertain to securities, commodities, banking, insurance, or real estate (including, but not limited to, acting as or being associated with an investment adviser, broker-dealer, municipal securities dealer, government securities broker or dealer, issuer, investment company, futures sponsor, bank, or savings association). *[Used in: Part 1A, Item 11; DRPs; Part 1B, Item 2; Part 2A, Item 9; Part 2B, Item 3]*

22. **Involved:** Engaging in any act or omission, aiding, abetting, counseling, commanding, inducing, conspiring with or failing reasonably to supervise another in doing an act. *[Used in: Part 1A, Item 11; Part 2A, Item 9; Part 2B, Item 3]*

23. **Management Persons:** Anyone with the power to exercise, directly or indirectly, a ***controlling*** influence over your firm's management or policies, or to determine the general investment advice given to the ***clients*** of your firm.

    Generally, all of the following are management persons:

    - Your firm's principal executive officers, such as your chief executive officer, chief financial officer, chief operations officer, chief legal officer, and chief compliance

officer; your directors, general partners, or trustees; and other individuals with similar status or performing similar functions;

- The members of your firm's investment committee or group that determines general investment advice to be given to ***clients***; and

- If your firm does not have an investment committee or group, the individuals who determine general investment advice provided to ***clients*** (if there are more than five people, you may limit your firm's response to their supervisors).

[Used in: Part 1B, Item 2; Part 2A, Items 9, 10]

24. **Managing Agent:** A managing agent of an investment adviser is any ***person***, including a trustee, who directs or manages (or who participates in directing or managing) the affairs of any unincorporated organization or association that is not a partnership. *[Used in: General Instructions; Form ADV-NR]*

25. **Minor Rule Violation:** A violation of a ***self-regulatory organization*** rule that has been designated as "minor" pursuant to a plan approved by the SEC. A rule violation may be designated as "minor" under a plan if the sanction imposed consists of a fine of $2,500 or less, and if the sanctioned ***person*** does not contest the fine. (Check with the appropriate ***self-regulatory organization*** to determine if a particular rule violation has been designated as "minor" for these purposes.) *[Used in: Part 1A, Item 11]*

26. **Misdemeanor:** For jurisdictions that do not differentiate between a ***felony*** and a misdemeanor, a misdemeanor is an offense punishable by a sentence of less than one year imprisonment and/or a fine of less than $1,000. The term also includes a special court martial. *[Used in: General Instructions; Part 1A, Item 11; DRPs; Part 2A, Item 9; Part 2B, Item 3]*

27. **Non-Resident:** (a) an individual who resides in any place not subject to the jurisdiction of the United States; (b) a corporation incorporated in or having its ***principal office and place of business*** in any place not subject to the jurisdiction of the United States; and (c) a partnership or other unincorporated organization or association that has its ***principal office and place of business*** in any place not subject to the jurisdiction of the United States. *[Used in: General Instructions; Form ADV-NR]*

28. **Notice Filing:** SEC-registered advisers may have to provide ***state securities authorities*** with copies of documents that are filed with the SEC. These filings are referred to as "notice filings." *[Used in: General Instructions; Part 1A, Item 2; Execution Page(s); Form ADV-W]*

29. **Order:** A written directive issued pursuant to statutory authority and procedures, including an order of denial, exemption, suspension, or revocation. Unless included in an order, this term

does not include special stipulations, undertakings, or agreements relating to payments, limitations on activity or other restrictions. *[Used in: Part 1A, Items 2 and 11; Schedule D; DRPs; Part 2A, Item 9; Part 2B, Item 3]*

30. **Performance-Based Fee:** An investment advisory fee based on a share of capital gains on, or capital appreciation of, ***client*** assets. A fee that is based upon a percentage of assets that you manage is not a performance-based fee. *[Used in: Part 1A, Item 5]*

31. **Person:** A natural person (an individual) or a company. A company includes any partnership, corporation, trust, limited liability company ("LLC"), limited liability partnership ("LLP"), or other organization. *[Used throughout Form ADV and Form ADV-W]*

32. **Principal Place of Business** or **Principal Office and Place of Business:** Your firm's executive office from which your firm's officers, partners, or managers direct, ***control***, and coordinate the activities of your firm. *[Used in: Part 1A, Instructions, Items 1 and 2; Schedule D; Form ADV-W, Item 1]*

33. **Proceeding:** This term includes a formal administrative or civil action initiated by a governmental agency, ***self-regulatory organization*** or ***foreign financial regulatory authority***; a ***felony*** criminal indictment or information (or equivalent formal charge); or a ***misdemeanor*** criminal information (or equivalent formal charge). This term does not include other civil litigation, investigations, or arrests or similar charges effected in the absence of a formal criminal indictment or information (or equivalent formal charge). *[Used in: Part 1A, Item 11; DRPs; Part 1B, Item 2; Part 2A, Item 9; Part 2B, Item 3]*

34. **Related Person:** Any ***advisory affiliate*** and any ***person*** that is under common ***control*** with your firm. *[Used in: Part 1A, Items 7, 8, 9; Schedule D; Form ADV-W, Item 3; Part 2A, Instructions, Items 5, 10, 11, 12, 14, 15]*

35. **Self-Regulatory Organization** or **SRO:** Any national securities or commodities exchange, registered securities association, or registered clearing agency. For example, the Chicago Board of Trade ("CBOT"), FINRA and New York Stock Exchange ("NYSE") are self-regulatory organizations. *[Used in: Part 1A, Item 11; DRPs; Part 1B, Item 2; Part 2A, Item 9; Part 2B, Item 3]*

36. **Sponsor:** A sponsor of a ***wrap fee program*** sponsors, organizes, or administers the program or selects, or provides advice to ***clients*** regarding the selection of, other investment advisers in the program. *[Used in: Part 1A, Item 5; Schedule D; Part 2A, Instructions, Appendix 1 Instructions]*

37. **State Securities Authority:** The securities commission (or any agency or office performing like functions) of any state of the United States, the District of Columbia, Puerto Rico, the Virgin Islands, or any other possession of the United States. *[Used throughout Form ADV]*

38. **Supervised Person:** Any of your officers, partners, directors (or other ***persons*** occupying a similar status or performing similar functions), or ***employees***, or any other ***person*** who provides investment advice on your behalf and is subject to your supervision or ***control***. *[Used in: Part 2, General Instructions; Part 2A, Item 6; Used throughout Part 2B]*

39. **Wrap Brochure** or **Wrap Fee Program Brochure:** The written disclosure statement that ***sponsors*** of ***wrap fee programs*** are required to provide to each of their ***wrap fee program clients***. *[Used in: Part 2, General Instructions; Used throughout Part 2A, Appendix 1]*

40. **Wrap Fee Program:** Any advisory program under which a specified fee or fees not based directly upon transactions in a ***client's*** account is charged for investment advisory services (which may include portfolio management or advice concerning the selection of other investment advisers) and the execution of ***client*** transactions. *[Used in: Part 1, Item 5; Schedule D; Part 2A, Instructions, Item 4, used throughout Appendix 1; Part 2B, Instructions]*

Appendix C

FORM ADV (Paper Version)
UNIFORM APPLICATION FOR INVESTMENT ADVISER REGISTRATION

PART 2: Uniform Requirements for Investment Adviser *Brochure* and *Brochure Supplements*

General Instructions for Part 2 of Form ADV

Under SEC and similar state rules, you are required to deliver to *clients* and prospective *clients* a *brochure* disclosing information about your firm. You also may be required to deliver a *brochure supplement* disclosing information about one or more of your *supervised persons.* Part 2 of Form ADV sets out the minimum required disclosure that your *brochure* (Part 2A for a firm *brochure*, or Appendix 1 for a *wrap fee program brochure*) and *brochure supplements* (Part 2B) must contain.

1. Narrative Format. Part 2 of Form ADV consists of a series of items that contain disclosure requirements for preparing your firm's *brochure* and any required supplements. The items require narrative responses. You may omit responses to the items that do not apply to your business. You do not have to provide responses in the same order as the items appear, and you should not repeat the items themselves in the *brochure* or the supplements. A *brochure* would not need to repeat information simply because the information is responsive to more than one item.

2. Plain English. The items in Part 2 of Form ADV are designed to promote effective communication between you and your *clients*. Write your *brochure* and supplements in plain English, taking into consideration your *clients*' level of financial sophistication. Your *brochure* should be concise and direct. In drafting your *brochure* and *brochure supplements*, you should: (i) use short sentences; (ii) use definite, concrete, everyday words; (iii) use active voice; (iv) use tables or bullet lists for complex material, whenever possible; (v) avoid legal jargon or highly technical business terms unless you explain them or you believe that your *clients* will understand them; and (vi) avoid multiple negatives. Consider providing examples to illustrate a description of your practices or policies.

   Note: The SEC's Office of Investor Education and Advocacy has published A Plain English Handbook. You may find the handbook helpful in writing your *brochure* and supplements. For a copy of this handbook, visit the SEC's web site at<www.sec.gov/news/extra/handbook.htm> or call 1-800-SEC-0330.

3. Full Disclosure of All Conflicts of Interest. Under federal and state law, you are a fiduciary required to make full disclosure to your *clients* of all material facts, including conflicts of interest between you and your *client* and any other material information that could affect the advisory relationship. You therefore may have to disclose to *clients* information not specifically required by Part 2 of Form ADV. You may disclose this additional information to *clients* in your *brochure* or by some other means.

4. Full and Truthful Disclosure. All information in your *brochure* and *brochure supplements* must be true and may not omit any material facts.

5. Filing. You must file your *brochure(s)* (and amendments) through the IARD system. See SEC rules 203-1 and 204-1 and similar state rules. If you are registered or are registering with the SEC, you are not required to file your *brochure supplements* through the IARD or otherwise. You must, however, preserve a copy of the supplements and make them available to SEC staff upon request. See SEC rule 204-2(a)(14). If you are registered or are registering with one or more of the *state securities authorities*, you must file a copy of the *brochure supplement* for each *supervised person* and each *investment adviser representative* doing business in that state. You should contact the appropriate *state securities authorities* to determine if this filing should be made electronically through the IARD or by a paper filing with the state.

Instructions for Part 2A of Form ADV: Preparing Your Firm *Brochure*

1. To whom must we deliver a firm *brochure*? You must give a firm *brochure* to each *client*. You must deliver the *brochure* even if your advisory agreement with the *client* is oral. See SEC rule 204-3(b)(1) and similar state rules.

   For SEC-registered advisers: You are not required to deliver your *brochure* to either (i) *clients* who receive only *impersonal investment advice* from you and who will pay you less than $500 per year or (ii) *clients* that are SEC-registered investment companies or business development companies (the *client* must be registered under the Investment Company Act of 1940 or be a business development company as defined in that Act, and the advisory contract must meet requirements of section 15(c) of that Act). See SEC rule 204-3(c).

   Note: Even if you are not required to give a *brochure* to a *client*, as a fiduciary you may still be required to provide your *clients* with similar information, particularly material information about your conflicts of interest and about your disciplinary information. If you are not required to give a *client* a *brochure*, you may make any required disclosures to that *client* by delivery of your *brochure* or through some other means.

2. When must we deliver a *brochure* to *clients*?
   - You must give a firm *brochure* to each *client* before or at the time you enter into an advisory agreement with that *client*. See SEC rule 204-3(b)(1) and similar state rules.
   - Each year you must deliver to each *client* a free updated *brochure* within 120 days of the end of your fiscal year. See SEC rule 204-3(b)(1) and similar state rules.
   - You do not have to deliver an interim amendment to *clients* unless the amendment includes information in response to Item 9 of Part 2A (disciplinary information). An interim amendment can be in the form of a "sticker" that identifies the information that has become inaccurate and provides the new information and the date of the sticker. See SEC rules 204-1 and 204-3(e) and similar state rules.

   Note: As a fiduciary, you have an ongoing obligation to inform your *clients* of any material information that could affect the advisory relationship. As a result, between *annual updating amendments* you must disclose material changes to *clients* even if those changes do not trigger delivery of an interim amendment. See General Instructions for Part 2 of Form ADV, Instruction 3.

3. May we deliver our *brochure* electronically? Yes. The SEC has published interpretive guidance on delivering documents electronically, which you can find at <www.sec.gov/rules/concept/33-7288.txt>.

4. When must we update our *brochure*? You must update your *brochure*: (i) each year at the time you file your *annual updating amendment*; and (ii) promptly whenever any information in the *brochure* becomes materially inaccurate. You are not generally required to update your *brochure* between annual amendments solely because the amount of *client* assets you manage has changed or because your fee schedule has changed. However, if you are updating your *brochure* for a separate reason in between annual amendments, and the amount of *client* assets you manage listed in response to Item 4.E or your fee schedule listed in response to Item 5.A has become materially inaccurate, you should update that item(s) as part of the interim amendment. All updates to your *brochure* must be filed through the IARD system and maintained in your files. See SEC rules 204-1 and 204-2(a)(14) and similar state rules.

5. We have determined that we have no *clients* to whom we must deliver a *brochure*. Must we prepare one? No.

6. We offer several advisory services. May we prepare multiple firm *brochure*s? Yes. If you offer substantially different types of advisory services, you may opt to prepare separate *brochure*s so long as each *client* receives all applicable information about services and fees. Each *brochure* may omit information that does not apply to the advisory services and fees it describes. For example, your firm *brochure* that describes one advisory service can omit the fee schedule for a different advisory service that is not discussed in the *brochure*. See SEC rule

204-3(f) and similar state rules. If you prepare separate *brochures* you must file each *brochure* (and any amendments) through the IARD system as required in SEC rules 203-1 and 204-1 and similar state rules.

7. We *sponsor* a *wrap fee program.* Is there a different *brochure* that we need to deliver to our wrap fee *clients*? Yes. If you *sponsor* a *wrap fee program*, you must deliver a *wrap fee program brochure* to your wrap fee *clients*. The disclosure requirements for preparing a *wrap fee program brochure* (also called a *wrap brochure*) appear in Part 2A Appendix 1 of Form ADV. If your entire advisory business is *sponsoring wrap fee programs*, you do not need to prepare a firm *brochure* separate from your *wrap brochure(s)*. See SEC rule 204-3(d).

8. We provide portfolio management services to *clients* in *wrap fee programs* that we do not *sponsor*. Which *brochure* must we deliver to these *clients*? You must deliver your firm *brochure* to your wrap fee *clients*. You also must deliver to these *clients* any *brochure supplements* required by Part 2B of Form ADV.

9. May we include information not required by an item in our *brochure*? Yes. If you include information not required by an item, however, you may not include so much additional information that the required information is obscured.

10. Item 18 requires us to give our *clients* an audited balance sheet. May any public accountant perform the audit? Your auditor must be independent. Article 2 of SEC Regulation S-X sets out the general rules for auditor independence. Please note that these requirements may be different from the rules of professional organizations.

11. We are a new firm. Do we need a *brochure*? Yes. Respond to items in Part 2A of Form ADV based on the advisory services you propose to provide and the practices, policies and procedures you propose to adopt.

12. We are a "separately identifiable department or division" (SID) of a bank. Must our *brochure* discuss our bank's general business practices? No. Information you include in your firm *brochure* (or in *brochure supplements*) should be information about you, the SID, and your business practices, rather than general information about your bank.

Part 2A of Form ADV: Firm *Brochure*

Item 1 Cover Page

A. The cover page of your *brochure* must state your name, business address, telephone number, Web site address (if you have one), and the date of the *brochure*.

Note: If you primarily conduct advisory business under a name different from your full legal name, and you have disclosed your business name in Item 1.B of Part 1A of Form ADV, then you may use your business name throughout your *brochure*.

B. Display on the cover page of your *brochure* the following (or other clear and concise language conveying the same information):

This brochure provides information about the qualifications and business practices of [your name]. If you have any questions about the contents of this brochure, please contact [name and telephone number of service center or name and/or title and telephone number of contact person]. The information in this brochure has not been approved or verified by the United States Securities and Exchange Commission or by any state securities authority.

Additional information about [your name] also is available on the Internet at www.adviserinfo.sec.gov.

C. If you refer to yourself as a "registered investment adviser" or describe yourself as being "registered," include a statement that registration does not imply a certain level of skill or training.

Item 2 Material Changes

If your *brochure* contains material changes from its last annual update, identify those changes on the cover page of the *brochure* or on the page immediately following the cover page, or in a separate communication accompanying the *brochure*. You must state clearly that you are discussing only material changes since the last annual update of your *brochure*, and you must provide the date of the last annual update of your *brochure*.

Note: You do not have to provide this information to a *client* or prospective *client* who has not received a previous version of your *brochure*.

Item 3 Table of Contents

Provide a table of contents to your *brochure*.

Note: Your table of contents must be detailed enough so that your *clients* can locate topics easily. However, your *brochure* is not required to follow the same order as the items listed in Part 2.

Item 4 Advisory Business

A. Describe your advisory firm, including how long you have been in business. Identify your principal owner(s).

Notes: (1) For purposes of this item, your principal owners include the *persons* you list as owning 25% or more of your firm on Schedule A of Part 1A of Form ADV (Ownership Codes C, D or E). (2) If you are a publicly held company without a 25% shareholder, simply disclose that you are publicly held. (3) If an individual or company owns 25% or more of your firm through subsidiaries, you must identify the individual or parent company and intermediate subsidiaries. If you are a state-registered adviser, you must

identify all intermediate subsidiaries. If you are an SEC-registered adviser, you must identify intermediate subsidiaries that are publicly held, but not other intermediate subsidiaries.

B. Describe the types of advisory services you offer. If you hold yourself out as specializing in a particular type of advisory service, such as financial planning, quantitative analysis, or market timing, explain the nature of that service in greater detail. If you provide investment advice only with respect to limited types of investments, explain the type of investment advice you offer, and disclose that your advice is limited to those types of investments.

C. Explain whether (and, if so, how) you tailor your advisory services to the individual needs of *clients*. Explain whether *clients* may impose restrictions on investing in certain securities or types of securities.

D. If you participate in *wrap fee programs* by providing portfolio management services, (1) describe the differences, if any, between how you manage wrap fee accounts and how you manage other accounts, and (2) explain that you receive a portion of the wrap fee for your services.

E. If you manage *client* assets, disclose the amount of *client* assets you manage on a *discretionary basis* and the amount of *client* assets you manage on a non-*discretionary basis*. Disclose the date "as of" which you calculated the amounts.

Note: Your method for computing the amount of "*client* assets you manage" can be different from the method for computing "assets under management" required for Item 5.F in Part 1A. However, if you choose to use a different method to compute "*client* assets you manage," you must keep documentation describing the method you use. The amount you disclose may be rounded to the nearest $100,000. Your "as of" date must not be more than three months before the date you last updated your *brochure* in response to this Item 4.E.

Item 5 Fees and Compensation

A. Describe how you are compensated for your advisory services. Provide your fee schedule. Disclose whether the fees are negotiable.

B. Describe whether you deduct fees from *clients*' assets or bill *clients* for fees incurred. If *clients* may select either method, disclose this fact. Explain how often you bill *clients* or deduct your fees.

C. Describe any other types of fees or expenses *clients* may pay in connection with your advisory services, such as custodian fees or mutual fund expenses. Disclose that *clients* will incur brokerage and other transaction costs, and direct *clients* to the section(s) of your *brochure* that discuss brokerage.

D. If your *clients* either may or must pay your fees in advance, disclose this fact. Explain how a *client* may obtain a refund of a pre-paid fee if the advisory contract is terminated before the end of the billing period. Explain how you will determine the amount of the refund.

E. If you or any of your *supervised persons* accepts compensation for the sale of securities or other investment products, including distribution or service ("trail") fees from the sale of mutual funds, disclose this fact and respond to Items 5.E.1, 5.E.2, 5.E.3 and 5.E.4.

1. Explain that this practice presents a conflict of interest and gives you or your *supervised persons* an incentive to recommend investment products based on the compensation received, rather than on a *client's* needs. Describe generally how you address conflicts that arise, including your procedures for disclosing the conflicts to *clients*. If you primarily recommend mutual funds, disclose whether you will recommend "no-load" funds.

2. Explain that *clients* have the option to purchase investment products that you recommend through other brokers or agents that are not affiliated with you.

3. If more than 50% of your revenue from advisory *clients* results from commissions and other compensation for the sale of investment products you recommend to your *clients*, including trail fees from the sale of mutual funds, disclose that commissions provide your primary or, if applicable, your exclusive compensation.

4. If you charge advisory fees in addition to commissions, disclose whether you reduce your advisory fees to offset the commissions you accept.

Note: If you receive compensation in connection with the purchase or sale of securities, you should carefully consider the applicability of the broker-dealer registration requirements of the Securities Exchange Act of 1934 and any applicable state securities statutes.

Item 6 Performance Fees and Side-By-Side Management

If you or any of your *supervised persons* accepts "performance fees" – that is, fees based on a share of capital gains on or capital appreciation of the assets of a *client* (such as a *client* that is a hedge fund or other pooled investment vehicle) – disclose this fact. If you or any of your *supervised persons* manage both accounts that are charged a performance fee and accounts that are charged another type of fee, such as an hourly or flat fee, or an asset-based fee, disclose this fact. Explain the conflicts of interest that you or your *supervised persons* face by managing these accounts at the same time, including that you or your *supervised persons* have an incentive to favor accounts for which you or your *supervised persons* receive a performance fee, and describe generally how you address these conflicts.

Item 7 Types of *Clients*

Describe the types of *clients* to whom you generally provide investment advice, such as individuals, trusts, investment companies, or pension plans. If you have any requirements for opening or maintaining an account, such as a minimum account size, disclose the requirements.

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

A. Describe the methods of analysis and investment strategies you use in formulating investment advice or managing assets. Explain that investing in securities involves risk of loss that *clients* should be prepared to bear.

B. If you primarily use a particular method of analysis or strategy, explain the specific risks involved. If the method of analysis or strategy involves significant or unusual risks, discuss these risks in detail. If your primary strategy involves frequent trading of securities, explain how frequent trading can affect investment performance, particularly through increased brokerage and other transaction costs and taxes.

C. If you recommend primarily a particular type of security, explain the specific risks involved. If the type of security involves significant or unusual risks, discuss these risks in detail.

D. Discuss your practices regarding cash balances in *client* accounts, including whether you invest cash balances for temporary purposes and, if so, how.

Item 9 Disciplinary Information

If there are legal or disciplinary events that are material to a *client's* or prospective *client's* evaluation of your advisory business or the integrity of your management, disclose all material facts regarding those events.

Items 9.A, 9.B, and 9.C list specific legal and disciplinary events that you must presume are material for this Item. If your advisory firm or a *management person* has been *involved* in one of these events, you must disclose it under this Item for ten years following the date of the event, unless (1) the event was resolved in your or the *management person's* favor, or was reversed, suspended or vacated, or (2) the event is not material (see Note below). For purposes of calculating this ten-year period, the "date" of an event is the date that the final *order*, judgment, or decree was entered, or the date that any rights of appeal from preliminary *orders*, judgments or decrees lapsed.

Items 9.A, 9.B, and 9.C do not contain an exclusive list of material disciplinary events. If your advisory firm or a *management person* has been *involved* in a legal or disciplinary event that is not listed in Items 9.A, 9.B, or 9.C, but nonetheless is material to a *client's* or prospective *client's* evaluation of your advisory business or the integrity of its management, you must disclose the event. Similarly, even if more than ten years have passed since the date of the event, you must disclose the event if it is so serious that it remains currently material to a *client's* or prospective *client's* evaluation.

A. A criminal or civil action in a domestic, foreign or military court of competent jurisdiction in which your firm or a *management person*

   1. was convicted of, or pled guilty or nolo contendere ("no contest") to (a) any *felony*; (b) a *misdemeanor* that *involved* investments or an *investment-related* business, fraud, false statements or omissions, wrongful taking of property, bribery, perjury, forgery, counterfeiting, or extortion; or (c) a conspiracy to commit any of these offenses;

   2. is the named subject of a pending criminal *proceeding* that involves an *investment-related* business, fraud, false statements or omissions, wrongful taking of property, bribery, forgery, counterfeiting, extortion, or a conspiracy to commit any of these offenses;

   3. was *found* to have been *involved* in a violation of an *investment-related* statute or regulation; or

   4. was the subject of any *order*, judgment, or decree permanently or temporarily enjoining, or otherwise limiting, your firm or a *management person* from engaging in any *investment-related* activity, or from violating any *investment-related* statute, rule, or *order*.

B. An administrative *proceeding* before the SEC, any other federal regulatory agency, any state regulatory agency, or any *foreign financial regulatory authority* in which your firm or a *management person*

   1. was *found* to have caused an *investment-related* business to lose its authorization to do business; or

   2. was *found* to have been *involved* in a violation of an *investment-related* statute or regulation and was the subject of an *order* by the agency or authority

      (a) denying, suspending, or revoking the authorization of your firm or a *management person* to act in an *investment-related* business;

      (b) barring or suspending your firm's or a *management person's* association with an *investment-related* business;

      (c) otherwise significantly limiting your firm's or a *management person's investment-related* activities; or

(d) imposing a civil money penalty of more than $2,500 on your firm or a *management person*.

C. A *self-regulatory organization* (*SRO*) *proceeding* in which your firm or a *management person*

1. was *found* to have caused an *investment-related* business to lose its authorization to do business; or

2. was *found* to have been *involved* in a violation of the *SRO's* rules and was: (i) barred or suspended from membership or from association with other members, or was expelled from membership; (ii) otherwise significantly limited from *investment-related* activities; or (iii) fined more than $2,500.

Note: Special circumstances may make an event immaterial (overcoming the materiality presumption). If an event is immaterial, you are not required to disclose it. When you review a legal or disciplinary event involving your firm or a *management person* for materiality, you should consider all of the following factors: (1) the proximity of the *person involved* in the disciplinary event to the advisory function; (2) the nature of the infraction that led to the disciplinary event; (3) the severity of the disciplinary sanction; and (4) the time elapsed since the date of the disciplinary event. If you conclude that the materiality presumption is overcome, you must prepare and maintain a file memorandum of your determination in your records. See SEC rule 204-2(a)(14)(iii).

Item 10 Other Financial Industry Activities and Affiliations

A. If you or any of your *management persons* are registered, or have an application pending to register, as a broker-dealer or a registered representative of a broker-dealer, disclose this fact.

B. If you or any of your *management persons* are registered, or have an application pending to register, as a futures commission merchant, commodity pool operator, a commodity trading advisor, or an associated person of the foregoing entities, disclose this fact.

C. Describe any relationship or arrangement that is material to your advisory business or to your *clients*, that you or any of your *management persons* have with any *related person* listed below. Identify the *related person* and if the relationship or arrangement creates a material conflict of interest with *clients*, describe the nature of the conflict and how you address it.

1. broker-dealer, municipal securities dealer, or government securities dealer or broker
2. investment company or other pooled investment vehicle (including a mutual fund, closed-end investment company, unit investment trust, private investment company or "hedge fund," and offshore fund)
3. other investment adviser or financial planner
4. futures commission merchant, commodity pool operator, or commodity trading advisor
5. banking or thrift institution
6. accountant or accounting firm
7. lawyer or law firm
8. insurance company or agency
9. pension consultant
10. real estate broker or dealer
11. sponsor or syndicator of limited partnerships.

D. If you recommend or select other investment advisers for your *clients* and you receive compensation directly or indirectly from those advisers, or you have other business relationships with those advisers, describe these practices and discuss the conflicts of interest these practices create and how you address them.

Item 11 Code of Ethics, Participation or Interest in *Client* Transactions and Personal Trading

A. If you are an SEC-registered adviser, briefly describe your code of ethics adopted pursuant to SEC rule 204A-1. Explain that you will provide a copy of your code of ethics to any *client* or prospective *client* upon request.

B. If you or a *related person* recommends to *clients*, or buys or sells for *client* accounts, securities in which you or a *related person* has a material financial interest (excluding an interest as a shareholder of an SEC-registered, open-end investment company), describe your practice and discuss the conflicts of interest it presents. Describe generally how you address conflicts that arise, including your procedures for disclosing the conflicts to *clients*. You do not need to repeat any information you provided in response to Item 5 of Part 2A.

   Examples: (1) You or a *related person*, as principal, buys securities from (or sells securities to) your *clients*; (2) you or a *related person* acts as general partner in a partnership in which you solicit *client* investments; or (3) you or a *related person* acts as investment adviser to an investment company that you recommend to *clients*.

C. If you or a *related person* invests in the same securities (or related securities, *e.g.*, warrants, options or futures) that you or a *related person* recommends to *clients*, describe your practice and discuss the conflicts of interest this presents and generally how you address the conflicts that arise in connection with personal trading.

D. If you or a *related person* recommends securities to *clients*, or buys or sells securities for *client* accounts, at or about the same time that you or a *related person* buys or sells the same securities for your own (or the *related person's* own) account, describe your practice and discuss the conflicts of interest it presents. Describe generally how you address conflicts that arise.

Note: The description required by Item 11.A may include information responsive to Item 11.B, C or D. If so, it is not necessary to make repeated disclosures of the same information.

Item 12 Brokerage Practices

A. Describe the factors that you consider in selecting or recommending broker-dealers for *client* transactions and determining the reasonableness of their compensation (*e.g.*, commissions).

   1. Research and Other Soft Dollar Benefits. If you receive research or other products or services other than execution from a broker-dealer or a third party in connection with *client* securities transactions ("soft dollar benefits"), disclose your practices and discuss the conflicts of interest they create.

      Note: Your disclosure and discussion must include all soft dollar benefits you receive, including, in the case of research, both proprietary research (created or developed by the broker-dealer) and research created or developed by a third party.

      a. Explain that when you use *client* brokerage commissions (or markups or markdowns) to obtain research or other products or services, you receive a benefit because you do not have to produce or pay for the research, products or services.

      b. Disclose that you may have an incentive to select or recommend a broker-dealer based on your interest in receiving the research or other products or services, rather than on your *clients*' interest in receiving best execution.

c. If you may cause *clients* to pay commissions (or markups or markdowns) higher than those charged by other broker-dealers in return for soft dollar benefits (known as paying-up), disclose this fact.

d. Disclose whether you use soft dollar benefits to service all of your *clients*' accounts or only those that paid for the benefits. Disclose whether you seek to allocate soft dollar benefits to *client* accounts proportionately to the soft dollar credits the accounts generate.

e. Describe the types of products and services you or any of your *related persons* acquired with *client* brokerage commissions (or markups or markdowns) within your last fiscal year.

Note: This description must be specific enough for your *clients* to understand the types of products or services that you are acquiring and to permit them to evaluate possible conflicts of interest. Your description must be more detailed for products or services that do not qualify for the safe harbor in section 28(e) of the Securities Exchange Act of 1934, such as those services that do not aid in investment decision-making or trade execution. Merely disclosing that you obtain various research reports and products is not specific enough.

f. Explain the procedures you used during your last fiscal year to direct *client* transactions to a particular broker-dealer in return for soft dollar benefits you received.

2. Brokerage for *Client* Referrals. If you consider, in selecting or recommending broker-dealers, whether you or a *related person* receives *client* referrals from a broker-dealer or third party, disclose this practice and discuss the conflicts of interest it creates.

a. Disclose that you may have an incentive to select or recommend a broker-dealer based on your interest in receiving *client* referrals, rather than on your *clients*' interest in receiving best execution.

b. Explain the procedures you used during your last fiscal year to direct *client* transactions to a particular broker-dealer in return for *client* referrals.

3. Directed Brokerage.

a. If you routinely recommend, request or require that a *client* direct you to execute transactions through a specified broker-dealer, describe your practice or policy. Explain that not all advisers require their *clients* to direct brokerage. If you and the broker-dealer are affiliates or have another economic relationship that creates a material conflict of interest, describe the relationship and discuss the conflicts of interest it presents. Explain that by directing brokerage you may be unable to achieve best execution of *client* transactions, and that this practice may cost *clients* more money.

b. If you permit a *client* to direct brokerage, describe your practice. If applicable, explain that you may be unable to achieve best execution of *client* transactions. Explain that directing brokerage may cost *clients* more money. For example, in a directed brokerage account, the *client* may pay higher brokerage commissions because you may not be able to aggregate orders to reduce transaction costs, or the *client* may receive less favorable prices.

Note: If you only permit *clients* to direct brokerage subject to best execution, you do not need to respond to Item 12.A.3.b.

B. Discuss whether and under what conditions you aggregate the purchase or sale of securities for various *client* accounts in quantities sufficient to obtain reduced transaction costs (known as bunching). If you do

not bunch orders when you have the opportunity to do so, explain your practice and describe the costs to *clients* of not bunching.

Item 13 Review of Accounts

A. Indicate whether you periodically review *client* accounts or financial plans. If you do, describe the frequency and nature of the review, and the titles of the *employees* who conduct the review.

B. If you review *client* accounts on other than a periodic basis, describe the factors that trigger a review.

C. Describe the content and indicate the frequency of regular reports you provide to *clients* regarding their accounts. State whether these reports are written.

Item 14 Payment for *Client* Referrals

A. If someone who is not a *client* provides an economic benefit to you for providing investment advice or other advisory services to your *clients*, generally describe the arrangement. For purposes of this Item, economic benefits include any sales awards or other prizes. You do not need to repeat any information you provided in response to Item 5 of Part 2A.

B. If you or a *related person* directly or indirectly compensates any *person* who is not your *employee* for *client* referrals, describe the arrangement and the compensation.

Note: If you compensate any *person* for *client* referrals, you should consider whether SEC rule 206(4)-3 or similar state rules regarding solicitation arrangements and/or state rules requiring registration of *investment adviser representatives* apply.

Item 15 *Custody*

A. If you have *custody* of *client* funds or securities and a qualified custodian as defined in SEC rule 206(4)-2 or similar state rules (for example, a broker-dealer or bank) does not send account statements with respect to those funds or securities directly to your *clients*, state that you have *custody* and explain the risks that *clients* will face because of this.

B. If you have *custody* of *client* funds or securities and a qualified custodian sends quarterly, or more frequent, account statements directly to your *clients*, explain that *clients* will receive account statements from the broker-dealer, bank or other qualified custodian and that *clients* should carefully review those statements.

Item 16 Investment Discretion

If you accept *discretionary authority* to manage securities accounts on behalf of *clients*, disclose this fact and describe any limitations *clients* may (or customarily do) place on this authority. Describe the procedures you follow before you assume this authority (*e.g.*, execution of a power of attorney).

Item 17 Voting *Client* Securities

A. If you have, or will accept, authority to vote *client* securities, briefly describe your voting policies and procedures, including those adopted pursuant to SEC rule 206(4)-6. Describe whether (and, if so, how) your *clients* can direct your vote in a particular solicitation. Describe how you address conflicts of interest between you and your *clients* with respect to voting their securities. Describe how *clients* may obtain information from you about how you voted their securities. Explain to *clients* that they may obtain a copy of your proxy voting policies and procedures upon request.

B. If you routinely rely on one or more third-party proxy voting services to advise you in connection with voting *client* securities, list the proxy voting services that you use, describe how you select the proxy voting services, and explain whether you permit *clients* to direct the use of a particular proxy voting service with respect to the securities held in their accounts. (You do not need to identify a proxy voting service that a *client* directs you to use unless you also use the service for the purpose of voting the securities of other *clients*). Describe whether you pay for proxy voting services with soft dollars or pass the cost on to your *clients* through a supplement to your advisory fee.

C. If you do not have authority to vote *client* securities, disclose this fact. Explain whether *clients* will receive their proxies or other solicitations directly from their custodian or a transfer agent or from you, and discuss whether (and, if so, how) *clients* can contact you with questions about a particular solicitation.

Item 18 Financial Information

A. If you require or solicit prepayment of more than $1,200 in fees per *client*, six months or more in advance, include a balance sheet for your most recent fiscal year.

1. The balance sheet must be prepared in accordance with generally accepted accounting principles, audited by an independent public accountant, and accompanied by a note stating the principles used to prepare it, the basis of securities included, and any other explanations required for clarity.

2. Show parenthetically the market or fair value of securities included at cost.

3. Qualifications and any accompanying independent accountant's report must conform to Article 2 of SEC Regulation S-X.

Note: If you are a sole proprietor, show investment advisory business assets and liabilities separate from other business and personal assets and liabilities. You may aggregate other business and personal assets unless advisory business liabilities exceed advisory business assets.

Note: If you have not completed your first fiscal year, include a balance sheet dated not more than 90 days prior to the date of your *brochure*.

Exception: You are not required to respond to Item 18.A of Part 2A if you also are: (i) a qualified custodian as defined in SEC rule 206(4)-2 or similar state rules; or (ii) an insurance company.

B. If you are an SEC-registered adviser and you have *discretionary authority* or *custody* of *client* funds or securities, or you require or solicit prepayment of more than $1,200 in fees per *client*, six months or more in advance, disclose any financial condition that is reasonably likely to impair your ability to meet contractual commitments to *clients*.

Note: With respect to Items 18.A and 18.B, if you are registered or are registering only with one or more of the *state securities authorities*, the dollar amount reporting threshold for including the required balance sheet and for making the required financial condition disclosures is more than $500 in fees per *client*, six months or more in advance.

C. If you have been the subject of a bankruptcy petition at any time during the past ten years, disclose this fact, the date the petition was first brought, and the current status.

Item 19 Index

The *brochure* you file with the SEC or *state securities authorities* must contain an index of the items required by this Part 2A, indicating where in the *brochure* you address each item (*e.g.*, Item 9 or "Disciplinary Information" on

page 12). If you do not include an item in the *brochure*, note that fact and the reason it is not included in the index (*e.g.*, Item 10 or "Other Financial Industry Activities and Affiliations" does not apply so it is not included). The *brochure* you provide to your *clients* does not need to include this index.

If you are registering or are registered with one or more *state securities authorities*, you must respond to the following additional Item.

Item 20 Requirements for State-Registered Advisers

A. Identify each of your principal executive officers and *management persons*, and describe their formal education and business background. If you have supplied this information elsewhere in your Form ADV, you do not need to repeat it in response to this Item.

B. Describe any business in which you are actively engaged (other than giving investment advice) and the approximate amount of time spent on that business. If you have supplied this information elsewhere in your Form ADV, you do not need to repeat it in response to this Item.

C. In addition to the description of your fees in response to Item 5 of Part 2A, if you or a *supervised person* are compensated for advisory services with *performance-based fees*, explain how these fees will be calculated. Disclose specifically that *performance-based compensation* may create an incentive for the adviser to recommend an investment that may carry a higher degree of risk to the *client*.

D. If you or a *management person* has been *involved* in one of the events listed below, disclose all material facts regarding the event.

1. An award or otherwise being *found* liable in an arbitration claim alleging damages in excess of $2,500, *involving* any of the following:

   (a) an investment or an *investment-related* business or activity;
   (b) fraud, false statement(s), or omissions;
   (c) theft, embezzlement, or other wrongful taking of property;
   (d) bribery, forgery, counterfeiting, or extortion; or
   (e) dishonest, unfair, or unethical practices.

2. An award or otherwise being *found* liable in a civil, *self-regulatory organization*, or administrative *proceeding involving* any of the following:

   (a) an investment or an *investment-related* business or activity;
   (b) fraud, false statement(s), or omissions;
   (c) theft, embezzlement, or other wrongful taking of property;
   (d) bribery, forgery, counterfeiting, or extortion; or
   (e) dishonest, unfair, or unethical practices.

E. In addition to any relationship or arrangement described in response to Item 10.C. of Part 2A, describe any relationship or arrangement that you or any of your *management persons* have with any issuer of securities that is not listed in Item 10.C. of Part 2A.

Instructions for Part 2A Appendix 1 of Form ADV:
Preparing Your *Wrap Fee Program Brochure*

1. Who must deliver a *wrap fee program brochure*? If you *sponsor* a *wrap fee program*, you must give a *wrap brochure* to each *client* of the *wrap fee program*.

   However, if a *wrap fee program* that you *sponsor* has multiple *sponsors* and another *sponsor* creates and delivers to your *wrap fee program clients* a *wrap brochure* that includes all the information required in your *wrap brochure*, you do not have to create or deliver a separate *wrap brochure.*

   A *wrap brochure* takes the place of your advisory firm *brochure* required by Part 2A of Form ADV, but only for *clients* of *wrap fee programs* that you *sponsor*. See SEC rule 204-3(b)(1) and (f).

2. When must a *wrap fee program brochure* be delivered?
   - You must give a *wrap brochure* to each *client* of the *wrap fee program* before or at the time the *client* enters into a *wrap fee program* contract.
   - Each year you must deliver to each *client* an updated *wrap brochure* within 120 days of the end of your fiscal year.
   - You do not have to deliver an interim amendment to *clients* unless the amendment includes information in response to Item 9 of Part 2A (disciplinary information). An interim amendment can be in the form of a "sticker" that identifies the information that has become inaccurate and provides the new information and the date of the sticker. See SEC rule 204-3(b)(1), (f)(1), and (g).

   Note: As a fiduciary, you have a continuing obligation to inform your *clients* of any material information that could affect the advisory relationship. As a result, between *annual updating amendments* you must disclose to *clients* changes that are material to them even if those changes do not trigger delivery of an interim amendment.

3. When must we update our *wrap brochure*? You must update your *wrap brochure*: (i) each year at the time you file your *annual updating amendment*, and (ii) promptly whenever any information in the *wrap brochure* (other than information in response to Item 4.A of this Appendix (service fees/schedule)) becomes materially inaccurate. See SEC rules 204-1 and 204-2(a)(14)(i).

4. May we deliver our *wrap fee program brochure* electronically? Yes. You may deliver your *wrap brochure* using electronic media. The SEC has published interpretive guidance on delivering documents electronically, which you can find at <www.sec.gov/rules/concept/33-7288.txt>.

5. Must we also deliver *brochure supplements* to *wrap fee program clients*? Yes. A *wrap brochure* does not take the place of any supplements required by Part 2B of Form ADV.

6. What if we *sponsor* more than one *wrap fee program*? You may prepare a single *wrap brochure* describing all the *wrap fee programs* you *sponsor*, or you may prepare separate *wrap brochure*s that describe one or more of your *wrap fee programs*. If you prepare separate *brochures*, each *brochure* must state that you *sponsor* other *wrap fee programs* and must explain how the *client* can obtain *brochure*s for the other programs.

7. We provide portfolio management services under a *wrap fee program* that we *sponsor*. Must we deliver both our *wrap brochure* and our firm *brochure* to our *wrap fee program clients*? No, just the *wrap brochure*. If you or your *employees* provide portfolio management services under a *wrap fee program* that you also *sponsor*, your *wrap brochure* must describe the investments and investment strategies you (or your *employees*) will use as portfolio managers. This requirement appears in Item 6.B of this Appendix.

8. We provide other advisory services outside of our *wrap fee programs*. May we combine our *wrap brochure* into our firm *brochure* for *clients* receiving these other services? No. Your *wrap brochure* must address only the *wrap fee program*s you *sponsor*. See SEC rule 204-3(d)(1).

Part 2A Appendix 1 of Form ADV: *Wrap Fee Program Brochure*

Item 1 Cover Page

A. The cover page of your *wrap fee program brochure* must state your name, business address, telephone number, Web site address (if you have one), and the date of the *wrap brochure*.

Note: If you primarily conduct advisory business under a name different from your full legal name, and you have disclosed your business name in Item 1.B of Part 1A of Form ADV, then you may use your business name throughout your *wrap brochure*.

B. Display on the cover page of your *wrap brochure* the following (or other clear and concise language conveying the same information):

This brochure provides information about the qualifications and business practices of [your name]. If you have any questions about the contents of this brochure, please contact [name and telephone number of service center or name and/or title and telephone number of contact person]. The information in this brochure has not been approved or verified by the United States Securities and Exchange Commission or by any state securities authority.

Additional information about [your name] also is available on the Internet at www.adviserinfo.sec.gov.

C. If you refer to yourself as a "registered investment adviser" or describe yourself as being "registered," include a statement that registration does not imply a certain level of skill or training.

Item 2 Material Changes

If your *wrap brochure* contains material changes from its last annual update, identify those changes on the page immediately following the cover page of the *wrap brochure* or in a separate letter accompanying the *wrap brochure*. You must clearly state that you are discussing only material changes since the last annual update of the *wrap brochure*, and must provide the date of the last annual update to the *wrap brochure*.

Note: You do not have to provide this information to a *client* or prospective *client* who has not received a previous version of your *wrap brochure*.

Item 3 Table of Contents

Provide a table of contents to your *wrap brochure*.

Note: Your table of contents must be detailed enough so that your *clients* can locate topics easily.

Item 4 Services, Fees and Compensation

A. Describe the services, including the types of portfolio management services, provided under each program. Indicate the wrap fee charged for each program or, if fees vary according to a schedule, provide your fee schedule. Indicate whether fees are negotiable and identify the portion of the total fee, or the range of fees, paid to portfolio managers.

B. Explain that the program may cost the *client* more or less than purchasing such services separately and describe the factors that bear upon the relative cost of the program, such as the cost of the services if provided separately and the trading activity in the *client's* account.

C. Describe any fees that the *client* may pay in addition to the wrap fee, and describe the circumstances under which *clients* may pay these fees, including, if applicable, mutual fund expenses and mark-ups, mark-downs, or spreads paid to market makers.

D. If the *person* recommending the *wrap fee program* to the *client* receives compensation as a result of the *client's* participation in the program, disclose this fact. Explain, if applicable, that the amount of this compensation may be more than what the *person* would receive if the *client* participated in your other programs or paid separately for investment advice, brokerage, and other services. Explain that the *person*, therefore, may have a financial incentive to recommend the *wrap fee program* over other programs or services.

Item 5 Account Requirements and Types of *Clients*

If a *wrap fee program* imposes any requirements to open or maintain an account, such as a minimum account size, disclose these requirements. If there is a minimum amount for assets placed with each portfolio manager as well as a minimum account size for participation in the *wrap fee program*, disclose and explain these requirements. To the extent applicable to your *wrap fee program clients*, describe the types of *clients* to whom you generally provide investment advice, such as individuals, trusts, investment companies, or pension plans.

Item 6 Portfolio Manager Selection and Evaluation

A. Describe how you select and review portfolio managers, your basis for recommending or selecting portfolio managers for particular *clients*, and your criteria for replacing or recommending the replacement of portfolio managers for the program and for particular *clients*.

1. Describe any standards you use to calculate portfolio manager performance, such as industry standards or standards used solely by you.

2. Indicate whether you review, or whether any third-party reviews, performance information to determine or verify its accuracy or its compliance with presentation standards. If so, briefly describe the nature of the review and the name of any third party conducting the review.

3. If applicable, explain that neither you nor a third-party reviews portfolio manager performance information, and/or that performance information may not be calculated on a uniform and consistent basis.

B. Disclose whether any of your *related persons* act as a portfolio manager for a *wrap fee program* described in the *wrap fee program brochure*. Explain the conflicts of interest that you face because of this arrangement and describe how you address these conflicts of interest. Disclose whether *related person* portfolio managers are subject to the same selection and review as the other portfolio managers that participate in the *wrap fee program*. If they are not, describe how you select and review *related person* portfolio managers.

C. If you, or any of your *employees* covered under your investment adviser registration, act as portfolio manager for a *wrap fee program* described in the *wrap brochure*, respond to Items 4.B, 4.C, 4.D (Advisory Business), 6 (Performance Fees and Side-By-Side Management), 8.A (Methods of Analysis, Investment Strategies and Risk of Loss) and 17 (Voting *Client* Securities) of Part 2A of Form ADV.

Item 7 *Client* Information Provided to Portfolio Managers

Describe the information about *clients* that you communicate to the *clients*' portfolio managers, and how often or under what circumstances you provide updated information.

Item 8 *Client* Contact with Portfolio Managers

Explain any restrictions placed on *clients*' ability to contact and consult with their portfolio managers.

Item 9 Additional Information

A. Respond to Item 9 (Disciplinary Information) and Item 10 (Other Financial Industry Activities and Affiliations) of Part 2A of Form ADV.

B. Respond to Items 11 (Code of Ethics, Participation or Interest in *Client* Transactions and Personal Trading), 13 (Review of Accounts), 14 (Payment for *Client* Referrals), and 18 (Financial Information) of Part 2A of Form ADV, as applicable to your wrap fee *clients*.

Item 10 Index

The *wrap brochure* you file with the SEC or *state securities authorities* must contain (or be accompanied by) an index of the items required by this Appendix, indicating where in the *wrap brochure* you address each item. The *wrap brochure* you provide to your *clients* does not need to include this index.

If you are registering or are registered with one or more *state securities authorities*, you must respond to the following additional Item.

Item 11 Requirements for State-Registered Advisers

Respond to Item 20.E of Part 2A of Form ADV.

Instructions for Part 2B of Form ADV: Preparing a *Brochure Supplement*

1. For which *supervised persons* must we prepare a *brochure supplement*? As an initial matter, if you have no *clients* to whom you must deliver a *brochure supplement* (see Instruction 2 below), then you need not prepare any *brochure supplements*. Otherwise, you must prepare a *brochure supplement* for the following *supervised persons*:

   (i) Any *supervised person* who formulates investment advice for a *client* and has direct *client* contact; and

   (ii) Any *supervised person* who has *discretionary authority* over a *client's* assets, even if the *supervised person* has no direct *client* contact. See SEC rule 204-3(b)(2) and similar state rules.

   Note: No supplement is required for a *supervised person* who has no direct *client* contact and has *discretionary authority* over a *client*'s assets only as part of a team.

2. To whom must we deliver *brochure supplements*? Are there any exceptions?

   You must deliver to a *client* the *brochure supplements* for each *supervised person* who provides advisory services to that *client*. However, there are four categories of *clients* to whom you are not required to deliver *supplements*. See SEC rule 204-3(c) and similar state rules.

   First, you are not required to deliver supplements to *clients* to whom you are not required to deliver a firm *brochure* (or a *wrap fee program brochure*).

   Second, you are not required to deliver supplements to *clients* who receive only *impersonal investment advice*, even if they receive a firm *brochure*.

   Third, you are not required to deliver supplements to *clients* who are "qualified purchasers" – a term defined in section 2(a)(51)(A) of the Investment Company Act of 1940. A "qualified purchaser" generally includes:

   (i) Any individual who owns not less than $5 million in investments;

   (ii) Any company that owns not less than $5 million in investments and that is owned by or for 2 or more natural persons who are related (*i.e.*, siblings or spouses, direct lineal descendants by birth or adoption, spouses of such persons, the estates of such persons, or foundations, charitable organizations, or trusts established by or for the benefit of such persons); and

   (iii) Any *person* who owns or invests on a *discretionary basis* (for his own account or for the accounts of other qualified purchasers) not less than $25,000,000 in investments.

   Fourth, you are not required to deliver supplements to *clients* who are individuals who would be "qualified clients" of your firm under SEC rule 205-3(d)(1)(iii). Those persons are:

   (i) Any executive officers, directors, trustees, general partners, or persons serving in a similar capacity, of your firm; and

   (ii) Any employees of your firm (other than employees performing solely clerical, secretarial or administrative functions) who, in connection with their regular functions or duties, participate in the investment activities of your firm and have been performing such functions or duties for at least 12 months.

3. When must we deliver a supplement to a *client*?

- You must deliver the supplement for a *supervised person* before or at the time that *supervised person* begins to provide advisory services to a *client*.

- You also must deliver to *clients* any update to the supplement that amends information in response to Item 3 of Part 2B (disciplinary information). Such an amendment can be in the form of a "sticker" that identifies the information that has become inaccurate and provides the new information and the date of the sticker.

  Note: As a fiduciary, you have a continuing obligation to inform your *clients* of any material information that could affect the advisory relationship. As a result, between *annual updating amendments* you must disclose material changes to *clients* even if those changes do not trigger delivery of an updated supplement.

You may have a *supervised person* deliver supplements (including his own) on your behalf. Furthermore, you are not required to file *brochure supplements* or updates, but you must maintain copies of them. See Instruction 5 of SEC General Instructions for Part 2 of Form ADV.

4. When must we update *brochure supplements*? You must update *brochure supplements* promptly whenever any information in them becomes materially inaccurate.

5. May we deliver *brochure supplements* electronically? Yes. You may deliver supplements using electronic media. The SEC has published interpretive guidance on delivering documents electronically, which you can find at <www.sec.gov/rules/concept/33-7288.txt>.

6. Must *brochure supplements* be separate documents? No. If your firm *brochure* includes all the information required in a *brochure supplement*, you do not need a separate supplement. Smaller firms with just a few *supervised persons* may find it easier to include all supplement information in their firm *brochure*, while larger firms may prefer to use a firm *brochure* and separate supplements.

   If your firm *brochure* includes some (but not all) supplement information about a *supervised person*, the supplement can refer the reader to the appropriate section(s) of your firm *brochure* and describe the type of information being referred to instead of repeating that information in the supplement.

   You may prepare supplements for groups of *supervised persons*. A group supplement, or a firm *brochure* presenting supplement information about *supervised persons*, must present information in a separate section for each *supervised person*.

7. Must an adviser who is a sole proprietor provide his own *brochure supplement* to *clients*? No, if that information is included in the firm *brochure*.

8. May we include information not required by an item in a *brochure supplement*? Yes. If you include information not required by an item, however, you may not include so much additional information that the required information is obscured.

Part 2B of Form ADV: *Brochure Supplement*

Item 1 Cover Page

A. Include the following on the cover page of the supplement:

1. The *supervised person's* name, business address and telephone number (if different from yours).
2. Your firm's name, business address and telephone number. If your firm *brochure* uses a business name for your firm, use the same business name for the firm in the supplement.
3. The date of the supplement.

B. Display on the cover page statements containing the following or other clear and concise language conveying the same information:

This supplement provides information about [name of *supervised person*] that supplements the [name of advisory firm] brochure. You should have received a copy of that brochure. Please contact [service center or name and/or title of your contact *person*] if you did not receive [name of advisory firm]'s brochure or if you have any questions about the contents of this supplement.

Additional information about [name of *supervised person*] is available on the Internet at www.adviserinfo.sec.gov.

Note: You do not have to include this statement directing *clients* to the public website until such time that information about *investment adviser representatives* is available through the Investment Adviser Public Disclosure System. In addition, you do not have to include this statement directing *clients* to the public website unless the *supervised person* is an *investment adviser representative* required to register with *state securities authorities*.

Item 2 Educational Background and Business Experience

Disclose the *supervised person's* name, age (or year of birth), formal education after high school, and business background for the preceding five years. If the *supervised person* either has no formal education after high school or has no business background, disclose this fact.

Item 3 Disciplinary Information

If there are legal or disciplinary events material to a *client's* or prospective *client's* evaluation of the *supervised person*, disclose all material facts regarding those events.

Items 3.A, 3.B, 3.C, and 3.D below list specific legal and disciplinary events that you must presume are material for this Item. If the *supervised person* has been *involved* in one of these events, you must disclose it under this Item for ten years following the date of the event, unless (1) the event was resolved in the *supervised person's* favor, or was reversed, suspended or vacated, or (2) the event is not material (see Note below). For purposes of calculating this ten-year period, the "date" of an event is the date the final *order*, judgment, or decree was entered, or the date any rights of appeal from preliminary *order*s, judgments or decrees lapsed.

Items 3.A, 3.B, 3.C, and 3.D do not contain an exclusive list of material disciplinary events. If the *supervised person* has been *involved* in a legal or disciplinary event that is not listed in Items 3.A, 3.B, 3.C, or 3.D but is material to a *client's* or prospective *client's* evaluation of the *supervised person's* integrity, you must disclose the event. Similarly, even if more than ten years have passed since the date of the event, you must disclose the event if it is so serious that it remains currently material to a *client's* or prospective *client's* evaluation.

A. A criminal or civil action in a domestic, foreign or military court of competent jurisdiction in which the *supervised person*

1. was convicted of, or pled guilty or nolo contendere ("no contest") to (a) any *felony*; (b) a *misdemeanor* that *involved* investments or an *investment-related* business, fraud, false statements or omissions, wrongful taking of property, bribery, perjury, forgery, counterfeiting, or extortion; or (c) a conspiracy to commit any of these offenses;

2. is the named subject of a pending criminal *proceeding* that involves an *investment-related* business, fraud, false statements or omissions, wrongful taking of property, bribery, forgery, counterfeiting, extortion, or a conspiracy to commit any of these offenses;

3. was *found* to have been *involved* in a violation of an *investment-related* statute or regulation; or

4. was the subject of any *order*, judgment, or decree permanently or temporarily enjoining, or otherwise limiting, the *supervised person* from engaging in any *investment-related* activity, or from violating any *investment-related* statute, rule, or *order*.

B. An administrative *proceeding* before the SEC, any other federal regulatory agency, any state regulatory agency, or any *foreign financial regulatory authority* in which the *supervised person*

1. was *found* to have caused an *investment-related* business to lose its authorization to do business; or

2. was *found* to have been *involved* in a violation of an *investment-related* statute or regulation and was the subject of an *order* by the agency or authority

   (a) denying, suspending, or revoking the authorization of the *supervised person* to act in an *investment-related* business;

   (b) barring or suspending the *supervised person's* association with an *investment-related* business;

   (c) otherwise significantly limiting the *supervised person's investment-related* activities; or

   (d) imposing a civil money penalty of more than $2,500 on the *supervised person*.

C. A *self-regulatory organization* (*SRO*) *proceeding* in which the *supervised person*

1. was *found* to have caused an *investment-related* business to lose its authorization to do business; or

2. was *found* to have been *involved* in a violation of the *SRO's* rules and was: (i) barred or suspended from membership or from association with other members, or was expelled from membership; (ii) otherwise significantly limited from *investment-related* activities; or (iii) fined more than $2,500.

D. Any other *proceeding* in which a professional attainment, designation, or license of the *supervised person* was revoked or suspended because of a violation of rules relating to professional conduct. If the *supervised person* resigned (or otherwise relinquished his attainment, designation, or license) in anticipation of such a *proceeding*, disclose the event.

Note: Special circumstances may make an event immaterial (overcoming the materiality presumption). If an event is immaterial, you are not required to disclose it. When you review a legal or disciplinary event involving the *supervised person* for materiality, you should consider all of the following factors: (1) the proximity of the *supervised person* to the advisory function; (2) the nature of the infraction that led to the disciplinary event; (3) the severity of the disciplinary sanction; and (4) the time elapsed since the date of the disciplinary event. If you

conclude that the materiality presumption is overcome, you must prepare and maintain a file memorandum of your determination in your records.

Item 4 Other Business Activities

A. If the *supervised person* is actively engaged in any *investment-related* business or occupation, including if the *supervised person* is registered, or has an application pending to register, as a broker-dealer, registered representative of a broker-dealer, futures commission merchant ("FCM"), commodity pool operator ("CPO"), commodity trading advisor ("CTA"), or an associated person of an FCM, CPO, or CTA, disclose this fact and describe the business relationship, if any, between the advisory business and the other business.

1. If a relationship between the advisory business and the *supervised person's* other financial industry activities creates a material conflict of interest with *clients*, describe the nature of the conflict and generally how you address it.

2. If the *supervised person* receives commissions, bonuses or other compensation based on the sale of securities or other investment products, including as a broker-dealer or registered representative, and including distribution or service ("trail") fees from the sale of mutual funds, disclose this fact. If this compensation is not cash, explain what type of compensation the *supervised person* receives. Explain that this practice gives the *supervised person* an incentive to recommend investment products based on the compensation received, rather than on the *client's* needs.

B. If the *supervised person* is actively engaged in any business or occupation for compensation not discussed in response to Item 4.A, above, and the other business activity or activities provide a substantial source of the *supervised person's* income or involve a substantial amount of the *supervised person's* time, disclose this fact and describe the nature of that business.

Item 5 Additional Compensation

If someone who is not a *client* provides an economic benefit to the *supervised person* for providing advisory services, generally describe the arrangement. For purposes of this Item, economic benefits include sales awards and other prizes, but do not include the *supervised person's* regular salary. Any bonus that is based, at least in part, on the number or amount of sales, *client* referrals, or new accounts should be considered an economic benefit, but other regular bonuses should not.

Item 6 Supervision

Explain how you *supervise* the *supervised person*, including how you monitor the advice the *supervised person* provides to *clients.* Provide the name, title and telephone number of the *person* responsible for supervising the *supervised person's* advisory activities on behalf of your firm.

If you are registering or are registered with one or more *state securities authorities*, you must respond to the following additional Item.

Item 7 Requirements for State-Registered Advisers

A. In addition to the events listed in Item 3 of Part 2B, if the *supervised person* has been *involved* in one of the events listed below, disclose all material facts regarding the event.

1. An award or otherwise being *found* liable in an arbitration claim alleging damages in excess of $2,500, *involving* any of the following:

(a) an investment or an *investment-related* business or activity;
(b) fraud, false statement(s), or omissions;
(c) theft, embezzlement, or other wrongful taking of property;
(d) bribery, forgery, counterfeiting, or extortion; or
(e) dishonest, unfair, or unethical practices.

2. An award or otherwise being *found* liable in a civil, *self-regulatory organization*, or administrative *proceeding involving* any of the following:

(a) an investment or an *investment-related* business or activity;
(b) fraud, false statement(s), or omissions;
(c) theft, embezzlement, or other wrongful taking of property;
(d) bribery, forgery, counterfeiting, or extortion; or
(e) dishonest, unfair, or unethical practices.

B. If the *supervised person* has been the subject of a bankruptcy petition, disclose that fact, the date the petition was first brought, and the current status.