

SEC Proposes Amendments to Form ADV and Related Rules

The Securities and Exchange Commission (the “SEC”) has proposed amendments to Part II of Form ADV and related rules under the Investment Advisers Act of 1940, as amended (the “Advisers Act”), to require, among other things, that registered investment advisers deliver to clients and prospective clients a brochure written in plain English.¹ Advisers would be required to file their brochures with the SEC electronically, and the brochures would be publicly available through the SEC’s website.

The SEC originally proposed amendments to the Form ADV Part II in 2000, as part of broader revisions to the entire document.² The SEC ultimately adopted changes to Form ADV Part I but deferred action on Form ADV Part II. The current proposal is, in effect, a re-proposal of these changes in response to public comments received at that time.

Part II of Form ADV sets forth the requirements for the disclosure statement that advisers must provide to prospective clients and offer to clients annually. Currently, Part II of Form ADV 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.³

The proposed amendments would rename this document “Part 2” and require a narrative brochure written in plain English. Advisers would file their brochures electronically with the SEC through the Investment Adviser Registration Depository (“IARD”) in PDF format, which would make the current version of the brochure available to the public through the SEC’s website.

The brochure would describe the adviser’s services (including whether it specializes in a particular type of advisory service and the amount of assets under management), adviser’s fees and other costs (such as brokerage, custody fees and fund expenses that the clients may pay in connection with the adviser’s services), business practices, conflicts of interests, and disciplinary history (including securities law violations). Further, the brochure would address specific additional disclosure requirements, including the receipt of a brokerage commission or similar compensation by the adviser or its personnel, directed brokerage practices, conflicts arising from simultaneous management of accounts that pay performance fees and those that do not, the receipt of “soft dollars” benefits, broker selection and determination of reasonableness of brokers’ compensation, personal trading by the adviser and its personnel, trade aggregation, proxy voting practices, the adviser’s interests in certain transactions, certain financial information about the adviser when material to clients, and other information necessary to make an informed decision about whether to rely on the adviser for advice. The adviser would also be required to describe briefly its code of ethics and to state that a copy is available upon request. Importantly, an adviser would have to respond only to the items that apply to its business and would have to explain succinctly how it addresses conflicts of interest (rather than disclosing its policies and procedures).⁴

Moreover, the SEC has proposed to amend Advisers Act Rule 204-3, which currently requires an adviser to annually deliver, or offer to deliver upon request, a written disclosure statement to each of its advisory clients. The proposed amendments would require that, in addition to the initial delivery requirement, the brochure must be delivered to existing clients annually within 120 days after the adviser’s fiscal year-end.⁵ The updated brochure (or an accompanying communication) would have to identify any material changes from the prior annual version of the brochure, unless the client did not receive the prior version. However, the initial delivery of the brochure would no longer be required to be at least 48 hours prior to the entry into the advisory contract. Under the proposed rule, the adviser would simply be required to deliver the brochure before or at the time of entering into the agreement.

Most significantly, an adviser who is not required to deliver the brochure to any clients (e.g., where its only clients are registered investment companies) would not be required to prepare or file Part 2 of Form ADV. Similar to existing requirements, the proposed rules would require advisers to keep the brochures they file with the SEC current by updating them at least annually and updating

¹ SEC Release Nos. IA-2711, 34-57419 (Mar. 3, 2008).

² SEC Release No. IA-1862, 65 FR 20524 (April 17, 2000).

³ Although advisers currently have the option of providing information in an entirely narrative format, the SEC noted that few advisers actually do so.

⁴ These proposed requirements represent a change from the 2000 proposal, and are intended to address industry concerns.

⁵ The proposal would 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 2 A of Form ADV.

them promptly when any information therein becomes materially inaccurate. The SEC has also proposed to expand the exception from the brochure delivery requirement, which is currently available to advisers of certain clients receiving only impersonal investment advice and registered investment companies, to include advisers to business development companies.

It should be noted that an adviser providing substantially different advisory services to different clients may provide them with different brochures, as long as each client receives all information about the services and fees applicable to that client. However, each brochure must be filed with the SEC through the IARD.

In addition, subject to certain exceptions, advisers would have to provide to clients brochure supplements that contain information about the advisory personnel on whom clients rely for investment advice.⁶ A brochure supplement ordinarily would be less than a page long and would contain information about the educational background, business experience, and disciplinary history (if any) of the supervised person who provides advisory services to that client. An adviser who does not have any clients to whom a supplement must be delivered is not required to prepare any supplements.⁷ The supplements would not need to be filed with the SEC or provided annually to existing clients.

As the proposal requires advisers to include disciplinary disclosures in their brochures, the SEC has proposed to withdraw the Advisers Act Rule 206(4)-4, which requires advisers to disclose certain financial and disciplinary information to clients.⁸ With respect to advisers who have clients to whom they are not required to deliver a brochure, the SEC has stated that such advisers' 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.

Furthermore, under the proposed amendment to Advisers Act Rule 204-2, registered investment advisers would be required to, among other things, retain copies of each brochure, brochure supplement and each amendment thereto that are prepared as required under Rule 204-3.

Finally, new applicants for registration with the SEC as investment advisers would not be required to include their brochures as part of their initial application for registration until six months after the effective date of these amendments.

Comments on the proposal are due on or before May 16, 2008. The proposal is available online at <http://www.sec.gov/rules/proposed/2008/ia-2711.pdf>.

⁶ The proposed amendment 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, or (ii) makes discretionary investment decisions for that client's assets, even if the supervised person has no direct client contact.

⁷ Also, 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.

⁸ In addition to requiring disclosure of 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.

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