SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 275 and 279

[Release No. IA-3060; File No. S7-10-00]

RIN 3235-AI17

Amendments to Form ADV

AGENCY: Securities and Exchange Commission.

ACTION: Final rule.

SUMMARY: The Securities and Exchange Commission is adopting amendments to Part 2 of Form ADV, and related rules under the Investment Advisers Act, to require investment advisers registered with us to provide new and prospective clients with a brochure and brochure supplements written in plain English. These amendments are designed to provide new and prospective advisory clients with clearly written, meaningful, current disclosure of the business practices, conflicts of interest and background of the investment adviser and its advisory personnel. Advisers must file their brochures with us electronically and we will make them available to the public through our website. The Commission also is withdrawing the Advisers Act rule requiring advisers to disclose certain disciplinary and financial information.

DATES: *Effective Date*: October 12, 2010. *Compliance Dates*: See Section V of this release.

FOR FURTHER INFORMATION CONTACT: Vivien Liu, Senior Counsel, Don L. Evans, Senior Counsel, Daniel S. Kahl, Branch Chief, or Sarah A. Bessin, Assistant Director, 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 20549-8549.

SUPPLEMENTARY INFORMATION: The Securities and Exchange Commission ("Commission" or "SEC") is adopting 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] under the Investment Advisers Act of 1940 [15 U.S.C. 80b] ("Advisers Act" or "Act");[1] and amendments to Form ADV [17 CFR 279.1] under the Advisers Act. The Commission also is withdrawing rule 206(4)-4 [17 CFR 275.206(4)-4] under the Advisers Act.

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I. INTRODUCTION

Investment advisers provide a wide range of advisory services and play an important role in helping individuals and institutions make significant financial decisions. From individuals

[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.

and families seeking to plan for retirement or save for college to large institutions managing billions of dollars, clients seek the services of investment advisers to help them evaluate their investment needs, plan for their future, develop and implement investment strategies, and cope with the ever-growing complexities of the financial markets. Today, the more than 11,000 advisers registered with us manage more than $38 trillion for more than 14 million clients.[2]

Under the Advisers Act, an adviser is a fiduciary whose duty is to serve the best interests of its clients, which includes an obligation not to subrogate clients' interests to its own.[3] An adviser must deal fairly with clients and prospective clients, seek to avoid conflicts with its clients and, at a minimum, make full disclosure of any material conflict or potential conflict.[4] A client may use this disclosure to select his or her own adviser and evaluate the adviser's business practices and conflicts on an ongoing basis. As a result, the disclosure clients and prospective clients receive is critical to their ability to make an informed decision about whether to engage an adviser and, having engaged the adviser, to manage that relationship.

To allow clients and prospective clients to evaluate the risks associated with a particular investment adviser, its business practices, and its investment strategies, it is essential that clients and prospective clients have clear disclosure that they are likely to read and understand. For example, such disclosure could enable a prospective client to screen advisers based on disciplinary history, financial industry affiliations or compensation methods. Such screening would allow clients to avoid advisers with a disciplinary history, should they wish to do so.

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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 May 3, 2010. We note that these figures will change due to the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

[3] *Proxy Voting by Investment Advisers*, Investment Advisers Act Release No. IA-2106 (Jan. 31, 2003) [68 FR 6585 (Feb. 7, 2003)] ("Proxy Voting Release").

[4] *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).

Clients also would be able to choose advisers based on affiliations and compensation methods; in some cases, the client may not be comfortable with the conflicts of interest that those affiliations and compensation methods create, while other clients may value an advisory relationship that allows for broader access to other financial services and may seek an adviser with financial industry affiliates. A prospective client may seek modifications to an investment advisory agreement to better protect the client against an investment adviser's potential conflict of interest, either by better aligning the adviser's interest with that of the client or by prohibiting a particular practice in the client's account. If an adviser is unwilling to make such modifications, a prospective client may select a different adviser.

Since 1979, the Commission has required each adviser registered with us to deliver a written disclosure statement to clients pursuant to rule 204-3 under the Advisers Act.[5] An investment adviser may use this client disclosure statement to satisfy its disclosure obligations as a fiduciary.[6] Part 2 of Form ADV sets out minimum requirements for this disclosure statement to clients, which is commonly referred to as the "brochure."[7]

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5 Advisers use Form ADV to apply for registration with us (Part 1A) or with state securities authorities (Part 1B), 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. Part 1(A and B) of Form ADV provides regulators with information to process registrations and to manage their regulatory and examination programs. Part 2A contains the requirements for the disclosure "brochure" that advisers must provide to prospective clients initially and to existing clients annually, and Part 2B contains information about the advisory personnel providing clients with investment advice. Prior to the amendments we are adopting today, Part 2 was designated as "Part II."

6 *See Investment Adviser Requirements Concerning Disclosure, Recordkeeping, Applications for Registration and Annual Filings*, Investment Advisers Act Release No. 664 (Jan. 30, 1979) [44 FR 7870 (Feb. 7, 1979)] ("1979 Adopting Release").

7 Items in Part 2 of Form ADV may not address all conflicts an adviser may have, and may not identify all material disclosure that an adviser may be required to provide clients. As a result, delivering a brochure prepared under Form ADV's requirements may not fully satisfy an adviser's disclosure obligations under the Advisers Act. *See* Instruction 3 of General Instructions for Part 2 of Form ADV; rule 204-3(f).

In the past, Part 2 has required 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 had the option of providing information required by Part 2 in an entirely narrative format, but few have done so.

In 2008, we proposed a different approach to enhance the disclosure statement advisers provide to their clients.[8] Instead of the check-the-box format, each adviser registered with us would provide clients with a narrative plain English brochure that describes the adviser's business, conflicts of interest, disciplinary history, and other important information that would help clients make an informed decision about whether to hire or retain that adviser. Our proposal was designed to require advisers to disclose meaningful information in a clearer format.[9] In addition, we proposed that advisers be required to file their brochures with us electronically so that we could make them available to the public on our website.[10]

We received 81 letters commenting on the Proposing Release.[11] Commenters agreed with our proposal to move to a narrative brochure,[12] although many suggested modifications to certain

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8 *Amendments to Form ADV*, Investment Advisers Act Release No. 2711 (Mar. 3, 2008) [73 FR 13958 (Mar. 14, 2008)] ("Proposing Release").

9 *See* Proposing Release, *supra* note 8at n.6 and accompanying text.

10 *Id.* at Section II.A.3.

11 Comment letters submitted in File No. S7-10-00 are available on the Commission's website at: http://www.sec.gov/rules/proposed/s71000.shtml.

12 *See, e.g.*, comment letter of the American Bar Association, Section of Business Law, Committee on Federal Regulation of Securities and Committee on State Regulation of Securities (June 18, 2008) ("ABA Committees Letter"); comment letter of the Consumer Federation of America (July 2, 2008) ("Consumer Federation Letter"); comment letter of Citigroup Global Markets Inc. (May 16, 2008) ("CGMI Letter"); comment letter of Fried, Frank, Harris, Shriver & Jacobson LLP (May 2, 2008) ("Fried Frank Letter"); comment letter of the Investment Adviser Association (May 16, 2008) ("IAA Letter"); comment letter of the Investment Company Institute (May 16, 2008) ("ICI Letter").

requirements.[13] After careful consideration of these comment letters, we are adopting amendments to Part 2 of Form ADV and related rules under the Advisers Act. In light of our adoption of Part 2, we also are withdrawing rule 206(4)-4, which separately required advisers to disclose to clients certain financial and disciplinary information, because our amendments render that rule largely duplicative.

II. DISCUSSION OF FORM ADV, PART 2

The revised Part 2 requirements that we are adopting today include two sub-parts, Part 2A and Part 2B.[14] Part 2A contains 18 disclosure items about the advisory firm that must be included in an adviser's brochure. We refer to Part 2B as the "brochure supplement," which includes information about certain advisory personnel on whom clients rely for investment advice. In this section, we discuss our amendments relating to each of these sub-parts, which are addressed separately because they are subject to differing content, updating and delivery requirements.

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13 *See, e.g.*, comment letter of Alternative Investment Compliance Association (May 16, 2008) ("AICA Letter"); comment letter of Capital Institutional Services, Inc. (May 16, 2008) ("CAPIS Letter"); comment letter of Shaun Eddy (May 9, 2008) ("Eddy Letter"); comment letter of the Financial Planning Association (May 16, 2008) ("FPA Letter"); Fried Frank Letter; IAA Letter; ICI Letter; comment letter of Janus Capital Management LLC (May 16, 2008) ("Janus Letter"); comment letter of Nancy Lininger (May 18, 2008) ("Lininger Letter"); comment letter of the National Association of Personal Financial Advisers (June 4, 2008) ("NAPFA Letter"); comment letter of National Compliance Services, Inc. (May 9, 2008) ("NCS Letter"); comment letter of National Regulatory Services (May 16, 2008) ("NRS Letter"); comment letter of L. A. Schnase (May 9, 2008) ("Schnase Letter"); comment letter of Sidley Austin LLP (May 23, 2008) ("Sidley Letter"); comment letter of USAA Investment Management Company/USAA Financial Planning Services Insurance Agency, Inc. (May 16, 2008) ("USAA Letter"); comment letter of Wellington Management Company, LLP (May 15, 2008) ("Wellington Letter").

14 Part 2 is a uniform form used by investment advisers registered with both the Commission and the state securities authorities. See Instruction 5 of General Instructions for Form ADV. This Release discusses the Commission's adoption of Form ADV and related rules applicable to advisers registered with the Commission. Form ADV is also used by state securities regulators to register investment advisers. It includes certain items and instructions to Part 2 (*e.g.*, Item 19 of Part 2A, Item 10 of Appendix 1 to Part 2A, and Item 7 of Part 2B) that apply only to state-registered advisers. State-registered advisers are required by state, rather than federal, law to respond to these items. Completion of these items, therefore, is not an SEC requirement, and these items are not included in this Release as an SEC rule.

A. Part 2A: Brochure Format and Content

1. Format

We are adopting a requirement that investment advisers registered with us provide prospective and existing clients with a narrative brochure written in plain English.[15] Commenters supported use of a narrative format.[16] For example, one commenter stated that "the current check-the-box format does not always result in clear and meaningful client disclosure and it presents challenges for advisers in identifying and presenting all of the types of information that should be addressed in Part 2."[17] Another commenter expressed the view that "the flexibility of a narrative format should result in clearer and more meaningful disclosures that make relevant information readily accessible to prospects and clients."[18] We believe these amendments 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.

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15 *See* Instructions 1 and 2 of General Instructions for Part 2 of Form ADV. In many instances where we refer to "client" in this release we are referring to both an existing and prospective client.

16 *See* ABA Committees Letter; comment letter of the American Institute of Certified Public Accountants (May 20, 2008) ("AICPA Letter"); CAPIS Letter; Consumer Federation Letter; CGMI Letter; Fried Frank Letter; IAA Letter; ICI Letter; Janus Letter; comment letter of Merrill Lynch, Pierce, Fenner & Smith, Incorporated (May 16, 2008) ("Merrill Lynch Letter"); comment letter of the Money Management Institute (May 16, 2008) ("MMI Letter"); comment letter of Morgan Stanley & Co. Incorporated (May 16, 2008) ("Morgan Stanley Letter"); NAPFA Letter; comment letter of the North American Securities Administrators Association, Inc. (May 16, 2008) ("NASAA Letter"); NRS Letter; comment letter of the National Society of Compliance Professionals Inc. (May 16, 2008) ("NSCP Letter"); comment letter of Charles Schwab & Co. and Charles Schwab Investment Management, Inc. (May 16, 2008) ("Schwab Letter"); Wellington Letter.

17 NAPFA Letter.

18 Wellington Letter.

We have added an instruction to Part 2 of Form ADV to require that an adviser provide the information in a specified format.[19] We are persuaded by commenters that this format for items in the brochure will facilitate investors' comparison of multiple advisers and are adopting this requirement.[20] An adviser must respond to each item in the brochure, and must present the information in order of the items in the form, using the headings provided by the form. If an item is inapplicable to an adviser, the adviser must include the heading and an explanation that the information is inapplicable.[21] If information an adviser provides in response to one item is also responsive to another item, the adviser may cross-reference the information in the other item.[22]

Also, it is critical that advisers communicate clearly to their clients and prospective clients in the brochure. Thus, instructions to Part 2 provide that, in drafting the brochure, advisers, among other things, should use short sentences; definite, concrete, everyday words; and the active voice. In addition, the brochure should discuss only conflicts the adviser has or is reasonably likely to have, and practices in which it engages in or is reasonably likely to engage.[23] If a conflict arises or the adviser decides to engage in a practice that it has not disclosed, supplemental information must be provided to the client.

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19 Instruction 1 of General Instructions for Part 2 of Form ADV.

20 *See* ABA Committees Letter; comment letter of First Allied Securities, Inc. (May 16, 2008) ("First Allied Letter"); comment letter of Mercer Advisors (May 2, 2008) ("Mercer Letter"); NCS Letter; NRS Letter; comment letter of Reed Smith on behalf of Federated Investors, Inc. (May 16, 2008) ("Federated Letter").

21 Instruction 1 of General Instructions for Part 2 of Form ADV.

22 *Id.*

23 Instruction 2 of General Instructions for Part 2 of Form ADV.

2. Brochure Items

Part 2A, as adopted, contains 18 separate items, each covering a different disclosure topic.[24] We have drawn the items in Part 2A largely from disclosure advisers have long been required to make in response to the previous Part 2, and have added items to address new concerns or developments. Much of the disclosure required in Part 2A addresses an adviser's conflicts of interest with its clients, and is disclosure that the adviser, as a fiduciary, must make to clients in some manner regardless of the form requirements.

Some commenters urged us to require fewer items and require advisers to provide less detailed information.[25] We have reviewed carefully these suggestions and have modified some of our items in response. In some cases, however, commenters urged us to eliminate particular proposed disclosures, such as the fee schedule, that have long been required in Part 2 and provide investors essential information. Elimination of such proposed disclosures would result in clients not receiving important information they currently receive from their advisers and on which they may rely. In many other cases, further cuts would not have reduced the amount of disclosure an adviser would have to make to clients, but rather would have permitted the disclosure to be made in a different document or manner. Thus, elimination of disclosure requirements in Part 2A suggested by some commenters would be unlikely to reduce burdens or eliminate the amount of information required to be provided to clients to satisfy an adviser's fiduciary obligations.[26]

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[24] Part 2A consists of 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 requires disclosure similar to current Schedule H of Part 2 of Form ADV. *See* rule 204-3(d); Appendix 1 to Part 2A; *infra* note 182 and accompanying text.

[25] *See*, *e.g.*, comment letter of the Financial Service Institute (May 16, 2008) ("FSI Letter"); Schwab Letter; comment letter of the Securities Industry and Financial Markets Association (May 16, 2008) ("SIFMA Letter"); comment letter of Sutherland Asbill & Brennan LLP (May 16, 2008) ("Sutherland Letter").

[26] Advisers with fewer conflicts and simpler business arrangements will be able to prepare shorter brochures.

We agree that disclosure to clients should be succinct and readable. We note that advisers, because of how they choose to present their programs or services to clients or the complexity of their disclosures, have the ability to take steps that would limit the length of their brochures. For example, advisers may create separate brochures for different types of advisory clients, each of which may be shorter, clearer, and contain less extraneous information than would a combined brochure.[27] Advisers that choose to disclose more than is required by the form (and their fiduciary obligations) will create lengthier brochures than those that take a more focused approach. Advisers with a more complicated offering of advisory services (or business arrangements) might consider including a summary in the beginning of their brochure, followed by a more detailed discussion of each item in the brochure. We have amended the instructions to clarify that including a summary is permissible.[28]

Below, we discuss each of the items in the form and the modifications we have made from our proposal.

Item 1. Cover Page. Item 1 requires that an adviser disclose on the cover page of its brochure the name of the firm, its business address, contact information, website (if it has one), and the date of the brochure. The cover page also must include a statement that the brochure has

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27 *See* rule 204-3(e) (allowing advisers that provide substantially different advisory services to different clients to provide clients with different brochures as long as each client receives all information about the services and fees that are applicable to that client). Note that an adviser may not omit any information required by Item 9 of Part 2A (Disciplinary Information) in any brochure provided to any client, and that each brochure must be filed through IARD. *See* rule 204-3(a); *see also* Instruction 2 for Part 2A of Form ADV. An adviser that creates separate brochures must file each brochure through the IARD system. *See* Instruction 9 for Part 2A of Form ADV.

28 *See* Instruction 8 of Instructions for Part 2A of Form ADV. We have also added an instruction to Part 2 explaining that advisers must provide the client with sufficiently specific facts so that the client is able to understand the conflicts of interest the adviser has and the business practices in which it engages, and can give his or her informed consent to the transaction or practice that gives rise to the conflict or to reject the transaction or practice. *See* Instruction 3 of General Instructions for Part 2 of Form ADV.

not been approved by the Commission or any state securities authority. If an adviser refers to itself as a "registered investment adviser," it also must include a disclaimer that registration does not imply a certain level of skill or training.[29]

The item reflects one change from our proposal. Item 1 requires an adviser to disclose on the cover page of the brochure only a general telephone number and/or e-mail address that clients can use to contact the adviser if they have questions about the brochure. Commenters asserted that some larger advisers would find it cumbersome to comply with our proposal, which would have required the name and phone number of a specific individual or service center.[30]

Item 2. Material Changes. Item 2 requires that an adviser amending its brochure identify and discuss the material changes since the last annual update on the cover page or the following page or as a separate document accompanying the brochure.[31] This item is designed to make clients aware of information that has changed since the prior year's brochure and that may be important to them.

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29 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.

30 *See* First Allied Letter; IAA Letter; SIFMA Letter.

31 Advisers may include the summary in their brochure or in a separate document. Item 2 of Part 2A. A summary prepared as a separate document can be used to satisfy an adviser's annual client delivery obligations. See rule 204-3(b)(2), discussed in Section II.A.3 below. Summaries provided as a separate document must be filed with the Commission as an exhibit to Part 2. *See* Note to paragraphs (a) and (b) of rule 204-1; Instruction 6 for Part 2A of Form ADV. If an adviser includes the summary of material changes in its brochure, and amends its brochure on an interim basis between annual updating amendments, the adviser should consider whether it should update its summary of material changes to avoid confusing or misleading clients reading the updated brochure. *See* Note to Instruction 6 for Part 2A of Form ADV.

Several commenters supported this requirement, agreeing that advisers can achieve meaningful disclosure with an annual disclosure highlighting changes to the brochure.[32] Others expressed concern that advisers would write lengthy summaries to avoid liability.[33] We emphasize that we intend this document to be a *summary* that identifies and broadly discusses the material changes,[34] and that it should *not* be a lengthy discussion that replicates the brochure itself.[35] Instead, the summary need contain no more than necessary to inform clients of the substance of the changes to the adviser's policies, practices or conflicts of interests so that they can determine whether to review the brochure in its entirety or to contact the adviser with questions about the changes.

Item 3. Table of Contents. Item 3 requires each adviser to include in its brochure a table of contents detailed enough to permit clients and prospective clients to locate topics easily. Some commenters supported the use of a table of contents but urged the Commission to mandate

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32 *See* ASG Letter; comment letter of the CFA Institute Centre for Financial Market Integrity (May 22, 2008) ("CFA Institute Letter"); Consumer Federation Letter; FPA Letter; IAA Letter; Janus Letter; NASAA Letter.

33 *See* AICA Letter; FSI Letter; ICI Letter; comment letter of Jackson, Grant Investment Advisers, Inc. (May 26, 2008) ("Jackson Letter"); comment letter of Katten Muchin Rosenman LLP (May 16, 2008) ("Katten Letter"); Mercer Letter; Morgan Stanley Letter; NSCP Letter; comment letter of the Financial Service Roundtable (May 16, 2008) ("Roundtable Letter"); SIFMA Letter; Sutherland Letter.

34 We have revised Item 2 to require advisers not only to identify, but also to "discuss" material changes to clarify our intent.

35 A few commenters also sought clarification of the term "material changes." *See* comment letter of the American Council of Life Insurance (May 16, 2008) ("ACLI Letter"); Fried Frank Letter; FSI Letter; IAA Letter; Roundtable Letter; comment letter of T. Rowe Price Associates, Inc. (May 16, 2008) ("T. Rowe Letter"). The standard of materiality under the Advisers Act is whether there is a substantial likelihood that a reasonable investor (here, client) would have considered the information important. *See S.E.C. v. Steadman*, 967 F.2d 636, 643 (D.C. Cir. 1992). *Cf. Basic Inc. v. Levinson*, 485 U.S. 224, 231-232 (1988); *TSC Industries v. Northway, Inc.*, 426 U.S. 438, 445, 449 (1976). This is a facts and circumstances test, requiring an assessment of the "total mix of information," in the characterization of the Supreme Court. *TSC Industries*, 426 U.S. at 449. Given that materiality depends on the factual situation, which may vary with each situation, we do not believe that it is appropriate to specifically define or provide any bright line tests for what is and is not material.

a uniform format so that investors can compare brochures of multiple advisers more easily.[36] Others opposed a uniform format, arguing that flexibility would enable an adviser to best convey information about its firm to clients.[37] As discussed above, we are persuaded by commenters that a uniform format for items in the brochure will facilitate investors' comparison of multiple advisers and are adopting this requirement. We therefore added an instruction to Part 2 of Form ADV to require advisers to present the information in the order of the items in the form, using the headings provided by the form.[38]

Item 4. Advisory Business. Item 4 requires each 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 may use a method that differs from the method used in Part 1A of Form ADV to report "assets under management."[39] An adviser opting to use a different method must keep documentation describing the method used.[40]

Two commenters urged the Commission not to require that advisers make additional disclosure if they hold themselves out as specializing in a particular type of advisory service. One was concerned that advisers would have interpretive problems in defining specialized advisory services and that disclosure describing specialized services would not provide

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36 *See supra* note 20.

37 *See* Fried Frank Letter; Janus Letter; Lininger Letter.

38 Instruction 1 of General Instructions for Part 2 of Form ADV.

39 For an explanation of Part 1A's requirements for computing "assets under management," see Instruction 5.B for Part 1A of Form ADV.

40 *See* rule 204-2(a)(14)(ii) and Note to Item 4.E of Part 2A.

meaningful information to clients.[41] The other argued that Item 8 (Strategies and Risks) covers similar information.[42] As we explained in the Proposing Release, we require that advisers identify a specialized advisory service because we believe that clients likely will want to understand this before engaging that adviser.[43] Accordingly, we are adopting this item as proposed.

Commenters were divided on whether we should require investment advisers to calculate the amount of their assets in a manner consistent with the instructions for Part 1A in order to avoid confusion.[44] The methodology for calculating assets required under Part 1A is designed for a particular purpose (*i.e.*, for making a determination as to whether an adviser should register with the Commission or with the states), rather than to convey meaningful information about the scope of the adviser's business. Thus, we are permitting advisers to use a different methodology for Part 2A disclosure.[45]

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41 *See* NAPFA letter.

42 *See* Sutherland Letter.

43 *See* Proposing Release at Section II.A.2.

44 The CFA Institute Letter, IAA Letter, Janus Letter, Mercer Letter, and NRS Letter argued that the calculation requirements should be the same. Others supported our proposal that would permit advisers to use a different calculation of assets under management than the one required for Part 1A, with most of these commenters arguing that this flexibility would allow advisers to more accurately portray the business of the firm and total assets managed. *See* comment letter of Ashland Compliance Group LLC (May 16, 2008) ("Ashland Letter"); Lininger Letter; MMI Letter; Morgan Stanley Letter.

45 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% of the portfolio's total value consists of securities. *See* current Form ADV: Instructions for Part 1A of Form ADV. Thus, for Part 1A purposes, an adviser will 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 division of responsibility for regulation of advisers between the Commission and state securities regulatory authorities. Pub. L. No. 104-290, 110 Stat. 3416 (1996).

Finally, several commenters urged that we permit an adviser to update the amount of assets under management only in its annual updating amendment rather than (as we proposed) at the time an adviser makes an interim update to its brochure if the amount had become materially inaccurate.[46] We believe that our proposal appropriately balanced the burdens that would be imposed on advisers by having to amend their brochures repeatedly with the need to provide clients with reasonably current information. Therefore, we are adopting this instruction as proposed.[47] Advisers must update the amount of their assets under management annually (as part of their annual updating amendment) and make interim amendments only for material changes in assets under management when they are filing an "other than annual amendment" for a separate reason. As we have noted, as a fiduciary, an adviser has an ongoing obligation to inform its clients of any material information that could affect the advisory relationship, which could include a material change to assets under management.[48]

Item 5. Fees and Compensation. Item 5 requires that an adviser describe in its brochure how it is compensated for its advisory services, provide a fee schedule, and disclose whether fees are negotiable.[49] An adviser must disclose whether it bills clients or deducts fees directly from clients' accounts, and how often it assesses fees (or bills clients).[50] The item also requires each adviser to describe the types of other costs, such as brokerage, custody fees and fund expenses

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46 *See* Morgan Stanley Letter; MMI Letter.

47 *See* Note to Instruction 4 of General Instructions for Form ADV.

48 Note to Instruction 2 of Instructions for Part 2A of Form ADV. Disclosure updating the adviser's assets under management could be provided to clients by means other than the brochure. We have brought enforcement actions charging advisers with engaging in fraud by misrepresenting their assets under management to advisory clients and prospective clients, including in advisory brochures. *See, e.g., SEC v. Locke Capital Management, Inc. and Leila C. Jenkins*, Litigation Release No. 20936 (Mar. 9, 2009) (settled order).

49 *See* Item 5.A of Part 2A.

50 *See* Item 5.B of Part 2A.

that clients may pay in connection with the advisory services provided to them by the adviser.[51] An adviser charging fees in advance must explain how it calculates and refunds prepaid fees when a client contract terminates.[52]

Item 5 also requires an adviser that receives compensation attributable to the sale of a security or other investment product (*e.g.*, brokerage commissions), or whose personnel receive such compensation, to disclose this practice and the conflict of interest it creates, and to describe how the adviser addresses this conflict.[53] Such an adviser also must disclose that the client may purchase the same security or investment product from a broker that is not affiliated with the adviser.[54]

Some commenters expressed strong support for these disclosure requirements, with one commenter stating that such disclosure is "essential to a healthy adviser-client relationship."[55] Others argued generally that most of the information is not relevant for many clients, and specifically that providing a complete set of fee schedules would impose an undue burden on

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51 *See* Item 5.C of Part 2A.

52 *See* Item 5.D of Part 2A. Item 18 of Part 2A also requires the disclosure of certain financial information about an adviser that requires prepayment of fees.

53 *See* Item 5.E of Part 2A. Because of this conflict of interest, advisers are required by the antifraud provisions of the Advisers Act to disclose their receipt of transaction-based compensation to clients. We have brought enforcement actions charging advisers with failures to make such disclosures. *See, e.g.*, *In the Matter of Financial Design Associates, Inc. and Albert L. Coles, Jr.*, Investment Advisers Act Release No. 2654 (Sept. 25, 2007) (settled order); *In the Matter of IMS, CPAs & Associates, Vernon T. Hall, Stanley E. Hargrave, and Jerome B. Vernazza*, Investment Advisers Act Release No. 1994 (Nov. 5, 2001) (settled order) (petitioners' appeal denied in *Vernazza v. SEC*, 327 F.3d 851 (9th Cir. 2003)).

54 *See* Item 5.E.2 of Part 2A. In addition to the requirement in Item 5.E.2 of Part 2A, an adviser that receives more than half of its revenue from commissions and other sales-based compensation must explain that commissions are the firm's primary (or, if applicable, exclusive) form of compensation. *See* Item 5.E.3 of Part 2A. An adviser that charges advisory fees in addition to commissions or markups to an individual client must disclose whether it reduces its fees to offset the commissions or markups. *See* Item 5.E.4 of Part 2A.

55 *See* comment letter of the Certified Financial Planner Board of Standards, Inc. (May 29, 2008) ("CFP Board Letter"). The ASG Letter, the CFA Institute Letter, the Lininger Letter, and the NRS Letter also expressed strong support for most of these requirements.

advisers.[56] We disagree with commenters who favored a broad elimination of fee information from the brochure. Information about fees is important to clients and can be used to compare fees of different advisers.[57] More persuasive, however, were arguments that brochure fee information is likely not useful to institutional and large, sophisticated clients who are often in a position to negotiate fee arrangements with their adviser and for whom, therefore, a fee table would have little utility.[58] These arguments have persuaded us to provide an exception which permits an adviser to omit disclosure of its fee schedule and the other information in Item 5.A in any brochure provided only to clients who are "qualified purchasers."[59]

A few commenters urged us to not require description of other types of fees or expenses because, among other things, such fees may vary significantly among clients and disclosure regarding them may confuse clients.[60] However, this simple and brief disclosure (which is not required to include the amount or range of the fees) may be helpful to investors unacquainted

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56 *See* comment letter of Eric A. Brill (Apr. 26, 2008) ("Brill Letter"); IAA Letter. The IAA Letter stated that larger firms may have to prepare extremely long fee schedules. They urged the Commission to provide flexibility regarding fee schedule disclosure as long as the fee is fully disclosed in the advisory contract. One commenter suggested that we amend General Instruction 4, which permits advisers to update any change to its fee schedules only annually, reasoning that potential clients would need this updated information in selecting advisers. *See* NASAA Letter. The exception contained in the instruction is designed to prevent an adviser from having to make multiple interim amendments as a result of small changes in a fee schedule each of which may be material only to certain affected clients or prospective clients who would learn of them when considering whether to enter into an advisory agreement that would reflect a revised fee. On balance, we believe that an annual update may be sufficient.

57 This information may be particularly useful to clients searching for an adviser by comparing information on brochures that will be available on the Internet.

58 *See* IAA letter; Wellington Letter.

59 "Qualified purchasers," as defined under section 2(a)(51)(A) of the Company Act [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.

60 *See* NAPFA Letter; NRS Letter; NSCP Letter.

with the practices of an adviser or the ancillary costs of actively managed investing. Therefore, we are adopting this disclosure requirement, as proposed.

As noted above, Item 5 also requires an adviser that receives transaction-based compensation, or whose personnel receive such compensation, to disclose this practice and the conflict of interest it creates and to describe how the adviser addresses this conflict. Some commenters argued that this item inappropriately implies endorsement of a "fee-based" compensation structure over a "commission-based" structure.[61] That is not our intent. The item simply recognizes that an adviser that accepts compensation from the sale to a client of securities has an incentive to base investment recommendations on the amount of compensation it will receive, rather than on the client's best interests, and thus involves a significant conflict of interest.[62] As a result, we are adopting the requirement as proposed.[63]

Item 6. Performance-Based Fees and Side-By-Side Management. Item 6 requires an adviser that charges performance-based fees or that has a supervised person who manages an account that pays such fees to disclose this fact. If such an adviser also manages accounts that are not charged a performance fee, the item also requires the adviser to discuss the conflicts of

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61 *See* FSI Letter; Sutherland Letter.

62 Moreover, the item is not, in substance, different from the previous Item 9 of Part 2, which, in recognition of this conflict, required an adviser to disclose whether the adviser effects securities transactions for clients. *See also supra* note 53; *Applicability of the Investment Advisers Act to Financial Planners, Pension Consultants, and Other Persons Who Provide Investment Advisory Services as a Component of Other Financial Services*, Investment Advisers Act Release No. 1092 (Oct. 16, 1987) [52 FR 38400 (Oct. 16, 1987)] ("Release 1092").

63 We note that nothing in the Advisers Act precludes an adviser from accepting transaction-based compensation. However, an adviser that receives compensation in connection with the purchase or sale of securities should carefully consider the applicability of the broker-dealer registration requirements of the Securities Exchange Act of 1934.

interest that arise from its (or its supervised person's) simultaneous management of these accounts, and to describe generally how the adviser addresses those conflicts.[64]

Two commenters explicitly supported this requirement.[65] Two other commenters urged us to eliminate it, arguing that the required disclosure already should be in Item 5 (Fees and Compensation) or is required by other items.[66] As discussed in the Proposing Release, an adviser charging performance fees to some accounts but not others faces a variety of conflicts of interest.[67] The number of advisers with these arrangements has grown, and we believe that it is important that clients and prospective clients receive disclosure regarding these conflicts and how the adviser addresses them.[68] While Item 5 requires disclosure of an adviser's fee arrangements, it does not specifically require disclosure of the conflicts any particular fee arrangement may create other than with respect to transaction-based compensation.

Item 7. Types of Clients. Item 7 requires that the brochure describe the types of advisory clients the firm generally has, as well as the firm's requirements for opening or maintaining an

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64 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 nn.13-14 and accompanying text (July 15, 1998) [63 FR 39022 (July 21, 1998)].

65 *See* CFA Institute Letter; Lininger Letter.

66 *See* IAA Letter; Schnase Letter.

67 *See* Proposing Release, at nn.51-53 and accompanying text. 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. We have brought enforcement actions charging advisers with undisclosed conflicts in regard to accounts that pay performance fees. *See*, *e.g.*, *In the Matter of Nevis Capital Management, LLC, et al.*, Investment Advisers Act Release No. 2214 (Feb. 9, 2004) (settled order). *See also In the Matter of Alliance Capital Management, L.P.*, Investment Advisers Act Release No. 2205 (Dec. 18, 2003) (settled order).

68 According to data derived from investment advisers' responses to Item 5.E of Part 1A of Form ADV reported through IARD as of May 3, 2010, approximately 28% of SEC-registered investment advisers reported charging performance-based fees to some accounts but not others.

account, such as minimum account size. One commenter recommended that we eliminate this proposed disclosure requirement, arguing that the information is not material to the decision of whether to hire or retain an investment adviser.[69] We disagree. We believe that many prospective clients would consider the type of clients to be an important factor in determining whether an adviser's business model is a good fit for them.[70] As a result, we are adopting Item 7 as proposed.

Item 8. Methods of Analysis, Investment Strategies and Risk of Loss. Item 8 requires that advisers describe their methods of analysis and investment strategies and disclose that investing in securities involves risk of loss which clients should be prepared to bear.[71] Item 8 also requires specific disclosure of how strategies involving frequent trading can affect investment performance. Finally, this item requires that advisers explain the material risks involved for each significant investment strategy or method of analysis they use and particular type of security they recommend, with more detail if those risks are unusual.

Several commenters supported this proposed disclosure requirement as central to the adviser's fiduciary relationship with its client.[72] One objected, stating that the item creates a different disclosure obligation for multi-strategy firms because, as proposed, it only required advisers primarily using a particular strategy to discuss the risks involved in their strategy.[73] We agree that advisers should disclose material risks associated with their strategies that will be

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69 *See* Sutherland Letter.

70 We note that disclosure of this information is already required in the previous Item 2 of Part 2 of Form ADV.

71 We have brought enforcement actions charging advisers with omissions and misrepresentations regarding investment strategies. *See, e.g.*, *In the Matter of George F. Fahey*, Investment Advisers Act Release No. 2196 (Nov. 24, 2003) (settled order); *In the Matter of Gary L. Hamby and Gary B. Ross*, Investment Advisers Act Release No. 1668 (Sept. 22, 1997) (settled order).

72 *See* CFA Institute Letter; Lininger Letter; NAPFA Letter; NRS Letter.

73 *See* NAPFA Letter.

relevant to most clients, regardless of whether they use one strategy or many strategies. We have, therefore, modified the item to require that advisers explain the material risks involved for each *significant* investment strategy or method of analysis they use, rather than those they *primarily* use, as we believe this threshold for disclosure better captures those methods of analysis or strategies that will be relevant to most clients.[74] However, as we noted in the proposal, the brochure may not always be the best place for a multi-strategy adviser to disclose risks associated with all of its methods of analysis or strategies.[75] Disclosure of that information likely would lengthen the brochure unnecessarily given that different clients will be pursuing different strategies, each of which poses specific and different risks.

Some commenters urged us to define the term "frequent trading of securities," which is used in Item 8.B, but did not suggest a definition in response to our request.[76] As commenters implicitly acknowledged, the phrase "frequent trading" is hard to define. We would expect advisers to respond to this item only if their intended investment strategies involve frequent trading of securities that a reasonable client would otherwise not expect in light of the other disclosures contained in the brochure.

Several commenters urged us to not require disclosure in the brochure of cash balance practices, arguing that such practices vary widely depending on the client, are typically addressed in the client's investment advisory agreement, and typically do not involve conflicts of interest.[77] We acknowledge that in many instances such practices do not involve conflicts of

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74 For these purposes, we would view a method of analysis or strategy as significant if more than a small portion of the adviser's clients' assets are advised using the method or strategy.

75 *See* Proposing Release at Section II.A.2.

76 *See* comment letter of Gary D. Case (May 12, 2008) ("Case Letter"); FSI Letter; IAA Letter; comment letter of ProEquities, Inc. (May 21, 2008) ("ProEquities Letter"); comment letter of the Trust Advisory Group (May 12, 2008) ("TAG Letter"); T. Rowe Price Letter.

77 *See* ASG Letter; IAA Letter; T. Rowe Letter.

interest and have omitted the requirement from Part 2A. We note, however, that an adviser may have an obligation (independent of Part 2A) to disclose material information about its policies regarding the management of cash balances where the omission of such information would constitute a breach of the adviser's fiduciary duty (*e.g.*, where the cash is not managed in the best interest of the client).[78]

One commenter noted that, as proposed, Items 8.B and 8.C would require disclosure of all risks associated with using a particular investment strategy or primarily recommending a particular type of security, and not just material risks.[79] We intended these items to require disclosure only of material risks, and have amended these items accordingly.[80]

This commenter also noted that Items 8.B and 8.C call for detailed discussions of "significant or unusual" risks, inquired whether this differed from "material" risks, and asked for clarification of this terminology. This requirement is intended to elicit from the adviser disclosure of significant risks associated with using a particular investment strategy or recommending a particular type of security that otherwise would not be apparent to the client from reading the adviser's brochure. An adviser that describes a wide range of investment advisory activities in its brochure but, in fact, specializes, for example, in investing in leveraged exchange-traded funds should disclose such information in response to this item.

Item 9. Disciplinary Information. Item 9 requires that an adviser disclose in its brochure material facts about any legal or disciplinary event that is material to a client's (or prospective client's) evaluation of the integrity of the adviser or its management personnel. These

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78 An adviser that is also registered as a broker-dealer may also have disclosure obligations relating to its cash balance practices arising under Commission and self-regulatory organization requirements. *See* NYSE information Memo No. 05-11 (Customer Account Sweeps to Banks) (Feb. 2005).

79 *See* Schnase Letter.

80 *See* Items 8.B and 8.C of Part 2A (requiring disclosure of "material risks").

requirements incorporate into the brochure the client disclosure regarding disciplinary information required by rule 206(4)-4 under the Advisers Act.

Items 9.A, B, and C provide a list of disciplinary events that are presumptively material if they occurred in the previous 10 years. 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. The list includes any convictions for theft, fraud, bribery, perjury, forgery, counterfeiting, extortion and violations of securities laws by the adviser or one of its executives. Events such as these reflect on the integrity of the adviser and its management personnel and, therefore, are presumptively material to clients. The adviser may rebut this presumption, in which case no disclosure to clients is required.[81] An adviser rebutting this presumption must document its determination in a memorandum and retain that record to enable our staff to monitor compliance with this important disclosure requirement.[82]

As required by rule 206(4)-4, Item 9 requires that disciplinary events more than 10 years old be disclosed if the event is so serious that it remains material to a client's or prospective client's evaluation of the adviser and the integrity of its management. Three commenters requested that the Commission further define and clarify what disciplinary information is material in these circumstances.[83] We have determined not to do so, however, as advisers should evaluate their obligations to disclose information to clients under existing materiality standards adopted by the courts and the Commission.[84] We note that a prior disciplinary event

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81 Note to Item 9 of Part 2A (explaining four factors an adviser should consider when assessing whether the presumption can be rebutted).

82 Rule 204-2(a)(14)(iii).

83 *See* AICPA Letter; Sutherland Letter; Jackson Letter.

84 *See supra* note 35 for a discussion of materiality under the Advisers Act. *See also* the note at the end of Item 9 of Part 2A and *Financial and Disciplinary Information that Investment Advisers*

involving an adviser would be important to clients for many reasons, including how it may reflect upon the adviser's integrity, the effect it may have on the degree of trust and confidence a client would place in the adviser, or if it imposed limitations on an adviser's activities.[85]

Two other commenters addressed the rebuttable presumption of materiality under Item 9.[86] One commenter supported the flexibility of allowing advisers to rebut the presumption of materiality.[87] Other commenters suggested, however, that an adviser should not be permitted to rebut this presumption, stating that this would give advisers little incentive to disclose disciplinary information that may be considered material.[88] We note that an adviser, as a fiduciary, has an obligation to disclose material information to clients.[89] We believe that the legal consequences that flow from its failure to meet this obligation provide an incentive for an adviser to disclose material disciplinary information. Moreover, advisers that seek to exclude information from their brochures because they believe that they can rebut the presumption of

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Must Disclose to Clients, Investment Advisers Act Release No. 1035 (Sept. 19, 1986) [51 FR 34229 (Sept. 26, 1986)](" Rule 206(4)-4 Proposing Release"), at nn.12-13 and accompanying text. One commenter noted the use of the term "currently material" in Item 9 and asked if this phrase differed in meaning from "material." *See* ABA Committees Letter. We did not intend this phrase to have a different meaning than "material" and, therefore, we have deleted the word "currently" in the Item 9 as adopted.

85 *See* Rule 206(4)-4 Proposing Release, at nn.12-13 and accompanying text. The Commission has long viewed information about a prior disciplinary proceeding involving an adviser as important to clients and that failure to disclose such a proceeding may violate the antifraud provisions of sections 206(1) and 206(2) of the Advisers Act. *See e.g.*, *In the Matter of Jesse Rosenblum*, Investment Advisers Act Release No. 913 (May 17, 1984).

86 *See* Morgan Stanley Letter; Sutherland Letter.

87 *See* IAA Letter.

88 *See* NASAA Letter; NCS Letter.

89 We note that failure to disclose material information to clients constitutes a violation of section 206 of the Advisers Act. We have brought enforcement actions charging advisers with failures to make such disclosures. *See, e.g., Colley Asset Management, Inc., and John E. Colley*, Investment Advisers Act Release No. 2363 (Feb. 25, 2005) (settled order).

materiality must memorialize the basis for that determination, which is subject to review by our staff.[90]

In the Proposing Release, we requested comment on whether we should require disclosure about arbitration awards and claims.[91] A few commenters supported arbitration disclosure, arguing that investors deserve the most complete information available to build a picture of an adviser's integrity.[92] Others objected, with some reasoning that arbitration claims are easy to make and that arbitration settlements and awards may not necessarily include findings of wrongdoing (*i.e.*, parties may settle arbitration proceedings and/or arbitration awards may be granted even in the absence of legal violations).[93] For this reason, we have determined not to require disclosure of arbitration awards in the client brochure. Advisers should, however, carefully consider whether particular arbitration awards or settlements do, in fact, involve or implicate wrongdoing and/or reflect on the integrity of the adviser, and should be disclosed to clients in the brochure or through other means.[94] Because many disputes involving securities firms (including investment advisers) are resolved through arbitration or other methods of

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90 We also note that an adviser is required in Part 1A of Form ADV to disclose disciplinary events regardless of whether they are material. Part 1A is filed electronically with the Commission and is publicly available on our website.

91 *See* Proposing Release at Section II.A.2. We also requested comment in the Proposing Release on whether we should require that advisers subject to a Commission administrative order provide clients with a copy of that order. Commenters did not support such a requirement and stated that, when appropriate, we should require delivery of orders in individual proceedings. *See* Federated Letter; Fried Frank Letter; Morgan Stanley Letter; Sutherland Letter. We agree with commenters and Part 2A does not require that such orders be provided to advisory clients.

92 *See* Consumer Federation Letter; CFA Institute Letter; CFP Board Letter; NASAA Letter.

93 *See* comment letter from Michael Berlin (Apr. 28, 2008) ("Berlin Letter"); Federated Letter; First Allied Letter; Fried Frank Letter; IAA Letter; ICI Letter; Janus Letter; Mercer Letter; Morgan Stanley Letter; NRS Letter; SIFMA Letter; comment letter of R.C. Verbeck (May 12, 2008) ("Verbeck Letter").

94 We note that failure to disclose material information to clients constitutes a violation of section 206 of the Advisers Act.

alternative dispute resolution, we will continue to assess whether we should require that these events be reported by firms registered with us.

Item 9 requires 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. "Involved" is defined as "[e]ngaging in any act or omission, aiding, abetting, counseling, commanding, inducing, conspiring with or failing reasonably to supervise another in doing an act."[95] Three commenters requested that we narrow the definition of "involved," arguing that the proposed definition is both overbroad and vague.[96] Other commenters supported using the term "involved," as defined.[97] One of these commenters noted that this term also is used in Form BD and in Form U4 and, as such, changing the meaning of the term (or eliminating it from Part 2A) would undermine uniformity and create disparate reporting between broker-dealers and advisers.[98] We believe that, for purposes of consistency, it is appropriate to continue to define the term "involved" as currently defined in Form ADV. This term and definition has been used in Form ADV for over 9 years and on Form BD for over 14 years, and we believe its meaning should be well understood.[99]

Some commenters recommended that advisers be permitted to satisfy the obligation to disclose and update disciplinary events by referring clients to the Investment Adviser Public Disclosure system (IAPD) to obtain the firm's disclosures from Part 1A of Form ADV and

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95 *See* the Glossary to Form ADV.

96 *See* Federated Letter; IAA Letter; Morgan Stanley Letter.

97 *See* CFA Institute Letter; NASAA Letter.

98 *See* NASAA Letter.

99 *See Amendments to Form ADV*, Investment Advisers Act Release No. 1897 (Sept. 12, 2000) [65 FR 57438 (Sept. 22, 2000)]; *Form BD Amendments*, Securities Exchange Act Release No. 37431 (July 12, 1996) [61 FR 37357 (July 18, 1996)].

providing a copy of the disciplinary disclosures to clients who do not have Internet access.[100] One commenter strongly opposed this recommendation, however, stating that "[a]rming investors with this information is one of the best tools we have to put investors on their guard so that they can protect their own interests."[101]

The disciplinary information provided in Part 1A is provided to the Commission primarily for registration purposes and not with an eye towards client disclosure. Part 1A, therefore, requires disclosure not just about the advisory firm and its management personnel, but also about all of its "advisory affiliates." A firm's advisory affiliates include all of the firm's employees, officers, partners, or directors and all persons directly or indirectly controlling or controlled by the firm.[102] Having disciplinary information about this broad group is important to the Commission for regulatory purposes. However, many of the largest investment advisers may have a large number of advisory affiliates and voluminous disciplinary disclosure, much of which may be regarding advisory affiliates with no relationship to particular clients. Accordingly, we believe that requiring clients to sift through an advisory firm's Part 1A disciplinary disclosure is not the most effective *client* disclosure. Therefore, we are adopting the proposed requirement that the brochure affirmatively disclose disciplinary information about the adviser and its management personnel.

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100 *See* comment letter of the Alternative Investment Management Association (May 16, 2008) ("AIMA Letter"); ASG Letter; Janus Letter; Morgan Stanley Letter; NRS Letter; SIFMA Letter; Sutherland Letter.

101 Consumer Federation Letter.

102 *See* Form ADV: Glossary. Firm employees that perform only clerical, administrative, support, or similar functions are excluded from the definition.

Because Part 2A, as amended, incorporates disciplinary disclosures formerly required by rule 206(4)-4 directly in the advisory brochure requirements, we are rescinding rule 206(4)-4.[103] The rescission of rule 206(4)-4 will be effective, with respect to any particular investment adviser, on the date by which that adviser must deliver its narrative brochure to existing clients and begin delivering its brochure to prospective clients under the rule and form amendments we are adopting today.[104] Some advisers, however, may have clients to whom they are not required to deliver a brochure, such as certain clients receiving only impersonal investment advice or those that are registered investment companies and business development companies.[105] For these advisers, their fiduciary duty of full and fair disclosure requires them to continue to disclose to *all* their clients material disciplinary and legal events and their inability to meet contractual commitments to their clients.[106]

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103 In addition to requiring disclosure of certain disciplinary information, rule 206(4)-4 requires an adviser to disclose certain financial information to clients. As with the disciplinary disclosure, we have incorporated this requirement into the new brochure. Similar to rule 206(4)-4(a)(1), Item 18.B of Part 2A requires certain advisers to disclose any financial condition that is reasonably likely to impair their ability to meet contractual commitments to clients. *See infra* note 177 and accompanying text.

104 *See infra* Section V.

105 Our requirements regarding to which clients an adviser must deliver a brochure are discussed in Section II.A.3 below. One commenter suggested that we retain rule 206(4)-4 to require only the delivery of disciplinary information to clients for whom the brochure delivery requirement does not apply. *See* ABA Committees Letter.

106 *See Financial and Disciplinary Information that Investment Advisers Must Disclose to Clients*, Investment Advisers Act Release No. 1035 (Sept. 19, 1986) ("Rule 206(4)-4 Adopting Release") ("explaining that rule 206(4)-4 was designed to codify an investment adviser's fiduciary obligation to disclose material financial and disciplinary information to clients."). We have brought enforcement actions charging advisers with failures to make such disclosures. *See, e.g.*, *In the Matter of Veritas Financial Advisors LLC, Veritas Advisors, Inc., Patrick J. Cox and Rita A. White*, Investment Advisers Act Release No. 2577 (Dec. 29, 2006) (settled order); *In the Matter of Harry Michael Schwartz*, Investment Advisers Act Release No. 1833 (Sept. 27, 1999) (settled order); *In the Matter of Renaissance Capital Advisors, Inc., and Richard N. Fine*, Investment Advisers Act Release No. 1688 (Dec. 22, 1997) (settled order). In addition, under section 9(a) of the Company Act [15 USC 80a-9(a)] an investment adviser to a registered investment company may be prohibited from serving in certain capacities with the fund as a result of a disciplinary event.

Item 10. Other Financial Industry Activities and Affiliations. Item 10 requires each adviser to describe in its brochure material relationships or arrangements the adviser (or any of its management persons) has with related financial industry participants, any material conflicts of interest that these relationships or arrangements create, and how the adviser addresses the conflicts.[107] In addition, if an adviser selects or recommends other advisers for clients, Item 10 requires that it disclose any compensation arrangements or other business relationships between the advisory firms, along with the conflicts created, and explain how it addresses these conflicts.[108] The disclosure that Item 10 requires highlights for clients their adviser's other financial industry activities and affiliations that can create conflicts of interest and may impair the objectivity of the adviser's investment advice.

Two commenters explicitly stated that they supported the disclosure required by this item.[109] At the suggestion of one commenter,[110] we have modified Item 10.D to require advisers that recommend other advisers to disclose, in particular, payments or business relationships *that create material conflicts of interest* with clients, so as not to capture all relationships.

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107 This item is similar to Item 8 of the previous Part 2. Two commenters requested that we clarify or provide guidance regarding "materiality" in describing relations and arrangements with related persons, and conflicts of interest arising from these relations or arrangements. *See* IAA Letter; NRS Letter. We address this comment earlier in this Release. *See supra* note 35 for a further discussion of materiality under the Advisers Act.

108 We have brought enforcement actions charging advisers with failures to make such disclosures. *See, e.g.*, *In the Matter of Morgan Stanley & Co., Incorporated*, Investment Advisers Act Release No. 2904 (July 20, 2009) (settled order); *In the Matter of Yanni Partners, Inc. and Theresa A. Scotti*, Investment Advisers Act Release No. 2642 (Sept. 5, 2007) (settled order).

109 *See* CFA Institute Letter; Lininger Letter.

110 *See* Sutherland Letter.

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

Code of Ethics. Item 11 requires each adviser to describe briefly its code of ethics and state that a copy is available upon request.[111] Two commenters strongly supported the proposed item, believing the required disclosure is indicative of an adviser's commitment to its fiduciary duties.[112] One recommended that we instead simply require an adviser to note in the brochure that a copy of its code of ethics is available upon request.[113] We believe that a brief, concise summary of the code of ethics (as the item requires) will be helpful to prospective clients who may not wish or feel the need to request the entire code of ethics and will assist those clients in determining whether they would like to read the entire code of ethics.[114]

Participation or Interest in Client Transactions. If the adviser or a related person recommends to clients, or buys or sells for client accounts, securities in which the adviser or a related person has a material financial interest, Item 11.B requires the brochure to discuss this practice and the conflicts of interest presented.[115] Conflicts could arise, for example, when an adviser recommends that clients invest in a pooled investment vehicle that the firm advises or for

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111 This requirement is almost identical to the previous disclosure requirement in Item 9 of the previous Part 2.

112 *See* CFA Institute Letter; CFP Board Letter.

113 *See* Morgan Stanley Letter.

114 This summary should not be a reiteration of the entire code of ethics, but rather should provide enough information for the client to determine if it would like to read the full code of ethics and to understand generally the adviser's ethical culture and standards, how the adviser controls sensitive information, and what steps it has taken to prevent employees from misusing their inside positions at clients' expense. *See Investment Adviser Code of Ethics*, Investment Advisers Act Release No. 2256 (July 2, 2004), at text accompanying notes nn.66-67 [69 FR 41696 (July 9, 2004)].

115 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. Items 11.B, 11.C, and 11.D are similar to Item 9 of the previous Part 2.

which it serves as the general partner,[116] or when an adviser with a material financial interest in a company recommends that a client buy shares of that company.[117] The item requires advisers to disclose any practices giving rise to these conflicts, the nature of the conflicts presented, and how the adviser addresses the conflicts. Two commenters expressed support for this requirement.[118] We are adopting Item 11.B. substantially as proposed, except that at the suggestion of three commenters, we have omitted the portion of the proposed item that required advisers to disclose "procedures" for making the disclosures to clients.[119] We agree with these commenters that the requirement was inconsistent with the Commission's general approach throughout the brochure of requiring disclosure about conflicts and how they are addressed, but not about "procedures."

Personal Trading. Items 11.C and 11.D require disclosure of personal trading by the adviser and its personnel.[120] Item 11.C requires 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 requires a similar discussion, but focuses on the specific conflicts an adviser has when

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116 We have brought enforcement actions charging advisers with failures to make such disclosures. *See, e.g.*, *In the Matter of Thomson McKinnon Asset Management, L.P.*, Investment Advisers Act Release No. 1243 (July 26, 1990) (settled order).

117 We have brought enforcement actions charging advisers with failures to make such disclosures. *See, e.g.*, *In the Matter of Chancellor Capital Management, Inc., et al.*, Investment Advisers Act Release No. 1447 (Oct. 18, 1994) (settled order).

118 *See* CFA Institute Letter; CFP Board Letter.

119 *See* IAA Letter; ICI Letter; T. Rowe Letter.

120 We have brought enforcement actions charging advisers with fraudulent personal trading. *See In the Matter of Roger W. Honour*, Investment Advisers Act Release No. 1527 (Sept. 29, 1995) (settled order).

it or a related person trades in the same securities at or about the *same time* as a client.[121] In response to this item, an adviser should 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.

One commenter suggested that we specify a minimum amount of assets that must be managed by an adviser in order for that adviser to be required to disclose personal securities transactions, arguing that small firms' securities transactions are not large enough to generate a market impact and thus should not require disclosure.[122] We disagree. A small firm could still place a trade large enough to have a market impact, especially in a thinly traded security. In addition, given that an adviser's ability to place its own trades before or after client trades in the same security may affect the objectivity of the adviser's recommendations, we believe disclosure of this practice is warranted. As a result, we are adopting Items 11.C and 11.D as proposed.

Finally, we note that we have modified the note to Item 11 to clarify that Items 11.B, 11.C, and 11.D would not require disclosure with respect to securities that are not "reportable securities" under Advisers Act rule 204A-1(e)(10), such as shares in unaffiliated mutual funds.[123] As we indicated in the Proposing Release, such securities are not reportable under Advisers Act Rule 204A-1 because they appear to present little opportunity for front-running.[124]

Item 12. Brokerage Practices. Item 12 requires that advisers describe how they select brokers for client transactions and determine the reasonableness of brokers' compensation. This

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121 We have brought enforcement actions charging advisers with inaccurate disclosure in this context. *See, e.g.*, *In the Matter of Hutchens Investment Management and William Hutchens*, Investment Advisers Act Release No. 2514 (May 9, 2006) (settled order).

122 *See* comment letter of Thaddeus Borek, Jr. (May 16, 2008).

123 *See* Code of Ethics Adopting Release, *supra* note 114 at n.42 and accompanying text.

124 *See* Proposing Release, *supra* note 2, at n.85.

item also requires advisers to disclose how they address conflicts of interest arising from their receipt of soft dollar benefits (*i.e.*, research or other products or services they receive in connection with client brokerage).[125]

Soft Dollar Practices. Many advisers receive brokerage and research services in reliance on section 28(e) of the Securities Exchange Act of 1934 ("Exchange Act"),[126] as well as other soft dollar products and services provided by brokers in connection with client transactions.[127] Use of client securities transactions to obtain research and other benefits creates incentives that result in conflicts of interest between advisers and their clients.[128] Because of these conflicts, we have long required advisers to disclose their policies and practices with respect to their receipt of soft dollar benefits in connection with client securities transactions.[129]

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125 Item 12 is similar to Item 12.B in the previous Part 2.

126 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 soft dollar benefits to clients, regardless of whether the benefits fall inside or outside of the safe harbor. *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)], at n.33 and accompanying text.

127 According to IARD data as of May 3, 2010, approximately 61% of advisers registered with the Commission report on Form ADV, Part 1A, Item 8.E that they or related persons receive soft dollar benefits in connection with client transactions.

128 *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").

129 *See* Item 12 of the previous Part 2.

Item 12 requires an adviser that receives soft dollar benefits in connection with client securities transactions to disclose its practices.[130] The description must 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 associated conflicts of interest. 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 services that do not aid in the adviser's investment decision-making process.[131]

Item 12 also requires that an adviser discuss in its brochure the types of conflicts it has when it accepts soft dollar benefits and explain how it addresses those conflicts.[132] The item requires 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 requires the adviser to explain whether it "pays up" for soft dollar benefits.[133]

Some commenters, including one association representing more than 130 pension funds, expressed their strong support for the soft dollar disclosure requirement.[134] Other commenters

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130 *See* Item 12.A.1 of Part 2A.

131 *See* note to Item 12.A.1.e of Part 2A.

132 *See* Item 12.A.1. An adviser accepting soft dollar benefits must 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 most favorable execution. *See* Item 12.A.1.a and b of Part 2A.

133 "Paying up" refers to an adviser causing a client account to pay more than the lowest available commission rate in exchange for soft dollar products or services.

134 *See* comment letter of the Council of Institutional Investors (May 16, 2008) ("CII Letter"); CFA Institute Letter; NRS Letter; comment letter of Carolina Capital Markets, Inc. (Aug. 8, 2008).

objected to various portions of this item.[135] Some of these commenters recommended elimination of the proposed requirements to disclose whether an adviser allocates soft dollar benefits to client accounts proportionately to the brokerage credits those accounts generate,[136] and to disclose the "procedures" it uses to direct client transactions to a particular broker-dealer.[137] Some of these commenters also questioned the conflicts we identified and expressed concern that the item will tend to create a misleading impression that the use of soft dollar arrangements is harmful.[138]

There are significant conflicts associated with soft dollar arrangements. Section 28(e) was enacted, in part, to address them.[139] We are not taking a view on the propriety of soft dollar arrangements, but rather are requiring full disclosure of arrangements that involve significant conflicts of interest.[140] Moreover, disclosure required by Item 12 is similar to disclosure requirements previously required in Part 2 of Form ADV.[141] We are adopting this requirement as proposed.

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135 *See, e.g.*, comment letter of the Alliance in Support of Independent Research (May 16, 2008) ("Alliance Letter"); CAPIS Letter; IAA Letter; ICI Letter; comment letter of Pickard and Djinis LLP (May 14, 2008) ("Pickard Letter"); SIFMA Letter; T. Rowe Letter.

136 *See* Alliance Letter; CAPIS Letter; IAA Letter; ICI Letter; Pickard Letter.

137 *See* Alliance Letter; CAPIS Letter; IAA Letter; ICI Letter.

138 *See* Alliance Letter; IAA Letter; ICI Letter; SIFMA Letter.

139 *See* 2006 Soft Dollar Release, *supra* note 128, at nn.4-6 and accompanying text.

140 We have brought enforcement actions charging advisers with not adequately disclosing soft dollar arrangements and related conflicts. *See, e.g.*, *In the Matter of Schultze Asset Management LLC and George J. Schultze*, Investment Advisers Act Release No. 2633 (Aug. 15, 2007) (settled order); *In the Matter of Rudney Associates, Inc. et al.*, Investment Advisers Act Release No. 2300 (Sept. 21, 2004) (settled order).

141 Item 12.B. of the previous Part 2 required, for example, that the adviser describe the factors considered in selecting brokers and determining the reasonableness of their commissions. In addition, if the value of products, research and services given to the adviser is a factor in selecting brokers, the adviser was required to, among other things, describe whether clients may pay commissions higher than those obtainable from other brokers in return for those products and services.

Client Referrals. If an adviser uses client brokerage to compensate or otherwise reward brokers for client referrals, it also must disclose this practice, the conflicts of interest 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).[142] Part 2 previously required that advisers disclose these arrangements, but did not specifically require that the description discuss the conflicts of interest created.[143] We did not receive any comments relating to this item and are adopting the requirement as it was proposed so that clients are aware that their adviser may have a bias toward referring brokers, a significant conflict of interest.[144]

Directed Brokerage. Item 12 requires an adviser that permits clients to direct brokerage to describe its practices in this area. Item 12 also requires that such an adviser explain that it may be unable to obtain the most favorable execution of client transactions if the client directs brokerage and that directing brokerage may be more costly for clients.[145] If, however, an adviser *routinely recommends, requests or requires* clients to direct brokerage, Item 12 also requires the adviser to describe this practice in its brochure, to disclose that not all advisers require directed brokerage, and to describe any relationship with a broker-dealer to which the brokerage may be

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142 Item 12.A.2 of Part 2A.

143 *See* Item 13.B. of the previous Part 2.

144 We have brought enforcement actions charging advisers with failing to disclose to clients that they directed their brokerage commissions in return for client referrals. *See, e.g.*, *In the Matter of Fleet Investment Advisors, Inc.*, Investment Advisers Act Release No. 1821 (Sept. 9, 1999) (settled order).

145 *See* Item 12.A.3.b of Part 2A. As we discussed in the Proposing Release, 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 also may 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.

directed that creates a material conflict of interest.[146] An adviser may omit disclosure regarding its inability to obtain best execution if directed brokerage arrangements are only conducted subject to the adviser's ability to obtain best execution.[147]

Two commenters addressed this requirement. One, representing pension funds, endorsed our proposal as supporting transparency in brokerage arrangements.[148] The other urged that we broaden the proposed exception in the item to all directed brokerage subject to best execution, whether recommended by the adviser or directed by the client. The commenter pointed out that such client-imposed limitations on direction of brokerage should address the Commission's concerns in proposing the item.[149] We agree, and have revised the note following the item accordingly.

Trade Aggregation. Clients engaging an adviser can benefit when the adviser aggregates trades to obtain volume discounts on execution costs. Item 12 requires the adviser to describe whether and under what conditions it aggregates trades. If the adviser does not aggregate trades when it has the opportunity to do so, the adviser must explain in the brochure that clients may therefore pay higher brokerage costs. One commenter supported this disclosure, stating that it is helpful and meaningful to clients.[150] However, another commenter expressed concern that such disclosure would suggest that advisers should always aggregate orders, and noted that there are circumstances where an adviser may decide that it is better for the client not to do so, such as

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146 *See* Item 12.A.3.a of Part 2A. We have brought enforcement actions charging advisers with failures to make such disclosures. *See also In the Matter of Callan Associates*, Investment Advisers Act Release No. 2650 (Sept. 19, 2007) (settled order); *In the Matter of Jamison, Eaton & Wood, Inc.*, Investment Advisers Act Release No. 2129 (May 15, 2003) (settled order).

147 *See* note to Item 12.A.2 of Part 2A.

148 *See* CII Letter.

149 *See* Alliance Letter.

150 *See* NRS Letter.

with multiple large trades that may create a market impact.[151] Other commenters argued that trade aggregation practices are not material to clients.[152] But aggregation practices may have a material effect on the quality of execution. Thus, we believe that such practices should be disclosed in the brochure.

Finally, one commenter suggested deleting the words "in quantities sufficient to obtain reduced transaction costs" from the first sentence of Item 12.B since there may be other circumstances in which advisers may aggregate client trades that should be disclosed to clients.[153] As this item was intended to require advisers to explain their aggregation practices along with the reasons for and consequences of those practices more generally, we have removed this limiting phrase.

Item 13. Review of Accounts. Item 13 requires that an adviser disclose whether, and how often, it reviews clients' accounts or financial plans, and identify who conducts the review.[154] An adviser that reviews accounts other than regularly must explain what circumstances trigger an account review.

Three commenters addressed this item. One supported it as being helpful to clients.[155] Two thought that this item provided non-critical information that could be eliminated in the interest of providing a shorter brochure to clients.[156] We believe the disclosure, which can be

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151 *See* IAA Letter.

152 *See* Fried Frank Letter.

153 *See* Schnase Letter.

154 Item 13 is similar to Item 11 in the previous Part 2.

155 *See* CFA Institute Letter.

156 *See* SIFMA Letter; Sutherland Letter.

brief, provides very useful information to clients about their advisers' management of their accounts. As a result, we are adopting this item substantially as it was proposed.[157]

Item 14. Client Referrals and Other Compensation. Item 14 requires an adviser to describe in its brochure any arrangement under which it or its related person compensates another for client referrals and describe the compensation. The brochure also must disclose any arrangement under which the adviser receives any economic benefit, including sales awards or prizes, from a person who is not a client for providing advisory services to clients.[158]

We received three comments on this item. One supported the proposed item, stating that these areas involve practices that raise conflicts of interest.[159] Another suggested that it be omitted because certain disclosure required under this item is already required by rule 206(4)-3 under the Advisers Act (the "cash solicitation rule").[160] The cash solicitation rule, however, applies only to certain types of payments and requires disclosure by the solicitor rather than the adviser.[161] Finally, one commenter urged that we amend the Item to disclose the conflicts of

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157 The Schnase Letter suggested changing the word "employee" in Item 13.A to "supervised person." As defined in the Form ADV Glossary, "supervised person" means "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." For purposes of consistency throughout Part 2A, we are making the change suggested by the commenter. We also are substituting the word "supervised person" for the word "employee" in Item 14.B, Instruction 6 for Part 2A, Appendix 1 (the wrap fee program brochure), and Item 6.C of Part 2A, Appendix 1.

158 Similar disclosure was previously required by Item 13 of Part 2.

159 *See* CFA Institute Letter.

160 *See* Sutherland Letter.

161 Rule 206(4)-3 applies to advisers paying *cash* referral fees to solicitors, and thus does not require disclosure of non-cash benefits. The rule requires, among other things, that an unaffiliated solicitor provide the adviser's brochure and a separate disclosure document described in the rule to clients or prospective clients at the time of any solicitation activities. *See* rule 206(4)-3(a)(2)(iii).

interest associated with these arrangements.[162] We agree. There are significant conflicts of interest when an adviser receives benefits from a third party for providing advisory services to a client, or when an adviser pays a third party for client referrals. We are revising Item 14.A from our proposal to require an adviser that accepts benefits from a non-client for providing advisory services to clients describe the arrangement, any conflicts of interests that arise from the arrangement, and how the adviser addresses those conflicts.

Item 15. Custody. Item 15 requires an adviser with custody of client funds or securities to explain in its brochure that clients will receive account statements directly from the qualified custodian, such as a bank or broker-dealer that maintains those assets. Advisers must also explain to clients that they should carefully review the account statements they receive from the qualified custodian. In addition, if an adviser also sends clients account statements, the adviser's explanation must include a statement urging clients to compare the account statements they receive from the qualified custodian with those they receive from the adviser. Comparing statements will allow clients to determine whether account transactions, including deductions to pay advisory fees, are proper. This disclosure is very similar to the statement required to be made by advisers under our recently amended custody rule.[163]

We proposed an alternative disclosure requirement in Item 15 that we are not adopting today. Proposed Item 15.A. would have required that, if clients did not receive account statements from qualified custodians, the adviser must disclose the risks that clients would face

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162 *See* Schnase Letter. This commenter also suggested that we rename this item since Item 14.B relates only to payment for client referrals. In light of this comment, we are renaming this item "Client Referrals and Other Compensation."

163 *See Custody of Funds or Securities of Clients by Investment Advisers*, Investment Advisers Act Release No. 2968 (Dec. 30, 2009) [75 FR 1456 (Jan. 11, 2010)] ("Custody Rule Adopting Release") at section II.A.

as a result.[164] This alternative is no longer relevant because the amendments to the custody rule eliminated the option that permitted advisers to substitute their own account statements for those from a qualified custodian.[165]

Item 16. Investment Discretion. Item 16 requires an adviser with discretionary authority over client accounts to disclose this fact in its brochure,[166] and any limitations clients may (or customarily do) place on this authority.[167] Two commenters suggested that the Commission not require advisers to provide duplicative disclosure regarding discretionary authority as it likely would be incorporated into the description of the advisory business in Item 4.[168] We note that if the information is provided in response to Item 4, the adviser may cross-reference the information. We therefore are adopting this item as proposed.

Item 17. Voting Client Securities. Item 17 requires advisers to disclose their proxy voting practices. This item parallels rule 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.[169] Item 17 also requires advisers to disclose whether they have or will accept authority to vote client securities and, if so, to describe briefly the voting policies

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164 *Id.* We received two comments on proposed Item 15.A. *See* ICI Letter; ABA Committee Letter.

165 Custody Rule Adopting Release, *see supra* note 163.

166 An adviser has "discretionary authority" if it is authorized to make purchase and sale decisions for client accounts. *See* Form ADV Glossary. 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. This Item is similar to Item 12.A of the previous Part 2.

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

168 *See* IAA Letter; Sutherland Letter. They argued that such information would already be disclosed under Items 4.B, 4.C and 4.E (advisory business) or Item 8 (strategies and risks).

169 Proxy Voting Release, *see supra* note 3. Rule 206(4)-6 requires advisers to adopt and implement written voting policies and procedures. Advisers also are 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.

they adopted under rule 206(4)-6. Each adviser must describe whether (and how) clients can direct it 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 requires 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 accept authority to vote securities must disclose how clients receive their proxies and other solicitations.[170]

Some commenters suggested that we eliminate Item 17 in its entirety, arguing either that the required disclosure is not important to clients or that most of the information already is available in advisory contracts.[171] Others supported this disclosure requirement, noting that clients are interested in understanding the potential conflicts of interest that may arise from an adviser's proxy voting.[172] We agree that proxy voting practices and the conflicts arising from such practices are important information that should be disclosed, and note that rule 206(4)-6 independently would require the same disclosure even if we were to eliminate it from the brochure.[173] Accordingly, we are adopting Item 17, but with one modification.

We had proposed to require detailed information about an adviser's use of third-party proxy voting services and how the adviser pays for proxy voting services. Most of the commenters addressing this proposed requirement argued that the information is not relevant for

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170 If an adviser accepts proxy voting authority for some accounts but not others, the adviser should disclose the relevant information required by this Item for each type of account unless the adviser has prepared separate brochures for the other accounts.

171 *See* NAPFA Letter; Morgan Stanley Letter.

172 *See* CFA Institute Letter; CII Letter.

173 We have brought enforcement actions relating to advisers' proxy voting policies and procedures. *See, e.g.*, *In the Matter of INTECH Investment Management LLC and David E. Hurley*, Investment Advisers Act Release No. 2872 (May 7, 2009) (settled order).

most clients.[174] In light of the Commission's Concept Release on the U.S. proxy system issued on July 14, 2010, which requests comment on a wide range of questions and issues relating to proxy advisory firms,[175] we are adopting Item 17 without this requirement. Clients interested in this information may obtain it from their advisers upon request.

Item 18. Financial Information. This item requires disclosure of certain financial information about an adviser when material to clients. Specifically, an adviser that requires prepayment of fees must give clients an audited balance sheet showing the adviser's assets and liabilities at the end of its most recent fiscal year.[176] The item also requires an 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.[177] For instance, disclosure may be required where a judgment or arbitration award was sufficiently large that payment of it would create such a financial condition. Under these circumstances, clients are exposed to the risk that their assets may not be properly managed — and prepaid fees may not be returned — if, for example,

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174 *See* ASG Letter; Fried Frank Letter; IAA Letter; ICI Letter; Janus Letter; Lininger Letter. A few commenters supported this disclosure. *See* CFA Institute Letter; CII Letter.

175 *Concept Release On The U.S. Proxy System*, Investment Advisers Act Release No. IA-3052 (July 14, 2010) [75 FR 42982 (July 22, 2010)].

176 As proposed, we are increasing the threshold amount from the existing threshold, $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. We also are requiring, as proposed, an audited balance sheet from advisers that *solicit* clients to prepay fees over $1,200. This portion of Item 18 is similar to Item 14 in the previous Part 2.

177 This disclosure was previously required by rule 206(4)-4. In the release adopting rule 206(4)-4, we noted that a determination about what constitutes financial condition reasonably likely to impair an adviser's ability to meet contractual commitments is inherently factual in nature but will generally include insolvency or bankruptcy. *See* Rule 206(4)-4 Adopting Release, *supra* note 106 at n.6.

the adviser becomes insolvent and ceases to do business. Finally, Item 18 requires an adviser that has been the subject of a bankruptcy petition during the past ten years to disclose that fact to clients.[178] As discussed above, although we are rescinding rule 206(4)-4 we caution advisers that their fiduciary duty of full and fair disclosure may require them to continue to disclose any precarious financial condition promptly to *all* clients, even clients to whom they may not be required to deliver a brochure or amended brochure.[179]

One commenter recommended elimination of the balance sheet requirement, stating that the balance sheet gives an imperfect picture of the financial health of an adviser,[180] and another was concerned that disclosure of financial information would unduly discriminate against smaller advisers.[181] We believe that a client that becomes a creditor of an adviser because it prepays fees would want information about the adviser's condition. This information is currently required to be disclosed to clients, and commenters have not persuaded us that it should be omitted. As a result, we are adopting Item 18 as proposed.

Item 19. Index. We proposed to require that the brochure filed with us include an index of the items required by Part 2A indicating where in the brochure the adviser addresses each item. This index was intended to facilitate review by our staff for compliance with the requirements of Part 2A. As discussed above, we are now requiring advisers to provide their responses to the items in Part 2 in the same order as the items appear in the form. As a result, the

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178 This includes the obligation of an adviser that is organized as a sole proprietorship to disclose a personal bankruptcy. This requirement conforms to our view that bankruptcy generally constitutes a "financial condition of the adviser that is reasonably likely to impair the ability of the adviser to meet contractual commitments to clients" requiring disclosure under rule 206(4)-4. *See* Rule 206(4)-4 Adopting Release, *supra* note 106.

179 *See supra* note 106 and accompanying text.

180 *See* Fried Frank Letter.

181 *See* Verbeck Letter.

index would be duplicative of the table of contents and is no longer necessary. We therefore are not adopting this requirement.

Part 2A Appendix 1: The Wrap Fee Program Brochure. Advisers that sponsor wrap fee programs[182] 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 brochure.[183] The items in Appendix 1 to Part 2A contain the requirements for a wrap fee program brochure, and are substantially similar to those previously in Schedule H, the separate wrap fee program brochure in previous Part 2.[184] However, we are revising the requirements of Schedule H to incorporate many of our amendments to the Part 2A firm brochure.

We also are adopting an additional disclosure requirement to the wrap fee program brochure. It requires an adviser to identify whether any of its related persons is a portfolio manager in the wrap fee program and, if so, to describe the associated conflicts. For example, an adviser may have an incentive to select a related person to participate as a portfolio manager

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182 Under wrap fee programs, which also are 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.

183 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)]. Advisers whose entire advisory business is sponsoring wrap fee programs will prepare a wrap brochure but will not be required to prepare a standard advisory firm brochure. *See* Instruction 10 of Instructions for Part 2A of Form ADV. An adviser will have to prepare both a standard firm brochure and a wrap fee program brochure if it both sponsors a wrap fee program *and* provides other types of advisory services, and will 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.

184 We have brought enforcement actions regarding wrap fee program disclosure. *See, e.g.*, *In re Banc of America Investment Services, Inc. and Columbia Management Advisors, LLC* (as successor in interest to Banc of America Capital Management, LLC), Investment Advisers Act Release No. 2733 (May 1, 2008) (settled order).

based on the person's affiliation with the adviser, rather than based on expertise or performance. This item requires advisers to disclose whether related person portfolio managers are subject to the same selection and review criteria as the other portfolio managers who participate in the wrap fee program and, if they are not, how they are selected and reviewed.

Two commenters requested clarification that an adviser can delegate its brochure delivery requirement to the sponsor of the wrap fee program,[185] and one of these commenters also requested clarification that the adviser could satisfy its recordkeeping obligations that evidence delivery of the brochure by such records being retained in the offices of the sponsor and not the adviser, as long as the adviser was able to provide the records to Commission staff upon request.[186] We confirm that a sponsor may deliver the adviser's brochures and maintain certain records as long as the sponsor, upon request of the Commission's staff, will produce promptly the records for the staff at the appropriate office of the adviser or the sponsor. This delegation does not relieve the adviser of its legal delivery obligation, however, and thus the adviser should take steps to assure itself that the sponsor is performing the tasks the adviser has delegated.

3. Delivery and Updating of Brochures

The Commission also is adopting amendments to rule 204-3; our rule under the Advisers Act that requires registered advisers to deliver their brochures and certain updates to clients and prospective clients.[187]

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185 *See* Federated Letter; MMI Letter.

186 *See* MMI Letter. Rules 204-2(a)(14) and 204-2(e)(1) under the Advisers Act describe advisers' recordkeeping obligations relating to brochure delivery.

187 The brochure delivery and updating obligations are the same for both a standard brochure and a wrap fee program brochure. *See* rule 204-3.

a. Delivery to Clients

Initial Delivery. Rule 204-3, as amended, requires an adviser to deliver a current brochure before or at the time it enters into an advisory contract with the client.[188] The rule does not require advisers to deliver brochures to certain advisory clients receiving only impersonal investment advice[189] or to clients that are investment companies registered under the Investment Company Act of 1940 ("Company Act").[190] As proposed, we have expanded the latter exception to cover advisers to business development companies ("BDCs") that are subject to section 15(c) of the Company Act, which requires a board of directors to request, and the adviser to furnish, information to enable the board to evaluate the terms of the proposed advisory contract.[191] Because of this safeguard, we believe that adopting an obligation for these advisers to deliver a brochure to these BDC clients is not necessary.[192] An adviser does not have to prepare (or file with us) a brochure if it does not have any clients to whom a brochure must be delivered.[193]

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188 *See* rule 204-3(b). Rule 204-3 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 2A or a written document containing the information required by Part 2A. Previously, such delivery had to 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 received two comments on this proposed change to the timing of the required initial brochure delivery, both in support. *See* Pickard Letter; T. Rowe Letter.

189 *See* rule 204-3(c)(2) and Instruction 1 for Part 2A of Form ADV. Advisers are not required to deliver brochures to advisory clients receiving only impersonal investment advice for which the adviser charges less than $500 per year. As proposed, we increased the dollar threshold triggering this exception from $200 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. We did not receive comments on this change.

190 *See* rule 204-3(c)(1) and Instruction 1 for Part 2A of Form ADV.

191 *See supra* note 190. As discussed above, an adviser's fiduciary duty of full and fair disclosure, however, may require it to continue to disclose any material legal event or precarious financial condition promptly to *all* clients, even clients to whom it may not be required to deliver a brochure or amended brochure. *See supra* note 106 and accompanying text.

192 Two commenters urged us to adopt an exception for "hedge funds," or clarify that advisers to hedge funds are not required to deliver copies of brochures to their investors. *See* ABA

Annual Delivery. Advisers must annually provide to each client to whom they must deliver a brochure either: (i) a copy of the current (updated) brochure that includes or is accompanied by the summary of material changes; or (ii) a summary of material changes that includes an offer to provide a copy of the current brochure.[194] As proposed, each adviser must make this annual delivery no later than 120 days after the end of its fiscal year.[195] Advisers may deliver a brochure and summary of material changes or summary of material changes, along with an offer to provide the brochure to clients electronically in accordance with the Commission's guidelines regarding electronic delivery of information.[196] An adviser that does not include, and therefore file, its summary of material changes as part of its brochure (on the cover page or the page immediately following the cover) must file its summary as an exhibit, included with its

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Committees Letter; Fried Frank Letter. We note that rule 204-3 requires only that brochures be delivered to "clients." We further note that the Court of Appeals for the D.C. Circuit stated that the "client" of an investment adviser managing a hedge fund is the fund itself, not an investor in the fund. *Goldstein v. SEC*, 451 F.3d 873 (D.C. Cir. 2006).

193 *See* Instruction 7 for Part 2A of Form ADV.

194 *See* rule 204-3(b) and Item 2 to Part 2A of Form ADV. The offer also must be accompanied by a website address and a telephone number and e-mail address for obtaining the complete brochure pursuant to the Instructions for Part 2, as well as the website address for obtaining information about the adviser through IAPD. We also are adopting an amendment to our recordkeeping rule that will require the adviser choosing this approach to preserve a copy of the summary of material changes, so that our examination staff has access to such separately provided summaries. *See* rule 204-2(a)(14)(i). *See* Section IV below.

If an adviser includes the summary of material changes in its brochure, and amends its brochure on an interim basis between annual updating amendments, the adviser should consider whether it should update its summary of material changes to avoid confusing or misleading clients reading the updated brochure.

195 *See* Rule 204-3(b) and Instruction 2 for Part 2A of Form ADV. 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 120-day period is designed to provide sufficient flexibility to allow advisers to include the updated brochure or summary in a routine quarterly mailing to clients. We expect that permitting an adviser to send this document together with these routine mailings could substantially reduce delivery costs. *See* Section VII below.

196 *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)] ("Electronic Media Release").

brochure when it files its annual updating amendment with us, so that the summary of material changes is available to the public through IAPD.[197]

We proposed that each adviser annually deliver an updated brochure to its clients because we were concerned that clients may be relying on "stale" brochures. Many commenters representing advisers objected, arguing that this requirement would cause advisers to incur significant costs,[198] and that clients are not interested in receiving an annual brochure.[199] We believe our revised approach — permitting advisers to deliver annually the summary of material changes, which was suggested by several commenters[200] — addresses our concern that clients may today be relying on "stale" brochures, while alleviating commenters' concerns regarding the costs and burdens of annual delivery of the brochure.[201]

Some commenters urged that we revise our electronic delivery guidance[202] so that disclosure placed on the adviser's web page or on IARD would be deemed to be delivered to its

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197 *See* Instruction 6 for Part 2A of Form ADV. The adviser must upload its brochure and the summary (as an exhibit) together in a single, text-searchable file in Adobe Portable Document Format (PDF) on IARD. *See* Instruction 6 for Part 2A of Form ADV.

198 *See* AICPA Letter; Eddy Letter; FPA Letter; IAA Letter; ICI Letter; Mercer Letter; Merrill Lynch Letter; Morgan Stanley Letter; MMI Letter; NAPFA Letter; NRS Letter; Pickard Letter; ProEquities Letter; Roundtable Letter; Schwab Letter; SIFMA Letter; Sutherland Letter; USAA Letter; comment letter of Wachovia Securities LLC (May 16, 2008) ("Wachovia Letter"); Wellington Letter, comment letter of Wall Street Financial Group (May 16, 2008) ("WSFG Letter").

199 *See, e.g.*, ASG Letter; comment letter of Clifford Swan Investment Counsel (May 5, 2008) ("Clifford Letter"); First Allied Letter; FPA Letter; FSI Letter; comment letter of Moody Aldrich Partners (May 15, 2008) ("Moody Aldrich Letter"); NRS Letter; Roundtable Letter; WSFG Letter.

200 *See* ASG Letter; Clifford Letter; Federated Letter; First Allied Letter; FPA Letter; FSI Letter; comment letter of the Investment Adviser Association (Aug. 26, 2008); Merrill Lynch Letter; Moody Aldrich Letter; NRS Letter; Roundtable Letter; Schnase Letter; WSFG Letter.

201 One commenter representing consumers agreed that such an approach could minimize the costs of delivery without significantly sacrificing investor protection. *See* Consumer Federation Letter.

202 *See* Electronic Media Release, *see supra* note196.

clients, regardless of whether the clients have provided consent to electronic delivery.[203] We note that an adviser's fiduciary duties may require it to obtain client consent to many of the disclosures required by Part 2 and that electronic access, without evidence that the adviser's delivery obligation has been met (such as by obtaining the client's consent to electronic delivery along with appropriate notice and access) would not, in our judgment, serve to adequately protect client interests.[204]

Some commenters recommended that advisers be required to send clients a notice providing a website link to where the brochure is posted on the Internet, rather than having to deliver the actual brochure to clients initially.[205] Another commenter objected, arguing that many investors are not yet willing to use the Internet to receive disclosure documents and that an approach that would rely on electronic delivery would be premature for retail investors.[206] We are not making such changes at this time, but will continue to consider different approaches to delivering financial information to investors.

Interim Delivery. As proposed, rule 204-3 requires advisers to deliver an updated brochure (or a document describing the material facts relating to the amended disciplinary event) promptly whenever the adviser amends its brochure to add a disciplinary event or to change material information already disclosed in response to Item 9 of Part 2A.[207] One commenter opposed the interim updating requirement, expressing concern that it would result in "frequent

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203 *See, e.g.*, ABA Committees Letter; IAA Letter; Mercer Letter; Roundtable Letter; Sutherland Letter; Wachovia Letter.

204 *See* Electronic Media Release, *supra* note 196 at Section II.A.3.

205 *See, e.g.*, ASG Letter; Borek Letter; FSI Letter; ICI Letter; Lininger Letter; Merrill Lynch Letter; MMI Letter; Morgan Stanley Letter; NAPFA Letter; Pickard Letter; SIFMA Letter; Wellington Letter.

206 *See* Consumer Federation Letter.

207 *See* rule 204-3(b)(4).

interim disclosure of information of minimal relevance to clients."[208] We disagree. We believe that disclosure of disciplinary information is highly relevant to clients because it reflects on the integrity of the investment adviser, may affect a client's trust and confidence in the adviser, and may be of even greater interest if the adviser is adding disciplinary information frequently. Therefore, we are adopting this requirement as proposed.

b. Updating Part 2A of Form ADV

Similar to the existing requirements, the amended rules 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 (except the summary of material changes and the amount of assets under management, which only has to be updated annually) becomes materially inaccurate.[209] In the case of both annual and interim updates, advisers will make changes to their brochures using their own computer systems and then simply file the revised versions of their brochures through IARD.[210]

In some cases, an adviser filing its annual updating amendment may not have any material changes to make to its brochure. If the adviser has not filed any interim amendments to its brochure since the last annual amendment and the brochure continues to be accurate in all material respects, the adviser would not have to prepare or deliver a summary of material changes to clients. The adviser also would not have to prepare and file an updated firm brochure as part of its annual updating amendment. If there was an interim amendment or the brochure contained a material inaccuracy, however, the adviser would have to file a summary of material

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208 *See* FSI Letter.

209 If an adviser is amending its brochure for a separate reason between annual amendments, and the amount of assets under management is materially inaccurate, the adviser should amend this disclosure. *See* Instruction 4 for Part 2A of Form ADV.

210 *See* rule 204-1(b).

changes describing any interim amendment(s) along with an updated firm brochure as part of its annual amendment filing. Although previously filed versions of an adviser's brochures will remain in the IARD system, only the most recent version of an adviser's brochure will be available to the public through the Commission's website.[211] The purpose of the public disclosure website is to provide the public with current information about advisers, rather than historic information.[212]

B. Part 2B: The Brochure Supplement

Rule 204-3 also requires that each firm brochure be accompanied by brochure supplements providing information about the advisory personnel on whom the particular client receiving the brochure relies for investment advice.[213] Among other things, the brochure supplements will contain information about the educational background, business experience, and disciplinary history (if any) of the supervised persons who provide advisory services to the client. The brochure supplement thus includes information that would not necessarily be included in the firm brochure about supervised persons of the adviser who actually provide the investment advice and interact with the client.

Several commenters supported the brochure supplement requirement.[214] One stated that the brochure supplement's "greater personal relevance to investors will make [it] among the

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211 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 will be available via the public disclosure website.

212 Instructions for obtaining historic brochure filings may be found at http://www.sec.gov/answers/publicdocs.htm.

213 *See* rule 204-3(b)(3). We believe that brochure supplements will be important to advisory clients in selecting an adviser because clients place great weight on the supervised person's qualifications and events that may reflect on the integrity of advisory personnel. *See* Proposing Release, *supra* note 8, at Section II.B.1.

214 *See* ASG Letter; Consumer Federation Letter; CFA Institute Letter; FPA Letter; IAA Letter; Lininger Letter; NASAA Letter.

most widely read of the disclosure documents they receive, particularly if they receive it in a timely fashion."[215] Another stated that the brochure items addressed areas of interest to clients and stated that "information on the qualifications and background of those who influence clients in connection with their investments are as relevant, if not more relevant, than the information currently required by Part 2 on senior executives of the firm that may have little or no direct contact with the client."[216]

Several advisers that also are registered as broker-dealers, however, urged that we not require a brochure supplement, arguing that the brochure supplement would prove excessively costly, that at least some of the information is available on the Financial Industry Regulatory Authority's (FINRA) web-based BrokerCheck system,[217] and that information not available through BrokerCheck (such as the "Educational Background," "Other Business Activities," "Additional Compensation," and "Supervision" sections) is either not important to clients or could be covered by general disclosure in the firm brochure about the firm's policies and procedures.[218] We disagree. We believe that the additional information required by the supplement will be important to many clients and, particularly for large advisers, cannot be sufficiently described by firm policies and procedures. For large advisers, such policies will by necessity tend to be general because they must cover a large number of supervised persons with a

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215 Consumer Federation Letter.

216 CFA Institute Letter.

217 Another commenter argued against reliance on BrokerCheck. *See* Consumer Federation Letter.

218 *See, e.g.*, CGMI Letter; Merrill Lynch Letter; Morgan Stanley Letter; Schwab Letter; SIFMA Letter. BrokerCheck, which is designed to help investors check the professional background of current and former FINRA-registered securities firms and brokers, is available at http://www.finra.org/Investors/ToolsCalculators/BrokerCheck/index.htm. The following commenters argued that we should not require the brochure supplement because it would provide little new or useful information but would create significant costs and burdens. *See, e.g.*, NAPFA Letter; Pickard Letter; Roundtable Letter; USAA Letter; comment letter of John H. Vineyard (Mar. 18, 2008) ("Vineyard Letter"). For the reasons discussed in the text, we disagree.

range of ancillary activities and conflicts. For example, we do not believe that a prospective client would find it particularly helpful to read in the firm brochure that all of the adviser's associated persons had earned a college degree. Or that some of their associated persons had additional business activities that may involve conflicts of interest. Disclosure of such generalized information about the firm's associated persons is unlikely to be meaningful to clients seeking to understand the background, particular conflicts and outside business activities of the individual providing investment advice to them.

Commenters have, however, persuaded us to permit advisers to make use of BrokerCheck as well as the IAPD system to disclose disciplinary information available on those systems when the client has received a brochure supplement electronically.[219] The instructions for Part 2B of Form ADV provide that the adviser may disclose in a supplement delivered electronically that the supervised person has a disciplinary event and provide a hyperlink to either the BrokerCheck or the IAPD systems.[220] We believe that this accommodation addresses commenters' concerns regarding duplication of disclosure requirements, while meeting our objective of providing advisory clients with convenient access to information necessary to assess the individuals they are relying on for investment advice.[221] In addition to this accommodation, we have made several other changes to the proposed brochure supplement requirements in response to comments, which we discuss below.

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219 IAPD was recently enhanced to allow investors to obtain disciplinary history of supervised persons. *See* http://www.nasaa.org/NASAA_Newsroom/Current_NASAA_Headlines/12811.cfm for a press release announcing the launch of an enhancement to IAPD to allow users to search for individuals.

220 See Instruction 3 for Part 2B of Form ADV.

221 We also believe that this approach addresses the concern expressed by one commenter that reliance on BrokerCheck would hurt those investors who are least sophisticated and therefore are most likely to need this information, but who are the very ones that are least likely to seek it out. *See* Consumer Federation Letter.

1. Format

As proposed, the amendments require advisers to write their supplements in plain English, but offer an adviser flexibility in presenting information in a format that is best suited to the advisory firm. This flexibility is designed to reduce the cost of preparing and delivering supplements. Advisers may include supplement information within the firm's brochure, an approach that may be attractive to smaller firms with few persons for whom they will be required to prepare supplements.[222] Advisers may elect to prepare a supplement for each supervised person. Alternatively, they can prepare separate supplements for different groups of supervised persons (*e.g.*, all supervised persons in a particular office or work group). To promote comparability of brochure supplements, we are requiring that a brochure supplement must be organized in the same order, and contain the same headings, as the items appear in the form, whether provided in a brochure or separately.[223]

2. Supplement Items

Part 2B, as we proposed and as we are adopting it today, consists of six items. Many commenters who addressed the specific proposed items supported the content of the brochure supplements generally.[224] Others offered specific comments on certain items; we address these comments below.

Item 1. Cover Page. Each supplement's cover page must include information identifying the supervised person (or persons) covered by the supplement as well as the advisory firm. One

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222 IARD data as of May 3, 2010 indicate that 81% of advisers registered with us have 10 or fewer employees performing investment advisory functions on their behalf. Over 65% have five or fewer employees performing advisory functions.

223 If provided in a brochure, supplements must be included at the end of the brochure and be sequenced for each supervised person. *See* Instruction 1 of General Instructions for Part 2 of Form ADV and Instruction 6 for Part 2B of Form ADV.

224 *See, e.g.*, CFA Institute Letter, CFP Board Letter; FPA Letter.

commenter stated that the brochure supplement should not require a separate cover page.[225] We intended Item 1 of the brochure supplement to require that the information specified in the item be included on the front page of the supplement, not that this be the *only* information on a cover page. We have modified Item 1 accordingly to clarify that the information required by the item may be presented either on a separate cover page or at the top of the first page of the brochure supplement.

Item 2. Educational Background and Business Experience. Item 2 requires the supplement to describe the supervised person's formal education and his or her business background for the past five years.[226] If the supervised person either has no high school education, no formal education after high school, or no business background, the adviser must disclose this fact in the supplement. The business background section must identify the supervised person's positions at prior employers and not merely list the names of prior employers.[227]

Advisers may include information about professional designations in the supplement if they so choose. One commenter urged the Commission to require the listing of any professional designations held as long as the designations conform to the North American Securities Administrators Association (NASAA) model rules and state regulations that prohibit the misleading use of designations or certifications.[228] A few other commenters encouraged the Commission to require disclosure about the minimum qualifications required for any disclosed

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225 *See* ASG Letter.

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

227 For example, clients may be interested in knowing that a supervised person was previously employed as an analyst at a hedge fund as opposed to being employed as a computer support specialist at a hedge fund.

228 *See* CFP Board Letter.

professional designation.[229] We are not electing to require a listing of professional designations as we do not require, nor do we endorse, any designations. We are concerned that the Commission requiring such disclosure could cause clients to mistakenly believe that we do endorse designations. We do believe, however, that some clients may be interested in learning of professional designations held by the individuals providing them with investment advice. However, we do not believe that such disclosure is meaningful without an explanation of the minimum qualifications required to obtain the designation. Accordingly, we are adding a requirement that if professional designations are disclosed in the supplement, the supplement must also provide a sufficient explanation of the minimum qualifications required for the designation to allow clients and potential clients to understand the value of the designation. The disclosure, of course, also cannot be materially false or misleading by suggesting, for example, that the designation implies more qualifications or experience than the actual designation standards require.[230]

Item 3. Disciplinary Information. Item 3 requires disclosure of any legal or disciplinary event that is material to a client's evaluation of the supervised person's integrity. It includes

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229 *See* ASG Letter; First Allied Letter; NASAA Letter. *But see* Vineyard Letter (stating that the supplement should not allow descriptions of professional designations since such disclosure could imply that the Commission advocated obtaining the particular designation).

230 We note that 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. *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 vary widely. FINRA has established and maintains a database of designations used across the financial services industry that contains basic information about the designation, such as the issuing organization, prerequisites, and educational requirements. http://apps.finra.org/DataDirectory/1/prodesignations.aspx.

certain disciplinary events that the Commission presumes are material to such an evaluation if they occurred during the last 10 years.[231] Several commenters supported this requirement, and stated that such information would be of great interest to clients.[232]

As proposed, Item 3 of the supplement would have required disclosure of any event for which the supervised person had 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). Two commenters recommended that we not require this particular disclosure, stating that an adviser would not know a supervised person's reason for relinquishing a designation or license.[233] We recognize that an adviser may not always know why a supervised person is relinquishing a designation or license. We are modifying this requirement to clarify that this disclosure need only be made if the adviser knew or should have known that the supervised person relinquished his or her designation or license.

As discussed above, we are modifying Item 3 to permit advisers that send supplements electronically to clients to include hyperlinks to disciplinary information available through the FINRA BrokerCheck system as well as the IAPD system. A number of supervised persons of

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231 This list parallels the 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 prior disclosure requirements set out in rule 206(4)-4. The list also is substantially similar to the list of disciplinary events advisers and their advisory affiliates are already required to disclose in response to Item 11 of Form ADV, Part 1A.

As under Item 9 of Part 2A, Item 3 of Part 2B permits an adviser to rebut the presumption with respect to a particular event, in which case no disclosure to clients about the event will be required. We 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 disclosure requirement. As under Item 9 of Part 2A, a note in Item 3 explains four factors the adviser should consider when assessing whether the presumption can be rebutted.

232 *See* CFA Institute Letter; CFP Board Letter; Consumer Federation Letter; FPA Letter; NASAA Letter.

233 *See* First Allied Letter; IAA Letter.

investment advisers also are registered representatives of a broker-dealer firm or are subject to state investment adviser reporting requirements and thus may have disciplinary disclosure available through BrokerCheck or IAPD. Permitting advisers to hyperlink to these systems may minimize the costs of brochure supplements by leveraging existing infrastructure established by broker-dealer and adviser regulation. To take advantage of this provision, the brochure supplement must be delivered electronically and must include: (i) a statement that the supervised person has a disciplinary history, the details of which can be found on BrokerCheck or the IAPD (as the case may be); and (ii) a hyperlink to the relevant system with a brief explanation of how the client can access the disciplinary history.

Two commenters recommended that the Commission reconcile the disclosure requirements in Item 3 of the brochure supplement with Item 14 of Form U4, the uniform form used by broker-dealer and state investment advisory representatives to register (which includes certain disciplinary disclosure and is the source of such information that is available on BrokerCheck), stating that a lack of uniformity would complicate compliance.[234] We may consider in the future whether the disclosure requirements in Item 3 and in Form U4 should be conformed, as we recognize the substantial overlap between these disclosure items. We note, however, that although the disclosure requirements are not phrased identically, any disclosure required by the brochure supplement would also have to be disclosed on Form U4.

Item 4. Other Business Activities. Item 4 requires an adviser to describe other business activities of its supervised persons. The item specifically requires disclosure with respect to other capacities in which the supervised person participates in any investment-related business

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234 *See* ICI Letter; NASAA Letter.

and any material conflicts of interest such participation may create.[235] In addition, the item requires the supplement to include information about any compensation, including bonuses and non-cash compensation, the supervised person receives based on the sales of securities or other investment products, as well as an explanation of the incentives this type of compensation creates.[236] We are adopting this item substantially as proposed. We believe that disclosure of any such compensation is important because it creates an incentive for the supervised person to base investment recommendations on his or her own compensation rather than on clients' best interests.

We also are adopting a requirement to disclose *other* business activities or occupations that the supervised person engages in if they involve a substantial amount of time or pay.[237] 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. Several commenters supported inclusion of this item.[238] A few commenters urged that we not require disclosure of this information,[239] with one commenter arguing that such information is irrelevant to the adviser's competence in providing investment advice,[240] and another stating that such a requirement would be burdensome.[241] We are retaining this requirement because we

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235 *See* Item 4.A of Part 2B.

236 *See* Item 4.A.2 of Part 2B.

237 *See* Item 4.B of Part 2B.

238 *See, e.g.*, Berlin Letter; CFA Institute Letter; CFP Board Letter; NASAA Letter. The NASAA Letter urged disclosure of all outside business activities regardless of whether they occupied a substantial amount of that person's time or income.

239 *See* IAA Letter; ProEquities Letter; Vineyard Letter.

240 *See* IAA Letter.

241 *See* ProEquities Letter.

believe that investors will find this information helpful in assessing the conflicts created by those activities.

Finally, some commenters stated that the Commission should define "substantial sources of income" and "substantial amount of time" by reference to specific percentages or in some other manner.[242] We believe that what amounts to "substantial" in many cases depends on particular facts and circumstances, and thus we are not establishing any specific definition of what is and is not substantial. However, we do understand the concern that there is likely some level at which a source of income or amount of time would rarely interfere or conflict with an adviser's business of providing investment advice. Accordingly, we are allowing advisers to make a presumption that if the other business activities represent less than 10 percent of the supervised person's time and income, they are not substantial.[243]

Item 5. Additional Compensation. This item requires 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.[244]

Two commenters suggested that we not require this disclosure, with one of these commenters stating that disclosure of any conflicts arising out of such compensation arrangements is already required by an adviser's fiduciary duty and that firms should be free to make such disclosure in the firm's brochure or investment advisory contract, rather than in the brochure supplement.[245] We are adopting Item 5 as proposed. We believe clients need to know

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242 *See* Case Letter; FSI Letter; ProEquities Letter; TAG Letter.

243 *See* Item 4.B of Part 2B.

244 Bonuses based (in part or whole) on sales, client referrals or new accounts trigger required disclosure, but other bonuses do not. Regular salaries need not be disclosed.

245 *See* Morgan Stanley Letter; Schwab Letter. Morgan Stanley made the comment regarding fiduciary duties.

if their individual adviser has these arrangements in order to assess the advisory services of that particular supervised person and that general disclosure of this conflict in a firm-wide brochure or advisory contract is not an adequate substitute. As we stated above, general disclosure of this type of conflict in many firm-wide brochures or advisory contracts will by necessity tend to be general because it must cover a variety of supervised persons with a range of compensation arrangements. Such general disclosure is unlikely to be meaningful to clients seeking to understand the particular compensation arrangements and associated conflicts of the individual providing investment advice to them.

Item 6. Supervision. This item requires an adviser to explain how the firm monitors the advice provided by the supervised person addressed in the brochure supplement. It also requires 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.

We are adopting Item 6 as proposed. One commenter supported this requirement, stating that it is important for clients to have the ability to locate a person within a firm to whom they can direct questions or voice concerns about their accounts.[246] Some commenters recommended that the Commission not require this item, asserting that investors would not be interested in this information and that this requirement would not make sense for smaller advisory firms.[247] We believe that it is important for clients to be able to contact an appropriate person at an advisory firm, regardless of the firm's size, if they have any questions or complaints about the handling of their account. This will allow clients to determine appropriate redress for their complaints without having to go through the particular supervised person that is the focus of the complaint. Therefore, we are requiring this disclosure.

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246 *See* CFA Institute Letter.

247 *See* FPA Letter; FSI Letter; IAA Letter; Sutherland Letter.

Several commenters requested that the Commission permit advisers to furnish clients with a general contact number and email address instead of the name and contact information for the supervisor because supervisory personnel may change frequently, triggering the need for updated supplements, and because some supervised persons have multiple supervisors.[248] We do not agree with commenters' suggestion and are adopting this requirement as proposed. We believe that providing the name and telephone number of a specific individual responsible for supervising the representative's advisory activities will ensure that the client has ready access to the supervisor if the client has any complaints or concerns. In the unlikely event that a supervised person has more than one direct supervisor of his or her *advisory* services, the adviser may identify any one of those supervisors as long as that supervisor has the authority to respond to the client's question or complaint (or can raise the issue to a higher-level supervisor, if appropriate).

3. Delivery and Updating

a. Delivery

We are requiring as proposed 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. We believe that clients are most interested in learning about the background and experience of these individuals from whom they receive investment advice.

In the Proposing Release, we stated that 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

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248 *See* FPA Letter; FSI Letter; Roundtable Letter; USAA Letter; Wachovia Letter.

has no direct client contact.[249] We explained our view that, when investment advice is formulated by a team, specific information about each individual team member takes on less importance. A few commenters stated that all representatives providing advice as part of a team will likely have direct client contact from time to time, and thus that the Commission's proposed exemption from the brochure supplement delivery requirement for supervised persons that provide advice as part of a team *and* that have no direct client contact, in fact, would not exempt any team members from this requirement as a practical matter, despite the limited utility of disclosure about each supervised person comprising a large advisory team.[250] We agree with commenters that volumes of disclosure about a large group of supervised persons likely would not be meaningful to investors. Accordingly, we are modifying this requirement, as suggested by one commenter,[251] based on the approach to disclosure under the Company Act where a team of individuals is jointly and primarily responsible for the day-to-day management of a mutual fund's portfolio.[252] If investment advice is provided by a team comprised of more than five supervised persons, brochure supplements need only be provided for the five supervised persons with the most significant responsibility for the day-to-day advice provided to the client.[253]

Another commenter urged the Commission to exempt from the brochure supplement requirement any supervised persons providing non-discretionary advice (even if not part of a team).[254] A commenter representing investors strongly opposed this recommendation, arguing

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249 *See* Proposing Release, *supra* note 8, at n.164.

250 *See, e.g.*, Federated Letter; ICI Letter; NAPFA Letter.

251 *See* ICI Letter.

252 *See* Instruction 2 for Item 5(b) of Form N-1A.

253 *See* rule 204-3(b)(3).

254 *See* SIFMA Letter.

that investors do not differentiate the advice they receive on this basis.[255] We believe that, where a supervised person is providing investment advice directly to a client, disclosure relating to the background and integrity of that person would be important to a client. It assists the client in evaluating the value of that investment advice, an evaluation we believe clients make regardless of whether the advice is non-discretionary.[256]

An adviser generally must provide its clients with a brochure supplement for each supervised person who provides the advisory services as described above. However, advisers are not required to deliver supplements to three 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); (ii) clients who receive only impersonal investment advice;[257] and (iii) certain "qualified clients" who also are officers, directors, employees and other persons related to the adviser.[258] An adviser that does not have any clients to whom a supplement will have to be delivered will not have to prepare any supplements.[259] Similarly, an adviser will not have to

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255 *See* Consumer Federation Letter.

256 We note that an adviser's fiduciary duties to its clients under the Advisers Act do not turn on whether its advice is provided on a discretionary or non-discretionary basis.

257 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 will result in an unnecessary expense with little appreciable benefit. We believe, however, that delivery of a firm brochure will be useful where the cost of the impersonal advisory services is significant, that is $500 or above.

258 Rule 205-3(d)(1)(iii) also 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; or (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.

259 *See* note to rule 203-1(a) and (b); Instruction 1 for Part 2B of Form ADV.

prepare a supplement for any supervised person who does not have clients to whom the adviser must deliver a supplement.

We proposed exempting advisers from delivering the brochure supplement to certain sophisticated clients,[260] and received several comments from those representing advisers supporting the exemption or urging its expansion.[261] The brochure supplement is intended to contain fundamental information about the qualifications of persons providing investment advice. Sophisticated clients are likely to request this type of information, even if not affirmatively provided by an investment adviser. Given that advisers will be preparing and delivering brochure supplements anyway, we believe the incremental burden of meeting the rule's obligations with respect to these sophisticated clients will be minimal and would not justify an exemption. We are therefore requiring that advisers deliver brochure supplements to all clients other than, as described above: (i) those clients to whom the adviser is not required to deliver a firm brochure; (ii) clients who receive only impersonal investment advice; and (iii) certain "qualified clients" who also are officers, directors, employees and other persons related to the adviser.

The supervised person's supplement initially must be given to each client at or before the time when *that* specific supervised person begins to provide advisory services to *that* specific client.[262] A few commenters argued that a large adviser with thousands of supervised persons may have staff changes on any given day and suggested that delivery be permitted *promptly after* the time the supervised person begins providing advisory services to the client.[263] But the

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260 *See* Proposing Release at Section II.B.1.

261 *See, e.g.*, IAA Letter; ICI Letter; Pickard Letter; T. Rowe Letter.

262 *See* rule 204-3(b)(3) and Instruction 3 for Part 2B of Form ADV.

263 *See* IAA Letter; ICI Letter.

brochure supplement is intended to assist investors in determining whether to retain the services of a particular adviser and in evaluating the individual advice they are receiving. This function could not be fully served if a client did not receive the supplement until after the supervised person already had begun providing advice to the client. As a result, we are adopting this delivery requirement as proposed.

b. Updating

We are adopting as proposed, the requirement that advisers deliver an updated supplement to clients only when there is new disclosure of a disciplinary event, or a material change to disciplinary information already disclosed, in response to Item 3 of Part 2B.[264] Because the final rule allows advisers to reference BrokerCheck or IAPD for disclosure of a supervised person's disciplinary information when the supplement is delivered electronically, if the supplement refers to BrokerCheck or IAPD a change in disclosure required by Part 2B would require the adviser to electronically deliver an updated supplement (or sticker) to clients when BrokerCheck or IAPD has been updated with new disclosure of a disciplinary event, or a material change to disciplinary information already disclosed, with the updated supplement (or sticker) indicating that the disciplinary information for the supervised person has changed and providing a hyperlink to BrokerCheck or IAPD. We believe this information is critical for clients because it reflects upon the supervised person's integrity and may affect a client's trust and confidence in that person and the adviser that employs the supervised person.

As with the brochure, advisers must amend a brochure supplement promptly if information in it becomes materially inaccurate.[265] Any new clients to whom the adviser is

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264 *See* rule 204-3(b)(4). We note that an adviser's fiduciary duty may require it to inform a client of material changes to disclosures in the supplement even if rule 204-3 does not require delivery of an updated supplement to clients.

265 *See* Instruction 4 for Part 2B of Form ADV.

obligated to deliver a supplement under our amended rule must be given an amended supplement (or the "old" supplement and a sticker). Supplements, like brochures, may be delivered on paper or electronically.[266] Because we believe most information in the supplement is unlikely to become materially inaccurate over time, advisers are not required to deliver supplements to existing clients annually. These requirements have not been modified from the proposal.

C. Filing Requirements, Public Availability

The Commission is amending rule 204-1 to require advisers to file their new brochures with us electronically through the IARD system.[267] Advisers are not required to file brochure supplements or supplement amendments with the Commission, and they will not be available on the Commission's public website.[268] Advisers are required to maintain copies of all supplements and amendments in their files.[269]

The IARD will accept brochure filings using the text-searchable Adobe Portable Document Format ("PDF").[270] The IARD provides advisers with online access to the Part 2A Items and instructions. Instead of completing Part 2A online, advisers will create their brochure on their own computers, convert it to a PDF, 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

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266 *See* Instruction 5 for Part 2B of Form ADV.

267 Rule 204-1 had required advisers to file only "Part 1A of Form ADV" electronically. We are amending it to require Part 1A and Part 2A of Form ADV to be filed electronically.

268 *See* rules 203-1(a) and 204-1(b) and Instruction 9 for Part 2B of Form ADV. Because brochure supplements would not be filed with us, they would not be deemed filed and 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).

269 *See* rule 204-2(a)(14)(i) and Instruction 9 for Part 2B of Form ADV.

270 FINRA will assist investment advisers with converting brochures into a text-searchable PDF format using software available to the adviser or, if necessary, providing the adviser with PDF conversion software.

make the necessary changes to the source file on their own computers and then attach the revised versions to their IARD filing. The IARD will not accept an annual updating amendment without an updated brochure, a representation by that adviser that the brochure on file does not contain any materially inaccurate information, or a representation that the adviser does not have to prepare a brochure because it does not have to deliver it to any clients (*e.g.*, the adviser's clients are limited to registered investment companies). The IARD also will not accept an annual updating amendment without a representation that the summary of material changes is attached as an exhibit to or included in the updated brochure or a representation that no summary of material changes is required because there have been no material changes to the adviser's brochure since its last annual updating amendment.[271] If an adviser using multiple brochures discontinues using a particular brochure, the IARD system will permit the adviser to eliminate that brochure from its current filing.[272]

Most commenters addressing electronic filing supported the new filing requirement and public availability of the brochures.[273] Some, however, expressed concern that public disclosure of advisers' brochures through IAPD could reveal proprietary and confidential business information to competitors.[274] We have reviewed our requirements and do not believe that they would require disclosure of proprietary or confidential business information. Indeed, the

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271 If the adviser's summary of material changes is a separate document, the adviser must attach the summary as an exhibit to its brochure and upload the brochure and the summary in one single, text-searchable, PDF file on IARD.

272 Similarly, if an adviser is no longer required to prepare a brochure for delivery, the IARD system will permit the adviser to eliminate that brochure from its current filing.

273 *See* CGMI Letter; Fried Frank Letter; CFA Institute Letter; Katten Letter; NAPFA Letter; NASAA Letter; NRS Letter; NSCP Letter; Sidley Letter.

274 *See* comment letter of Brown & Brown Financial Services, Inc. (Mar. 27, 2008) ("Brown Letter"), comment letter of Executive Advisers, Inc. (May 14, 2008); comment letter of Larry Laws and Associates, Inc. (May 14, 2008); comment letter of James E. Wernli (May 20, 2008) ("Wernli Letter").

information that would be disclosed is very similar to that which we have long required to be disclosed by advisers in their brochures and which until 2000 was filed in paper with the Commission and publicly available.[275] We believe that there is a substantial public interest in having this information readily available to prospective clients, which may assist them in their search for an investment adviser. In addition, we believe that public disclosure will have a beneficial effect on business practices by, for example, discouraging advisers from engaging in certain practices because those practices would have to be publicly disclosed.

Other commenters expressed concern that a fund adviser's required public disclosure of Part 2 through IAPD could jeopardize the reliance of any private funds that it advised on the private offering exemption in the Securities Act of 1933 and the safe harbor for offshore transactions from the registration provisions in Section 5 of that statute.[276] We believe registrants can provide information required by Part 2 without jeopardizing reliance on those exemptions. The inclusion of private fund information beyond that required in Part 2, however, such as subscription instructions, performance information, and financial statements, may jeopardize such reliance by constituting a public offering or conditioning the market for the securities issued by those funds.

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275 Until 2000, our rules required advisers to file both Part I and Part 2 of Form ADV with us and it was available in our public reference room. *See* Section I.C.2 of *Electronic Filing by Investment Advisers; Amendments to Form ADV*, Investment Advisers Act Release No. 1897 (Sept. 12, 2000) [65 FR 57438 (Sept. 22, 2000)].

276 15 U.S.C. 77e. Some expressed specific concern that the public disclosure may be deemed to violate the prohibition on "general solicitation" and "general advertising" that applies to private offerings conducted in accordance with Rule 506 of Regulation D. *See* AICA Letter; AIMA Letter; Fried Frank Letter; Janus Letter; NSCP Letter. One mentioned that the public disclosure could raise questions as to whether there are "directed selling efforts" in the United States, which would be inconsistent with the rules applicable to offshore offerings under Regulation S under the Securities Act. *See* Sidley Letter.

D. Transition to New Requirements

As discussed below in the discussion of compliance and effective dates,[277] we are adopting transition requirements that, as proposed, provide advisers with at least six months to comply with the amended rules and forms.[278] While a few commenters asked for more time to prepare the brochures and brochure supplements,[279] we believe the proposed transition period is sufficient. Advisers that are currently registered with us will have at least 8 months (from the end of July 2010 through the end of March 2011) to prepare and file narrative brochures as a result of the compliance dates discussed below. We also note that we have changed the period by which firms must deliver the new brochure and brochure supplements to their existing clients after this electronic filing compliance date from 30 days to 60 days to make sure that advisers have enough time to comply with the requirement.[280]

III. AMENDMENTS TO FORM ADV INSTRUCTIONS AND GLOSSARY

Together with the Part 2 amendments, we also are making conforming amendments to the General Instructions and the Glossary of Terms for Form ADV. We are amending the General Instructions to Form ADV to include instructions regarding brochure filing requirements. Similarly, we are amending the Glossary of Terms to add the following five terms that are used

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277 *See* Section V of this Release.

278 Rule 204-1(c). We proposed 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 six months after the date the revised form becomes effective.

279 *See* AICPA Letter; First Allied Letter; NAPFA Letter; T. Rowe Letter.

280 Two commenters suggested a rolling transition over several months to avoid an inordinate demand on outside consulting and legal services by many advisers at the same time. *See* Fried Frank Letter; NAPFA Letter. We believe that the transition period we have provided to comply with the new Part 2 requirement permits advisers to work with their service providers in advance of the date their filings are required.

in Part 2: (i) "brochure;"[281] (ii) "brochure supplement;"[282] (iii) "custody;"[283] (iv) "investment adviser representative;"[284] (v) "supervised person;"[285] and (vi) "wrap brochure or wrap fee program brochure."[286] We also are updating 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 updating 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 revision properly reflects

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281 "Brochure" means: "A written disclosure statement that you must provide to clients and prospective clients." *See* Form ADV: Glossary.

282 "Brochure supplement" means: "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.

283 "Custody" means "holding, directly or indirectly, client funds or securities, or having any authority to obtain possession of them. You have custody if a related person holds, directly or indirectly, client funds or securities, or has any authority to obtain possession of them, in connection with advisory services you provide to clients. Custody includes: (i) Possession of client funds or securities (but not of checks drawn by clients and made payable to third parties) unless you receive them inadvertently and you return them to the sender promptly but in any case within three business days of receiving them; (ii) Any arrangement (including a general power of attorney) under which you are authorized or permitted to withdraw client funds or securities maintained with a custodian upon your instruction to the custodian; and (iii) Any capacity (such as general partner of a limited partnership, managing member of a limited liability company or a comparable position for another type of pooled investment vehicle, or trustee of a trust) that gives you or your supervised person legal ownership of or access to client funds or securities." *See* rule 206(4)-2(d)(2).

284 "Investment adviser representative" means: "Any of your firm's supervised persons (except those that provide only impersonal investment advice) is an investment adviser representative, if – (i) the supervised person regularly solicits, meets with, or otherwise communicates with your firm's clients, (ii) the supervised person has more than five clients who are natural persons and not high net worth individuals, and (iii) more than ten percent of the supervised person's clients are natural persons and not high net worth individuals." *See* Form ADV: Glossary. *Cf*. rule 203A-3(a).

285 "Supervised person" means: "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.

286 "Wrap brochure or wrap fee program brochure" means: "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*.

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.[287] 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 registered advisers. Certain entities will need to file Form ADV-NR with the Commission to appoint agents for service of process because they relied on the glossary definition and therefore were not required to file the form. We received no comments on these changes and are adopting them as proposed.

IV. AMENDMENTS TO RULE 204-2

We also are adopting 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 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.[288] Additionally, the amendments require registered advisers to prepare and preserve documentation of the method they use to calculate 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.[289] The amendments also 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 for the period the event is presumed material, if the event is not disclosed in the

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287 This amendment will 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 275.0-2(b)(2)].

288 *See* rule 204-2(a)(14)(i). The rule also will require advisers to keep and maintain a copy of the summary of material changes that is not included in the brochure, as well as a record of the dates that each brochure, amendment, and summary of material change was given to any client.

289 *See* discussion at *supra* note 40 and accompanying text.

adviser's brochure or the relevant brochure supplement.[290] These records will 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 received no comments on these changes and are adopting them as proposed.

V. EFFECTIVE AND COMPLIANCE DATES

The amended rules and forms will be effective on October 12, 2010.

A. New Investment Advisers

Each adviser applying for registration with the Commission after January 1, 2011 must file a brochure or brochures that meet the requirements of amended Part 2A as part of the application for registration on Form ADV.[291] Such advisers must, upon registering, begin to deliver to their clients and prospective clients a brochure and brochure supplements that meet the requirements of the amended form in accordance with the amended rules discussed above.[292]

B. Registered Advisers

Each adviser registered with the Commission whose fiscal year ends on or after December 31, 2010, must include in its next annual updating amendment to its Form ADV a brochure or brochures that meet the requirements of the amended form.[293] Accordingly, each adviser with a fiscal year end of December 31, 2010 must file an annual updating amendment with the new brochures no later than March 31, 2011. Within 60 days of filing such amendment,

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290 *See* discussion at *supra* notes 86 - 89 and accompanying text.

291 Rule 203-1(b). This requirement applies only if the adviser is required to deliver a brochure. *See* note to Rule 203-1.

292 Rule 204-3(b).

293 Rule 204-1(c). This filing requirement applies only if the adviser is required to deliver a brochure. *See* note to Rule 203-1.

the adviser must deliver to its existing clients a brochure and brochure supplement that meet the requirements of amended Form ADV.[294] Each adviser must, after the initial filing of the brochures, begin to deliver to new clients and prospective clients a new brochure and brochure supplements in order to satisfy its obligations under the brochure rule.[295]

VI. PAPERWORK REDUCTION ACT

As explained in the Proposing Release, certain provisions of the rule and form amendments that we are adopting today contain "collection of information" requirements within the meaning of the Paperwork Reduction Act of 1995 ("PRA").[296] In the Proposing Release, the Commission published notice soliciting comment on the collection of information requirements. The Commission submitted the collection of information requirements to the Office of Management and Budget ("OMB") for review in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11, and OMB approved these collections of information under control numbers 3235-0049 (expiring 2/28/2011), 3235-0278 (expiring 3/31/2011), 3235-0047 (expiring 2/28/2011), and 3235-0345 (expiring 3/31/2011). The titles for these collections of information are "Form ADV," "Rule 204-2," "Rule 204-3," and "Rule 206(4)-4," respectively, all under the Advisers Act. 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 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.

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294 Rule 204-3(g)(1).

295 Rule 204-3(g)(2).

296 44 U.S.C. 3501.

The rule and form amendments that we are adopting 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 amendments to Part 2 of Form ADV. The second collection of information involved is that under the amendment to rule 204-2, which requires advisers to maintain and preserve specified books and records. The third collection involved is that related to an amendment to rule 204-3, which requires advisers to deliver certain information required under Form ADV to their clients.

In addition, we are withdrawing rule 206(4)-4, the rule requiring advisers to disclose certain disciplinary and financial information, because the disclosure required by that rule is incorporated into the amendments to Part 2 of Form ADV that we are adopting.

A. Summary of Comment Letters

We requested comment on the Paperwork Reduction Act analysis contained in the Proposing Release. A number of commenters expressed concerns that the paperwork burdens associated with our proposed amendments to Part 2 of Form ADV were understated.[297] Several commenters stated that our estimates of the burdens of preparing and delivering brochure supplements were too low and that the requirement would impose heavy burdens on advisers, in particular, large advisory firms with thousands of employees and clients.[298] Several commenters noted that these costs would increase particularly in the context of wrap fee programs.[299] In response to comments on the requirements of Form ADV Part 2, we have made several substantive modifications to the proposed amendments that we believe in general will reduce the

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297 *See* ASG Letter; Berlin Letter; Federated Letter; First Allied Letter; Fried Frank Letter; FSI Letter; IAA Letter; Jackson Letter; NAPFA Letter; NRS Letter; Pickard Letter; Sutherland Letter; Vineyard Letter.

298 *See* Merrill Lynch Letter; Morgan Stanley Letter; Schwab Letter; SIFMA Letter; Sutherland Letter.

299 *See* Federated Letter; MMI Letter; Morgan Stanley Letter.

paperwork burdens associated with the rule and form amendments. For example, we have modified the annual brochure delivery requirement to allow it to be satisfied by delivering just a summary of material changes in the brochure. We have revised Item 5 so that advisers do not need to include a fee schedule in brochures provided only to clients that are "qualified purchasers." We have not adopted proposed disclosure of cash balance practices and proxy voting services from Items 8 and 17, respectively. We are permitting supervised persons with certain disciplinary information disclosed through FINRA's BrokerCheck system or the IAPD system to refer clients to that information in their brochure supplements (if they are provided electronically and contain a hyperlink to the BrokerCheck or the IAPD system, as relevant) rather than reproducing that information. When investment advice is provided to a client by a team, we are requiring that brochure supplements need only be provided for the five supervised persons with the most significant responsibility for the day-to-day advice provided to the client.

B. Revisions to Paperwork Reduction Act Burden Estimates

After considering commenters' concerns that the Commission's estimated paperwork burdens for firms complying with the amended Form ADV Part 2 were too low, and in light of revisions we have made to our proposed amendments to Part 2, we are revising our estimates for purposes of the Paperwork Reduction Act.

1. Amendments to Form ADV

a. Part 2 of Form ADV

The information required by the amendments to Form ADV is mandatory. Advisers are required to disclose this information to their clients and, therefore, it is not kept confidential. The currently approved total annual burden for all advisers completing, amending, and filing revised Form ADV with us is 132,599 hours. As stated in the Proposing Release, we continue to believe that most of the paperwork burden will be incurred in advisers' initial preparation of a

revised brochure and brochure supplements, as most advisers will have to draft a narrative brochure and all advisers will have to prepare new brochure supplements, and that over time this burden will decrease substantially because the paperwork burden will be limited to updating information. The paperwork burdens of preparing a narrative firm brochure and brochure supplements are likely to vary substantially among advisers, because Part 2 gives an adviser considerable flexibility in structuring its disclosure, the amount of disclosure required will vary among advisers, and the number of supplements that will need to be prepared depends on the number of supervised persons at a firm that provide investment advice. We believe that the revisions to Part 2 will impose a small burden on advisers in collecting information because there is a significant overlap between the information required by the previous Part 2 and the new Part 2A requirements and because advisers already collect information on the business background and disciplinary histories of their supervised persons to comply with state investment adviser representative registration requirements.[300] Accordingly, we expect that most of the paperwork burden from amended Part 2 will arise from an adviser drafting the narrative disclosure for its brochure and brochure supplements based on disclosures it and its supervised persons already made in Schedule F of Part 2 and in Form U4, and in expanding its discussion of how the adviser addresses certain conflicts of interest.

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[300] There are three entirely new items in the Part 2A we are adopting today—Item 2's summary of material changes, Item 6's performance fee disclosure requirement, and Item 15's custody disclosure requirement. The remainder of the items in Part 2A either were generally covered by the previous Part 2 or were required disclosure under other Advisers Act rules, such as rule 206(4)-6 regarding proxy voting and rule 206(4)-4 regarding financial and disciplinary information. In addition, most states require that supervised persons of SEC-registered investment advisers that are investment adviser representatives file Form U4, which requires similar business background and disciplinary information as the brochure supplement.

As noted above, we have revised our estimated burdens for purposes of the Paperwork Reduction Act to take into account comments received as well as substantive modifications to Part 2 from the form that was proposed.

In the Proposing Release, we estimated the average initial annual burden associated with Form ADV to be 5 hours for smaller advisers.[301] We received several comments that provided estimates of the paperwork burden associated with the proposed rule and form amendments for small advisers. One commenter estimated that preparing the initial Form ADV Part 2 would require 16 to 40 hours, depending on the nature of the firm's business, and that each subsequent amendment to that form would take 10 to 32 hours, depending on the nature of the amendments.[302] Another said that a small firm would take 60 hours to draft the initial brochure.[303] A small firm commenter estimated that it would take 40 to 60 hours to prepare the initial brochure and another 20 to 40 hours per year thereafter to update it.[304] A compliance consulting firm estimated that it would take on average 15 hours for a small firm to prepare the initial brochure.[305] One law firm estimated that smaller advisers would spend at least 44.5 hours preparing the new brochure.[306] We do not believe that small advisers will require as many as 60 hours for their initial revision of Part 2A because, as discussed above, firms already have collected much of the information for Part 2A, many of the disclosures were already required under previous Part 2 requirements or other Advisers Act rules or as a result of the adviser's

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301 For purposes of the estimates in this section, we have categorized small advisers as those with 10 or fewer employees, medium-sized advisers as those with between 11 and 1,000 employees, and large advisers as those with over 1,000 employees. Unless otherwise noted, the IARD data cited below is based on advisers' responses to questions on Part 1A of Form ADV as of May 3, 2010.

302 ASG Letter.

303 NAPFA Letter.

304 Jackson Letter.

305 NCS Letter.

306 Fried Frank Letter.

fiduciary obligations, and small advisers are unlikely to have extensive conflicts of interest that would necessitate lengthy brochure disclosures. We have reviewed several brochures of small investment advisers drafted in a narrative format that would appear to be generally responsive to the requirements we are adopting today, and these brochures are short, likely because of the relative simplicity of most small advisers' business models.[307] We also do not believe that small advisers will spend significant amounts of time preparing brochure supplements because they have a small number of supervised persons. Based on these considerations, we estimate that the average initial annual burden associated with Form ADV to be at the low end of the 15 to 60 hour range provided by commenters, or 15 hours for each small adviser.

In the Proposing Release, we estimated that the average initial annual burden associated with Form ADV for medium-sized advisers would be approximately 50 hours. We received a comment from a medium-sized adviser stating that it currently spends approximately 45 hours per year to update its Part 2 brochure.[308] This commenter did not estimate how long it took to prepare its initial Part 2 brochure under the prior format and did not estimate how long it would take to prepare or update the new Part 2A brochure and brochure supplements. We received a comment from another medium-sized adviser estimating that it would take a minimum of 163 hours for the initial preparation and internal handling of the brochure supplement.[309] Most of our medium-sized advisers are closer to the size of small advisers than large advisers, with 77% of medium-sized advisers having between 11 and 50 employees.[310] Accordingly, we expect that

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307 We note that advisers that choose to disclose more than is required by Part 2A (or their fiduciary obligations) will create lengthier brochures than those that take a more focused approach.

308 *See* Federated Letter.

309 *See* First Allied Letter. The First Allied Letter stated that it had approximately 325 investment advisory representatives and assumed that each supplement would take 30 minutes to prepare.

310 Based on IARD data as of May 3, 2010.

while these advisers will have a higher burden than smaller advisers due to the greater size and complexity of their business model, the majority will not have burdens dramatically greater than small advisers. We also estimated that each medium adviser, on average, will require 30 minutes to prepare each brochure supplement, based on an estimate of brochure supplement preparation time provided by one medium adviser commenter.[311] Based on these considerations and the comments on small firm burdens, we have revised our estimate of the average initial annual burden associated with Form ADV for each medium-sized adviser to be 97.5 hours.[312]

Finally, in the Proposing Release we estimated that the average initial annual burden associated with Form ADV for large advisers would be approximately 3,300 hours. We received no estimates from commenters of the burden on large advisers from preparing the new brochure. We received estimates from two of the largest advisers that the brochure supplement would require between 30,000 to 45,000 hours initially.[313] Unlike with respect to small and medium advisers, the brochure supplement dramatically increases the estimated burden associated with

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311 First Allied Letter.

312 We assume that preparing Part 1 and Part 2A of Form ADV would take each medium adviser on average 60 hours per year based on our estimate for smaller advisers, the fact that the average medium adviser is closer in size to a small adviser than a large adviser, the discussion above that advisers already have much of the information required by the new Part 2A and it is largely a matter of converting it to a narrative format, and the one comment we did receive from a medium sized adviser on the time it took to amend its brochure annually. We estimate that each medium adviser, on average, has 75 supervised persons based on the average number of employees performing investment advisory functions at medium sized advisers according to IARD data. We thus estimated that each medium adviser on average would spend 37.5 hours preparing the initial brochure supplements (75 supervised persons x 30 minutes per supervised person = 37.5 hours per year), for a total of 97.5 hours for the initial preparation of all of Form ADV.

313 The Merrill Lynch Letter estimated that the brochure supplement requirement would require 45,000 hours per year. The Morgan Stanley Letter estimated that it would take in the range of 30,000 to 35,000 hours for it to comply with the brochure supplement requirement initially and 8,000 to 10,000 hours annually to comply going forward. In their comment letters, Merrill Lynch and Morgan Stanley stated that approximately 8,000 and 14,000 employees, respectively, performed investment advisory functions at their firms. These employee numbers place these two commenters at the highest end of the range of the 36 advisers in our large category with only four other firms reporting as of May 3, 2010 that they had 8,000 or more employees performing such functions.

preparing Form ADV for large advisers because of their significantly larger number of employees that provide investment advice (some with over 1,000 per firm according to IARD data). The primary difference between the burden associated with preparing the brochure for large and smaller firms is the likelihood that there will be additional items to which large firms will have to respond and the likelihood that large firms will have additional conflicts of interest to address. We estimate that these additional brochure disclosures will add a relatively small amount compared to the burden estimate for medium advisers, but that the brochure supplement requirement will add a significant burden compared to medium advisers. We do not expect the burden for most large firms to be as substantial, on average, as estimated in the Merrill Lynch and Morgan Stanley comment letters, however, because these firms based their estimate on substantially more supervised persons providing investment advisory services than an average large adviser.[314] We estimate that preparing Part 1 and Part 2A of Form ADV would take each large adviser on average 100 hours per year.[315] Based on commenters' estimates, we now estimate that the brochure supplement will take each large adviser on average 30 minutes per supervised person to collect and prepare a supplement.[316] As a result, we now estimate the

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314 *See supra* note 114.

315 This estimate is based on our estimate for medium advisers, the discussion above that advisers already have much of the information required by the new Part 2A and it is largely a matter of converting it to a narrative format, and our view that the additional disclosure required by large advisers' business models is not so substantial as to require dramatically more brochure preparation time than medium advisers.

316 We estimate that each large adviser, on average, has 3,777 supervised persons based on the average number of employees performing investment advisory functions at large advisers according to IARD data. The Merrill Lynch Letter estimated that each supplement would require 3 hours to prepare. We believe that this estimate includes the burden to track and update brochure supplements which we discuss and account for separately, and which are not part of this burden estimate. We do not expect that brochure supplements for supervised persons at large advisers are likely to require more preparation time than supplements at medium advisers, particularly when more supervised persons at large advisers than medium advisers are likely to have information available through BrokerCheck or the IAPD that can be referenced in those supervised persons' supplements, reducing supplement preparation time. Brochure supplements

initial average burden associated with preparing Form ADV for each large adviser to be 1,989 hours.[317]

In the Proposing Release, we estimated that an average investment adviser's collection of information burden associated with initial preparation of Form ADV would be 22.25 hours per year. According to IARD data, there are 9,482 small advisers, 2,140 medium-sized advisers, and 36 large advisers. Based on the revised hourly burden estimates discussed above, we now believe that 36.24 hours is an accurate reflection of the time that it will take the *average* adviser to initially complete revised Form ADV (including both Parts 1 and 2).[318] This is an increase of 13.99 hours over our initial estimate.

Respondents under this collection of information will be advisers registered with the Commission as well as new applicants for investment adviser registration with the Commission. We estimate that approximately 1000 new investment advisers will register with us each year.[319] Thus, in combination with the approximately 11,658 existing investment advisers registered with the Commission, we estimate that the total number of respondents under this collection of information will be 12,658 advisers. Based on the estimated average collection of information burden of 36.24 hours per adviser, the total initial collection of information would amount to 458,726 hours for new registrants and for currently registered advisers that re-file Form ADV

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consist of only 6 disclosure items, several of which (*i.e.*, cover page, supervision, education) are simple to collect and draft in a few minutes). Accordingly, we estimate that an adviser would spend 30 minutes per supervised person to collect and prepare a supplement.

317 We estimate that each large adviser on average would spend 1,889 hours preparing the initial brochure supplements (3,777 supervised persons x 30 minutes per supervised person = 1,889 hours per year), for a total of 1,989 hours per year on average per large adviser for the initial preparation of all of Form ADV.

318 9,482 small advisers x an estimated 15 hours/adviser + 2,140 medium-sized advisers x an estimated 97.5 hours/adviser + 36 large advisers x an estimated 1,989 hours/adviser = 422,484 hours total. 422,484 hours / 11,658 total advisers = 36.24 hours/adviser.

319 Based on IARD data over the last five years.

(including Part 2) through the IARD system.[320] Amortizing this total burden imposed by Form ADV over a three-year period to reflect the anticipated period of time that advisers would use the revised Form would result in an average burden of an estimated 152,909 hours per year,[321] or 12.08 hours per year for each new applicant and for each adviser currently registered with the Commission that would re-file through the IARD.[322]

We estimate that some advisers may incur a one-time initial cost for outside legal and compliance consulting fees in connection with preparation of Part 2 of Form ADV. While we received no specific comments on our estimate regarding outside legal costs in the Proposing Release, one commenter did state that compliance consultants assist a significant percentage of advisers in preparing their Form ADV.[323] As a result, we are changing our estimate to reflect a quarter of small advisers using compliance consulting services and a quarter of small advisers using outside legal services and to reflect half of medium advisers using compliance consulting services in lieu of outside legal services and a quarter of medium advisers still using outside legal services. We estimate that the initial per adviser cost for legal services related to preparation of Part 2 of Form ADV would be $3,200 for small advisers, $4,400 for medium-sized advisers, and $10,400 for larger advisers.[324] We estimate that the initial per adviser cost for compliance consulting services related to initial preparation of the amended Form ADV will range from

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320 (12,658 advisers x 36.24 hours) = 458,726 hours.

321 458,726 hours / 3 years = 152,909 hours/year.

322 152,909 hours / 12,658 advisers = 12.08 hours/adviser.

323 *See* NCS Letter.

324 Outside legal fees are in addition to the projected hourly per adviser burden discussed above. $400 per hour for legal services x 8 hours per small adviser = $3,200. $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 on average is based on our consultation with advisers and law firms who regularly assist them in compliance matters.

$3,000 for smaller advisers to $5,000 for medium-sized advisers.[325] We estimate that a quarter of small and half of medium advisers, or 2,371 and 1,070 advisers, respectively, are likely to seek outside compliance consulting services in their preparation of Form ADV.[326] We estimate that a quarter of small advisers, or 2,370 advisers, and a quarter of medium advisers, or 535 advisers, are likely to engage outside legal services.[327] We estimate that all of the 36 large advisers will engage outside legal services in preparation of Form ADV. Thus, we estimate that approximately 2,941 advisers will elect to obtain outside legal assistance and approximately 3,441 advisers will elect to obtain outside consulting services, for a total cost among all respondents of $22,775,400.[328]

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 two times during the year.[329] A few commenters believed that we had underestimated the information burden associated with amending Form ADV.[330] As a result, we

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325 Outside compliance consulting fees are in addition to the projected hourly per adviser burden discussed above. Based on consultation with compliance consulting firms who regularly assist investment advisers in Form ADV preparation, we estimate that small advisers will incur expenses of $3000 per year for the initial preparation of the new Form ADV and medium advisers will incur expenses of $5000 per year for the initial preparation of the new Form ADV.

326 9,482 small advisers x 0.25 = 2,371. 2,140 medium-sized advisers x 0.5 = 1,070.

327 2,140 medium-sized advisers x 0.25 = 535.

328 For outside legal services, ($4,400 x 535 medium advisers) + ($3,200 x 2,370 small advisers)) + ($10,400 x 36 large advisers) = $ 10,312,400. For compliance consulting services, ($3,000 x 2,371 small advisers) + ($5,000 x 1,070 medium advisers) = $12,463,000. $10,312,400+$12,463,000 = $22,775,400

329 In the Proposing Release, we estimated that each adviser, on average, filing Form ADV through the IARD system amended its form 1.5 times per year. We have updated this estimate based on IARD system data regarding the number of filings of Form ADV amendments.

330 In the Proposing Release, we estimated that each adviser, on average, would spend 0.75 hours per year amending its Form ADV. The ASG Letter estimated that amendments to Part 2 would take 10 to 32 hours, depending on the nature of the amendments. The Jackson Letter estimated that it would take small firms 20 to 40 hours per year to update Part 2. The Federated Letter stated that they currently spend approximately 45 hours per year amending the previous Part 2.

are revising our estimate of the collection of information burden for preparing amendments. One of the two amendments that firms on average make each year will be an interim updating amendment, and we estimate that this amendment will require 0.5 hours per amendment because interim amendments typically only amend one or two items[331] in Form ADV and thus should not require much time to prepare. The other amendment is the firm's annual updating amendment of Form ADV. Part 2A requires only a few additional requirements with the annual updating amendment than is required throughout the year—the summary of material changes since the last annual updating amendment, an updated fee schedule, and an updated figure for assets under management. We also expect that advisers will not have to spend a significant amount of time generally reviewing their brochure before filing their annual updating amendment as the instructions to the form and their fiduciary obligations require them to keep information they provide to clients free of material inaccuracies. Based on these considerations, we estimate that the average adviser will spend 6 hours per year completing their annual updating amendment to Form ADV. Finally, we believe that the information required in the brochure supplements is unlikely to change frequently for any particular supervised person, and, as a result, that brochure supplements will be amended infrequently.[332] We also estimate that changes to most of the supplement information is already tracked by advisers in order to allow them to keep Forms U4 for their investment advisory representatives current, and that tracking changes to this information for brochure supplement purposes as well will impose negligible additional costs. Accordingly, we estimate that it will require an average burden per adviser of one hour per year

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331 Based on IARD system data.

332 Largely for this reason, we have not broken down our estimated burden for preparing the annual updating amendment to Form ADV based on the size of the adviser since most of the difference in the initial Form ADV preparation burden was driven by the brochure supplement. We also do not believe that the burden for preparing an annual updating amendment to Part 2A of Form ADV will vary significantly based on the size of the adviser.

for interim amendments to brochure supplements, for a total burden on all advisers of 11,658 hours per year.[333] Thus, we estimate that the total paperwork burden on advisers of amendments to Form ADV will be 87,435 hours per year.[334]

Commenters also highlighted the fact that the particular supervised persons for whom the adviser will have to deliver brochure supplements to particular clients will change over time and that these changes will generate costs.[335] The adviser may hire new employees who may begin providing investment advisory services that require preparation of a brochure supplement. We estimate that advisers on average will hire two new supervised persons each year for which a brochure supplement would have to be prepared.[336] We further estimate that, on average, an adviser will spend 0.5 hours preparing each new brochure supplement.[337] Preparation of these new supplements thus would require all advisers to spend 11,658 hours per year.[338]

The revised 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 as well as creating new supplements for new employees, is estimated to be approximately 252,002 hours

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333 1 hour per year x 11,658 advisers = 11,658 hours per year.

334 11,658 advisers x 1 interim brochure amendment per year x 0.5 hours = 5,829 hours per year for interim amendments. 11,658 advisers x 1 annual brochure amendment per year x 6 hours = 69,948 hours per year for annual amendments. 11,658 advisers x 1 hour per year for supplement amendments = 11,658 hours per year for supplement amendments. 5,829 + 69,948 + 11,658 = 87,435 hours.

335 *See, e.g.*, Schwab Letter; SIFMA Letter; Sutherland Letter.

336 Estimate is weighted average based on analysis of changes in aggregate responses to Item 5.B(1) of Part 1A of Form ADV over the last 5 years and the number of investment advisers registered with the Commission.

337 See discussion at *supra* note 311 and accompanying text.

338 Two new supervised persons per year x 0.5 hours per supplement x 11,658 investment advisers = 11,658.

per year.[339] This burden represents an increase of 151,026 hours over that estimated in the Proposing Release.[340] This increase is attributable primarily to our increased estimates of the hourly preparation burden associated with Part 2 in response to comments. As discussed in the Proposing Release, in addition to these estimated burdens, under this collection of information there is also a burden of 16,455 hours associated with advisers' obligations to deliver to clients copies of their adviser codes of ethics upon request.[341] Thus, the estimated revised total annual hourly burden under this collection of information would be 268,457 hours.[342] This represents an increase of 135,858 hours per year from the currently approved burden.[343]

b. Rule 206(4)-4

Rule 206(4)-4 currently requires advisers to disclose certain disciplinary and financial information to clients. We are rescinding rule 206(4)-4 and incorporating its substantive provisions into Part 2 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

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339 152,909 hours per year attributable initial preparation of Form ADV + 87,435 hours per year for amendments to Form ADV + 11,658 hours per year for supplements for new employees = 252,002 hours.

340 Revised burden 252,002 hours - proposing release burden of 100,976 hours = 151,026 hours.

341 *See* Code of Ethics Adopting Release, *supra* note114. As we estimated in the Proposing Release (and on which we received no comment), we estimate that only one percent of an adviser's clients actually request a copy the adviser's code of ethics. 0.01 x 1,300 (the estimated average number of clients per adviser) = 13 requests per registrant. *See infra* note 357 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 1.3 hours for each adviser stemming from the obligation to deliver copies of their codes of ethics to clients. 13 requests per adviser x 0.10 hours = 1.3 hours/adviser. This obligation applies to both currently-registered (11,658 respondents) and newly-registered advisers (1000 respondents), for a total annual burden of 16,455 hours. 12,658 respondents x 1.3 hours = 16,455 hours.

342 16,455 hours + 252,002 hours = 268,457 hours.

343 Revised burden 268,457 hours - currently approved burden of 132,599 hours = 135,858 hours.

Form ADV already includes an estimate of the burdens associated with the disclosure of disciplinary and financial information connected with Part 2.

2. 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.[344] The likely respondents to this collection of information requirement are all of the approximately 11,658 advisers currently registered with the Commission.

The amendments to rule 204-2 require advisers to prepare and preserve a memorandum describing any legal or disciplinary event listed in Item 9 in Part 2A of Form ADV 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. Additionally, the amendments require advisers to prepare and preserve documentation of the method they use to calculate 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. These records are 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 we stated in the Proposing Release, we believe that the amendments to rule 204-2 will result in an increased burden of four hours for each adviser subject to the additional requirements. We received no comments on the Commission's burden estimates relating to rule 204-2 and are leaving these estimates unchanged, except to update collection estimates based on IARD data.

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

We estimate that 350 advisers will use a method for calculating managed assets in Part 2A 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 2A.[345] We also estimate that 156 advisers will conclude that the materiality presumption in Part 2 has been 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.[346]

We estimate that a total of 506 advisers will have to prepare and preserve additional records in accordance with amendments to rule 204-2.[347] Only 487 of these are already accounted for in the currently approved burden estimate. We estimate that adding 19 advisers to those subject to the amended provisions of rule 204-2 will yield a 76 hour increase in burden under the rule.[348]

The approved annual aggregate burden for rule 204-2 is currently 1,954,109 hours based on an estimate of 10,787 registered advisers, or 181.15 per registered adviser.[349] Taking into account the estimated increased burden of 76 hours as discussed above, as well as an increase of

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345 Based on the Commission staff's conversations with industry professionals, we anticipate that approximately three percent of the 11,658 advisers registered with us as of May 3, 2010 will use a method for computing managed assets in Part 2A of Form ADV that differs from the method used to compute assets under management in Part 1A of Form ADV. 11,658 advisers x 0.03 = 350 advisers.

346 Approximately 1,559 advisers registered with the Commission report disciplinary information in Part 1A of their Form ADV as of May 3, 2010. We anticipate that most of these advisers will include all disciplinary information in their brochures and supplements, but that approximately 10% of these advisers, or 156, will need to prepare and preserve a memorandum explaining their basis for not disclosing a legal or disciplinary event listed in Part 2 in their brochures and supplements. 1,559 advisers x 0.10 = 156 advisers.

347 350 advisers that we estimate would prepare memoranda regarding an alternative method for calculating assets under management + 156 advisers that we estimate would prepare memoranda regarding unreported nonmaterial disciplinary events = 506 advisers.

348 506 advisers – 487 advisers = 19 advisers. 19 advisers x 4.0 hours = 76 hours.

349 1,954,109 hours / 10,787 registered advisers = 181.15 hours per adviser.

871 registered advisers,[350] the revised annual aggregate burden for all respondents to the recordkeeping requirements under rule 204-2 is therefore estimated to be 2,111,967 total hours.[351]

We further estimate that some advisers may incur a one-time cost for outside legal fees in connection with preparing a memorandum explaining their basis for not disclosing a legal event listed in Part 2 in their brochures and supplements. We estimate this one-time cost would include fees for approximately three hours of outside legal review and would amount on average to approximately $1,200 per adviser.[352] We believe that approximately 80 percent of the advisers preparing such memoranda would likely engage outside legal services to assist in their preparation.[353] Thus, we estimate that approximately 125 advisers will incur these costs, for a total cost among all respondents of $150,000.[354]

3. 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 11,658 investment advisers registered with the Commission.

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350 As stated above, our IARD data show that as of May 3, 2010 there were 11,658 advisers registered with the SEC. 11,658 – 10,787 = 871.

351 (1,954,109 current burden hours + 76 hours due to an increase in the estimated number of registered advisers subject to additional recordkeeping under the amendments + (871 due to an increase of total number of registered advisers x 181.15 hours per adviser)) = 2,111,967. The annual average burden per registered adviser is therefore 181.16 hours. 2,111,967 total hours / 11,658 advisers = 181.16 hours per adviser.

352 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.

353 We made the same estimate in the Proposing Release and received no comment on this estimate.

354 156 advisers x 0.80 = 125. $1,200 x 125 = $150,000.

Rule 204-3 previously required 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. The rule previously required no further brochure delivery unless the client accepted 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 require advisers to deliver their brochures and brochure supplements at the start of an advisory relationship and to deliver annually thereafter the full updated brochure or a summary of material changes to their brochure.[355] The amendments also require that advisers deliver an amended brochure or brochure supplement (or just a statement describing the amendment) to clients only when disciplinary information in the brochure or supplement becomes materially inaccurate.[356]

The total annual burden currently approved by OMB for rule 204-3 is 6,902,278 hours. This currently approved burden is based on each adviser having, on average, an estimated 670 clients. Our records now currently indicate that the 11,658 advisers registered with the Commission have, on average, 1,300 clients.[357] This change, along with our amendments permitting annual delivery of a summary of material changes to the brochure (instead of the entire brochure) alters the collection of information burden from that currently approved.

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355 *See* rule 204-3(b).

356 *See* rule 204-3(b).

357 This average is based on advisers' responses to Item 5.C of Part 1A of Form ADV as of May 3, 2010, excluding the three advisers that reported the largest number of clients. Those advisers account for over 50% of all advisory clients of SEC registrants and not excluding them would raise the average client count to 2,576 clients. These three 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 that it is appropriate to exclude these firms from our calculations.

We expect that advisers will send their brochure or summary of material changes annually in a "bulk mailing" to clients that may include clients' account statements, periodic reports, or other important documents. We estimate that, with a bulk mailing, an adviser will require no more than 0.02 hours to send the adviser's brochure or summary of material changes to each client, or an annual burden of 26 hours per adviser.[358] Thus, we estimate the total burden hours for 11,658 advisers to distribute their firm brochure to existing clients initially and annually thereafter to be 303,108 hours per year.[359] We have revised our estimate of the amount of time it will take an adviser to deliver its brochure or summary of material changes based on our view that most advisers will make their annual delivery as part of the mailing of an account statement or other periodic report that they already make to clients, and thus the additional burden will be adding a few pages to the mailing.

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 deliver is approximately 583.[360] We further estimate that an adviser will require no more than 0.1 hours per client for

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358 (0.02 hours per client x 1,300 clients per adviser based on IARD data as of May 3, 2010) = 26 hours per adviser. We note that the burden for *preparing* brochures is already incorporated into the burden estimate for Form ADV discussed above. The Proposing Release estimated that it would require 0.25 hours to send the adviser's brochure to each client. Upon further consideration we determined that it would not take an adviser 15 minutes to mail or email an adviser's brochure to a client.

359 (0.02 hours per client x 1,300 clients per adviser) x 11,658 advisers based on IARD data as of May 3, 2010 = 303,108 hours.

360 Of the advisers registered with the Commission, 13% report disciplinary events on their Form ADVs (as of May 10, 2010, only 1,559 of all 11,658 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, 5% of advisers will be required to deliver a single interim update to each of their clients, resulting in a total of approximately 583 interim updates per year. 0.05 x 11,658 x 1 update = 583 updates.

delivery of each such update.[361] This represents about 130 hours per interim update.[362] Thus, the aggregate annual hour burden for affected advisers to deliver interim updates to their brochures or supplements will be approximately 75,790 hours per year.[363]

Several commenters noted that some advisers will incur costs in creating systems to track which brochure supplements need to be delivered to which clients as supervised persons providing investment advice to particular clients change over time.[364] Because most medium advisers tend to resemble small advisers in terms of the number of employees providing investment advisory services,[365] we estimate that only large advisers will need to design and implement systems to track changes in supervised persons providing investment advice to particular clients. We estimate that on average each of the 36 large advisers will spend 200 hours per year designing and implementing such systems, for a total of 7,200 hours per year.[366]

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

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361 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. Since this mailing may not be included with a mailing of a statement or other periodic report, we estimate that it will take slightly more time than to deliver the annual brochure or summary of material changes. We also revised this estimate based on our belief that it would only take one or two minutes, not fifteen minutes to mail a brochure or summary of material changes. *See supra* note 358.

362 0.1 hours per client x 1,300 clients per adviser = 130 hours per update.

363 583 updates x 130 hours = 75,790 hours.

364 *See, e.g.*, Schwab Letter; SIFMA Letter; Sutherland Letter.

365 According to IARD data, only 4% of medium advisers report in response to Item 5.B(1) of Part 1A of Form ADV that more than 250 employees perform investment advisory functions.

366 36 large advisers x 200 hours per year per large adviser = 7,200 hours per year.

386,098 hours per year, or 33.1 hours per adviser.[367] This represents a decrease of 6,516,180 hours from the currently approved PRA burden.[368] The decreased burden results primarily from our revised estimate of the time it will take firms to deliver their brochures, supplements and amendments.

VII. COST-BENEFIT ANALYSIS

A. Background

The Commission is sensitive to the costs and benefits of its rules. This rulemaking will 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 also essentially move into the form itself existing rule provisions that require advisers to disclose certain disciplinary and financial information.[369]

The amendments require that advisers deliver this narrative brochure to clients at the outset of the advisory relationship and deliver an updated brochure or a summary of material changes to that brochure annually thereafter. Advisers generally will have to deliver to each client an initial brochure supplement for each supervised person who provides advisory services to that client. Advisers must deliver to clients interim updates to their brochure and brochure supplements that involve a change to disciplinary information required by Part 2. The rules provide exceptions to the brochure and supplement delivery requirements for certain types of

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367 303,108 hours (initial and annual delivery) + 75,790 hours (interim delivery of updates to disciplinary information) + 7,200 (supplement tracking systems) = 386,098 hours. 386,098 hours / 11,658 advisers = 33.1 hours per adviser.

368 6,902,278 hours – 386,098 hours = 6,516,180 hours.

369 Accordingly, the Commission is withdrawing rule 206(4)-4 as duplicative.

clients, and excuse the adviser from preparing a brochure and supplements if there is no client to whom they must be delivered. The rule amendments 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 rule and form amendments. In the Proposing Release,[370] 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. Several commenters thought that the costs of the proposed annual brochure delivery requirement would be substantial and would not be offset by a significant corresponding benefit since they believed that few clients would read the brochure on an annual basis.[371] We note that, in response to these concerns, we have made several changes that are designed to reduce costs to advisers, including eliminating the proposed requirement for advisers to deliver an updated brochure annually to clients and instead allowing advisers to deliver to clients a summary of the material changes made to the brochure. Several commenters also argued that the Proposing Release had underestimated the costs of the brochure supplement, and urged that we not impose this disclosure requirement.[372] For many of the same reasons we discussed in the Paperwork Reduction Act section above, we are revising certain estimates of costs as described below.

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370 *See supra* note 8.

371 *See, e.g.*, Berlin Letter; CGMI Letter; FSI Letter; Jackson Letter; Merrill Lynch Letter.

372 *See supra* note 298 and accompanying text. These commenters often asserted that the costs of the supplement outweighed any benefits but did not discuss the benefits the supplement would provide to clients and how these benefits may outweigh the costs. In addition to the supplement cost estimates in the Merrill Lynch Letter and the Morgan Stanley Letter discussed above, the Schwab Letter estimated that it would cost it in excess of $5 million to design, build, and implement systems associated with supplement creation and compliance for its approximately 1,600 investment advisory representatives. The SIFMA Letter estimated that the supplement would impose industry-wide costs in excess of $100 million.

B. Form ADV Part 2 and IARD Filing

As discussed above, the revisions to Part 2 require substantially all advisers to prepare plain English narrative brochures.[373] Advisers file their brochures electronically through the IARD in a process much like attaching a file to an email.

The new narrative brochures and electronic filing provide substantial benefits to advisory clients and prospective clients. The brochures present clients with critically important information they need to determine whether to hire or continue the services of a particular adviser. This information will be presented in a uniform format easy for most investors to understand. Investors searching for an adviser will be able to access the firm's brochures through our public disclosure website even before contacting the firm, and thus will be in a better position to know whether they wish to inquire further about the services the firm is offering or conflicts raised by the adviser's business activities or practices. The narrative brochure will enable prospective clients to determine more easily whether they wish to engage an adviser that does not have certain conflicts, that does not have a disciplinary history, or that does not engage in certain business practices. The electronic availability of the brochures will provide further benefits. Clients will be able to compare business practices, strategies, and conflicts of a number of advisers, which may help them to select the most appropriate adviser for them. Third parties will be able to access adviser brochure information, which would allow academics, businesses

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[373] Under the amendments, advisers that are not required to deliver a brochure to clients are not 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 or business development companies, therefore, are not required to prepare a brochure. We estimate, based on information filed with us on Form ADV, that approximately 292 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 14 advisers offer 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 also would be excused from preparing any brochure supplements.

and others to access additional information about registered investment advisers, which they can use to study the industry.

Brochure supplements will provide benefits to clients and prospective clients by providing them, for the first time, with information about the educational background, business experience, disciplinary history (if any) and conflicts of the individuals providing them with investment advice. This information will allow clients and prospective clients to determine whether there are safeguards or precautions that they would like to take before receiving investment advice from that person or whether they would prefer to receive investment advice from someone else. A prospective client could be satisfied with its selection of an advisory firm based on the firm brochure disclosures, but then determine that the firm is not the right fit once he or she reviewed the supplements of the actual individuals that would provide investment advice to him or her. Alternatively, the prospective client could retain the firm but request that other individuals provide advice in their place, potentially preventing costly or disruptive replacement or termination at a later date. This is a substantial improvement over the more limited information available today to clients and prospective clients about individuals in which clients place great trust.

To the extent that clients and prospective clients feel more confident as a result of the revised brochure that they understand the business, practices, and conflicts of an adviser, these clients may be more willing to place their trust in investment advisers, seek professional investment advice, and invest their financial assets. This could have benefits for the clients, and possibly impact capital formation and the economy.

Most commenters strongly supported the narrative, plain English format, and viewed it as a significant improvement over the current form.[374] 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.[375] They observed that the enhanced disclosure required by the revised form would benefit clients by improving their ability to thoroughly evaluate advisers, their business practices and their conflicts of interest,[376] and by better equipping them with the knowledge to make informed decisions about whether to hire or retain a particular adviser.[377] Commenters also generally supported making the brochures available to the public through the Commission's website.[378]

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 enhanced clarity provided by the new form will yield substantial benefits for advisers.

We recognize, however, that revised Part 2 also imposes costs on advisers. Advisers will be required to replace their previous Part 2 with the new narrative brochure and brochure supplements, and will be required to file their brochures electronically with us. In addition, the disclosure in the new brochure may be more extensive than what was previously required, although there is significant overlap between the items in new and old Part 2. Drafting the new narrative brochure will likely entail additional expenses. As discussed above, we believe that most of the costs that advisers will incur in connection with preparing the new narrative firm

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374 *See supra* note 16.

375 *See, e.g.*, ICI Letter; MMI Letter; NASAA Letter; Wellington Letter.

376 *See, e.g.*, AICPA Letter; Janus Letter.

377 *See* Consumer Federation Letter.

378 *See, e.g.*, AICPA Letter; CAPIS Letter; CFA Institute Letter; CGMI Letter; Fried Frank Letter; NAPFA Letter; NASAA Letter; NRS Letter. *But see, e.g.*, Brown Letter; Wernli Letter (stating that public website disclosure of Part 2 was a violation of an adviser's privacy).

brochure and supplements will be in the initial drafting of these documents. 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 U4) filed with state securities authorities.

The cost of preparing a narrative brochure likely will vary significantly among advisers, depending on the complexity of their operations and the choices advisers make about how to structure their disclosure given the flexibility permitted by Part 2. Some firms may choose to prepare multiple brochures for several different services. These firms likely will 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 because there will be substantial overlap between the multiple brochures of such advisers. We understand that some smaller- and medium-sized firms outsource the initial preparation of their brochures to compliance consultants. These compliance consultants likely will achieve certain economies of scale in preparing many brochures complying with the new Form ADV Part 2 requirements which may lessen the costs imposed by the amendments on these advisers. Because compliance consultants work on many firms Part 2 disclosures and are familiar with industry practices generally, they will begin their review of a firm's Part 2 with more familiarity with the requirements of Part 2 and conflicts that should be addressed.

Most of the comments relating to the costs of the brochure focused not on the costs of brochure preparation, but rather on the costs of annual delivery of an updated brochure. As noted above, in the rule amendments we are adopting today, we are permitting advisers to satisfy

their annual brochure delivery obligation by delivering a summary of material changes to the brochure with information about how clients can receive the full updated brochure if they desire. This change should reduce costs significantly for advisers relating to annual brochure delivery but should improve client experiences with the disclosures they receive by focusing their attention on the material changes in the brochure. The timing of brochure and supplement delivery should allow these documents to be included in other packages that the adviser is already mailing to clients, providing additional cost savings. The primary comment we received on brochure preparation cost was that we had underestimated the time and thus costs of drafting the new narrative brochure. As noted above, we have increased this estimate in response to these comments.

Similarly, the costs of preparing brochure supplements will vary from one adviser to the next. Costs will vary most significantly depending on the number of supervised persons for whom an adviser must provide disclosure. An adviser with very few supervised persons for whom a supplement must be prepared will incur lower costs than a large adviser. Costs associated with preparing supplements also will vary greatly depending on the amount of disciplinary information, if any, required to be disclosed about a particular supervised person. Many large advisers, who will have to prepare the largest number of brochure supplements, have significant numbers of supervised persons that are also registered representatives of broker-dealers and thus may be able to reference the BrokerCheck or IAPD systems for disciplinary disclosure, which will reduce preparation costs of the supplement for these firms. The preparation of brochure supplements would be most demanding for those few advisers whose supervised persons have 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.[379]

Many comments on the brochure supplement asserted that for a large adviser registered both as an investment adviser and as a broker-dealer, the supplement would impose substantial costs in creating systems to track this information among a changing group of supervised persons providing investment advice. Yet these same commenters also often stated that much of the information required by the supplement is available on FINRA's BrokerCheck system and thus collected on Form U4. Accordingly, we assume that these firms already have in place systems to track much of this information for a changing workforce (because Form U4 also must be updated as responses to its information requests change). Therefore, we believe that the supplement should impose negligible new costs in this regard since we believe these same systems could be used for supplement information tracking at negligible additional costs. We also are allowing advisers that have supervised persons with disciplinary information available through BrokerCheck or IAPD to reference that information in their electronically delivered supplements rather than reproducing that information in the supplement. This also should further decrease the costs and burdens cited by these firms in their comment letters. We do recognize, however, that large advisers may need to implement systems to track which supplements need to be provided to which clients as personnel advising clients will change from time to time. In our Paperwork Reduction Act analysis, we added an estimate of the burden for designing and implementing these systems and the cost estimate for this burden is reflected below.

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[379] As of May 3, 2010, IARD data indicate that in response to Item 11 in Part 1A of Form ADV, only 1,559, or 13%, of the 11,658 advisers registered with us report any disciplinary information about their firms or advisory affiliates, including their advisory employees.

We expect that only a few advisers would incur substantial costs in preparing supplements. IARD data indicate that less than one third of one percent of advisers registered with us has over 1,000 employees performing investment advisory functions on their behalf.[380] Indeed, less than five percent of our registrants have over 50 employees performing investment advisory functions. The vast majority of SEC-registered advisers – approximately 81 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.

For purposes of the Paperwork Reduction Act, we have estimated the number of hours the *average* adviser would spend in the initial preparation of its brochure and supplements.[381] Based on those estimates, we estimate that advisers would incur costs of approximately $33,639,980 in drafting these documents in the first year.[382] Furthermore, for Paperwork Reduction Act purposes we also have estimated that advisers may incur costs of approximately $22,775,400 in connection with their use of outside legal services and compliance consulting services to assist in preparation of their Form ADV.

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

381 *See* Section VI.A of this Release. Unless otherwise noted, the IARD data cited below is based on advisers' responses to questions on Part 1A of Form ADV as of May 3, 2010.

382 We expect that this function will most likely be performed by a senior compliance examiner at small firms, a compliance manager at medium firms, and a compliance attorney at large firms. Data from the Securities Industry and Financial Markets Association's *Report on Management & Professional Earnings in the Securities Industry 2008*, modified to account for an 1,800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead, suggest that costs for these positions are $212, $258, and $270 per hour, respectively. Based on the number of small, medium and large advisers (and assuming that the 1,000 additional advisers per year are small advisers as is typically the case), this results in a blended rate of $220 per hour. ((10,482 small advisers x $212) + (2,140 medium advisers x $258) + (36 large advisers x $270)) divided by 12,658 advisers = $220. 152,909 hours x $220 per hour = $33,639,980.

Advisers will incur annual expenses in addition to the initial costs of preparing firm brochures and supplements, but we believe these costs will be modest and similar to current costs. The rule amendments, similar to the current requirements, 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 each year at the time of their required annual updating amendment. For Paperwork Reduction Act purposes, we have estimated that advisers in the aggregate would spend 87,435 hours per year on Part 2 amendments. We estimate that advisers would incur annual costs of $12,153,465 in meeting these requirements.[383] We also estimated for Paperwork Reduction Act purposes that advisers would spend some time creating brochure supplements for new employees hired each year. We estimate that advisers would incur annual costs of $1,620,462 in creating these new supplements.[384]

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.[385] We believe conversion of

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383 We expect that preparing the amendments to Part 2 will also most likely be performed equally by compliance managers (as described in *supra* note 382) and compliance clerks. Data from the Securities Industry and Financial Markets Association's *Report on Management & Professional Earnings in the Securities Industry 2008*, 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 costs for a compliance clerk is $63 per hour. Blending this rate with the blended rate for a compliance manager of $215 per hour results in a cost per hour of $139. ($63 x 0.5) + ($215 x 0.5) = $139. 87,435 hours per year for amendments x $139 per hour = $12,153,465.

384 We expect that preparing the new supplements will most likely be performed equally by compliance managers (as described in *supra* note 382) and compliance clerks. The blended rate for this work is $139 per year. *See supra* note 383. 11,658 hours per year for new supplements x $139 per hour = $1,620,462.

385 We note that all advisers registered with the Commission currently file Form ADV electronically via the IARD system and, 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)].

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 will be required to deliver their updated brochure or a summary of material changes in their brochure to clients annually. The amended rules require that, between annual brochure 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 advisers. Moreover, we believe that because advisers must deliver brochures to new clients, the cost of delivering brochure supplements to new clients should not increase the existing cost of delivery. Annual delivery of the updated brochures or summary of material changes in the advisers' brochures will benefit advisory clients by ensuring that they are kept apprised of material changes to their advisers' business practices and procedures for managing conflicts and will enable clients to make decisions with respect to the adviser using the most currently available information. The shorter summary will focus clients' attention on the material changes in its adviser's business practices and conflicts and, unlike the prior annual offer requirement, permit them to evaluate when they would like a full copy of the brochure or to determine whether they want to take some other action in response to the change. Previously, clients were just given notice that they could request an updated brochure. In those circumstances, the client would have to read through the entire brochure and try to determine what had changed. Many clients may have determined that this would not be a fruitful exercise and thus declined to request the brochure. Now clients will be

able to easily determine what has changed in the brochure and thus decide if they would like to take any action in response.

In addition, we believe that changes to disciplinary information disclosed in the brochure and supplements are of such importance to clients that they merit interim delivery of these amendments. This disciplinary information reflects on the integrity of the advisory firm and the individuals providing the client with advice. Given that clients entrust their financial assets and financial well being to these firms and individuals, this information is vital to clients. Moreover, advisers are already required to make disclosures regarding disciplinary information under 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 and thus are unlikely to incur additional costs as a result of this requirement. The brochure supplement will increase costs relating to *disseminating* disciplinary disclosure, but it will not impose new costs in collecting this information since firms already had to collect this information to respond to Part 1A of Form ADV. The cost of disseminating brochure supplements is reflected below.

For Paperwork Reduction Act Purposes, we have estimated that the total annual paperwork burden associated with annual and interim delivery of brochures, supplements and the summary of material changes is approximately 386,098 hours. This includes estimated time for large advisers to design and implement systems to track that the right supplements are delivered to the right clients as personnel providing investment advice to those clients change. We estimate the burden associated with annual and interim delivery of brochures, supplements and the summary of material changes would represent an annual cost of $18,918,802.[386]

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[386] Based on data from the Securities Industry and Financial Markets Association's *Report on Management & Professional Earnings in the Securities Industry 2008*, modified to account for an

Advisers may significantly minimize the costs associated with delivery of brochures, supplements and the summary of material changes by arranging to deliver these documents to some or all clients by electronic media.[387] Advisers also may minimize delivery costs by mailing some of these documents along with quarterly statements or other routine mailings they already send to clients. No commenters indicated the extent to which they collectively mail such documents. Our rule and form amendments do not require advisers to take advantage of any of these cost saving options—advisers alone bear this choice. Accordingly, 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.

D. Amendments to Rule 204-2

The amendments to rule 204-2 require registered advisers to retain certain records relating to brochures and supplements. These records will benefit our examination staff by enhancing their ability to determine advisers' compliance with Form ADV's requirements. One of the revisions to the rule requires advisers to retain copies of brochure supplements and separate summaries of material changes prepared as required by Part 2. This provision generally imposes no additional costs because advisers currently are required to retain records relating to materials they distribute to their clients. Other revisions to the rule require advisers to maintain certain records in the event they use an alternative method to calculate assets under management

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1,800-hour work-year and multiplied by 2.93 to account for bonuses, firm size, employee benefits and overhead, we expect that delivery of amendments to Part 2 will also most likely be performed by a clerk at an estimated cost for a general clerk of $49 per hour. 386,098 hours x $49 = $18,918,802. We estimate that advisers will not incur any incremental postage costs in these mailings because we assume that advisers will mail annual summary of material changes with another mailing the adviser was already delivering to clients and that advisers were already delivering to clients disclosure of new material disciplinary events on an interim basis under rule 206(4)-4.

387 *See* Instruction 3 for Part 2A of Form ADV, which refers to the Commission's interpretive guidance on electronic delivery. *See also supra* note 198 for additional discussion of electronic delivery.

in response to Item 4.E of Part 2A and if they do not disclose in their brochure a presumptively material legal or disciplinary event listed in Item 9 of Part 2A or Item 3 of Part 2B. These provisions benefit advisers by permitting them flexibility in drafting their firm brochures and supplements while providing for maintenance of records needed by our examination staff. Because we anticipate that only a relatively small number of advisers will be subject to these provisions, we expect that the cost of maintaining these records will be relatively minimal. We estimate that advisers would incur annual costs of $595,280 in meeting these requirements.[388]

VIII. FINAL REGULATORY FLEXIBILITY ANALYSIS

We have prepared this Final Regulatory Flexibility Analysis (FRFA) in accordance with section 4(a) of the Regulatory Flexibility Act (RFA).[389] It relates to the 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 amendments also revise the instructions for updating and filing Form ADV (including adviser brochures). We also are adopting conforming rule amendments that revise the recordkeeping requirements relating to Part 2 of Form ADV.

We included in the Proposing Release an Initial Regulatory Flexibility Analysis (IFRA). We received no comments specifically on that IRFA.

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388 For Paperwork Reduction Act purposes we estimate that only 506 advisers will 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 2,024 hours per year and that such advisers will incur $150,000 per year in outside legal expenses relating to such records. We expect that preparing the records will most likely be performed by compliance managers (as described in *supra* note 382). 2,024 hours x $220 per hour = $445,280. $445,280 + $150,000 = $595,280.

389 5 U.S.C. 604(a).

A. Need for the Rule and Form Amendments

The rule and form amendments are necessary to improve the quality of disclosure that advisers provide to their clients.[390] Form ADV with its two parts was adopted by the Commission in 1979 and advisers use it to register with the Commission (Part 1A) and to provide clients disclosure about their advisory firm and personnel (Part 2).[391] Over the years, however, experience has shown that the format and content of the previous Part 2 of Form ADV did 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. Significant Issues Raised by Public Comment

In the Proposing Release, we requested comment on the IRFA. None of the comment letters specifically addressed the IRFA. A few commenters made specific comments about the proposed rule and form amendments' impact on smaller advisers. One commenter was concerned that disclosure of assets under management and financial information would unduly discriminate against smaller advisers.[392] As we discussed above with respect to Item 18 of Part 2, we believe that a client that becomes a creditor of an adviser because it prepays fees would want information about the adviser's financial condition. In addition, this information is currently required to be disclosed to clients, and the commenter did not persuade us that it should be omitted. Another commenter stated that Item 8's requirement that advisers primarily using a particular strategy discuss the risks involved in its strategy discriminates against smaller firms

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390 Sections I through IV of this Release describe in more detail the reasons for the amendments.

391 *See* 1979 Adopting Release, *supra* note 6.

392 Verbeck Letter.

who are less likely to be multi-strategy firms.[393] As discussed earlier in this Release,[394] we agree that advisers should disclose material risks associated with their strategies, regardless of whether they use one strategy or many strategies but believe that the brochure may not always be the best place for a multi-strategy adviser to disclose these risks. Another commenter suggested that we permit smaller advisers to provide short-form brochures.[395] As discussed earlier in the release,[396] we have not determined to shorten the brochure for any type of advisers because we believe that the brochure contains important information upon which clients rely and much of which advisers are already required to make to satisfy their fiduciary duty to their clients. We have, however, allowed advisers to satisfy their annual brochure delivery obligation by delivering a summary of material changes in their brochure to their clients.

C. Small Entities Subject to the Rules

In developing the amendments, we have considered their potential impact on small entities that may be affected. The rule and form amendments will 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

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393 NAPFA Letter.

394 *See supra* notes 71-75 and accompanying text.

395 NSCP Letter.

396 *See supra* notes 25-28 and accompanying text.

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.[397]

Our rule and form amendments will 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.[398] The Commission estimates that as of May 3, 2010, of the 11,658 registered with us, there were approximately 708 that were small entities that would be affected by the amendments.[399]

D. Projected Reporting, Recordkeeping, and Other Compliance Requirements

The rule and form amendments 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 require advisers to deliver their brochures to clients and to file them electronically through the IARD. The amendments also impose new recordkeeping requirements. These requirements and the burdens on small advisers are discussed below.[400]

1. Amendments to Part 2 of Form ADV

The amendments to Part 2, because they require registered advisers to prepare and disseminate narrative brochures, impose additional costs on all registered advisers, including

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397 *See* rule 0-7 [17 CFR 275.0-7].

398 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].

399 This estimate is based on information advisers have filed with the Commission on Part 1A of Form ADV as of May 3, 2010.

400 Sections I through IV of this Release describe these requirements in more detail.

small advisers. We assume that all small advisers previously distributed Part 2 of Form ADV and did not draft the optional narrative brochure. If our assumption is correct, these advisers would have to redraft their brochures completely to comply with the new format, although a lot of information in the previous Part 2 will 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 example, those advisers may not have soft dollar or directed brokerage arrangements, or may not have custody of client assets. However, certain of the brochure compliance costs may be fixed and thus impose a disproportionate impact on small advisers. 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 antifraud provisions, although the disclosure currently is not required to be in the firm's written brochure.

For the first time, advisers also will 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 may choose to avoid preparing and distributing separate brochure supplements. We believe many small advisers would take advantage of this option and reduce their compliance burden. We also note that small advisers are unlikely to have many supervised persons for whom a brochure supplement is required, so the supplement should impose a proportionately smaller burden on small advisers. The rule amendments may increase compliance costs for investment advisers.

Certain of these increased compliance costs attributable to supplements may be fixed and thus impose a disproportionate impact on small advisers.

2. Updating and Delivery Requirements

The amended rules, like the prior rules, require advisers to update their brochures and supplements whenever information in them becomes materially inaccurate. In updating its brochure and supplements on an interim basis, an adviser may minimize its burden by delivering a statement describing this updated information instead of reprinting its entire brochure or supplement.

The amendments require advisers to deliver an updated brochure or a summary of material changes in the adviser's brochure to clients annually and to deliver interim updates of the brochure and supplements to clients to disclose new or revised disciplinary information. To minimize the burden of delivery, advisers are permitted with client consent to deliver brochures, supplements and the summary of material changes, as well as updates, electronically.[401] To the extent that small advisers are more likely to have fewer advisory clients than larger advisers, the delivery requirements should impose lower costs on small advisers than on larger firms.

3. Recordkeeping Requirements

The amendments impose new recordkeeping requirements on advisers, including small advisers. As under the previous rules, advisers will be required to maintain copies of their brochures. The amendments also require all advisers to maintain copies of their brochure supplements. Advisers will be required to maintain a copy of any summary of material changes in their brochure that is separate from the brochure. In addition, the amendments require advisers, including small advisers, to maintain certain records if they determine that a

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401 *See supra* notes 196-198.

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. Agency Action to Minimize Effect on Small Entities

We have considered various alternatives in connection with the 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 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. Small advisers have few supervised persons providing investment advice, so they will need to prepare few brochure supplements. Moreover, certain rule and form amendments were designed specifically to reduce the burden on small advisers. For example, the Part 2 instructions 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 amendments clarify requirements for all advisers, including small advisers. The amended 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 amendments already appropriately use performance rather than design standards in many instances. The amendments permit advisers flexibility in designing their brochures and supplements so as best to communicate the required information to clients. In preparing brochure supplements, advisers 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.[402] The amendments clarify that advisers may, with client consent, deliver their brochures and supplements, along with any updates, to clients electronically.[403] Advisers may incorporate their supplements into the brochure or provide them separately.

Regarding the fourth alternative, it would be inconsistent with the purposes of the Advisers Act to exempt small advisers from the 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,

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402 *See* Section II.B of this Release. A brochure supplement, however, must be organized in the same order, and use the same headings, as the items appear in the form, whether incorporated in a brochure or provided separately. *See* Instruction 1 of General Instructions for Part 2 of Form ADV.

403 *See supra* notes 196-198.

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.

IX. EFFICIENCY, COMPETITION, AND CAPITAL FORMATION

Section 23(a)(2) of the Exchange Act requires the Commission, in adopting rules under the Exchange Act, to consider the impact that any new rule would have on competition, and prohibits the Commission from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.[404] Section 3(f) of the Exchange 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.[405] 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.[406]

In the Proposing Release, we solicited comment on whether, if adopted, the proposed rule and form amendments would promote efficiency, competition and capital formation. We further encouraged commenters to provide empirical data to support their views on any burdens on efficiency, competition or capital formation that might result from adoption of the proposed amendments. We did not receive any empirical data in this regard concerning the proposed amendments. We received one comment stating that the proposed amendments would not

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404 15 U.S.C. 78w(a)(2).

405 15 U.S.C. 78c(f).

406 15 U.S.C. 80b-2(c).

promote efficiency, competition, and capital formation, but the commenter did not state why.[407] Accordingly, since the adopted rule and form amendments are similar to the proposed rule and amendments, we continue to believe the amendments will contribute to efficiency, competition and capital formation.

Today the Commission is adopting 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. We believe that the rule and form amendments that we are adopting today are likely to promote efficiency and competition in the marketplace for advisory services provided by advisers registered with us by improving the disclosure that they must provide to clients.[408] 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, and background of investment advisers and the advisory personnel on whom clients rely for

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407 Jackson Letter. Another commenter stated that the requirement to disclose the amount of assets under management in the brochure would discriminate against smaller firms because of a perceived notion that a larger company does a better job. *See* Verbeck Letter. As discussed at *supra* 181 and accompanying text, assets under management is an objective measure that provides important information to clients. Clients have different preferences and some, for example, may view a smaller adviser as being more likely to provide more personal service. In addition, the NAPFA Letter stated that Item 8's requirement that advisers primarily using a particular strategy discuss the risks involved in its strategy discriminates against smaller firms who are less likely to be multi-strategy firms. As discussed at *supra* notes 72-75 and accompanying text, we disagree.

408 Along with the brochure amendments, the Commission also is adopting 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 adopting conforming amendments to the Advisers Act books and records rule. These amendments require advisers to maintain copies of their brochures, brochure supplements, amendments, and summaries of material changes, and are intended to update the books and records rule in light of our changes to Part 2. None of these conforming amendments are expected to have an independent impact on efficiency, competition, or capital formation. To the extent that they facilitate the purposes of the amendments, the conforming amendments may, however, contribute to the expected effects on efficiency, competition and capital formation that would stem from the amendments and which are discussed below.

investment advice. As a result, we believe that advisory clients will be provided with improved disclosure from advisers that will allow them to select an adviser based on a clearer and more thorough understanding of the business practices, conflicts of interest, and disciplinary information than exists with the check-the-box format of the current brochure. While advisers currently have the option of providing a narrative brochure, few do so. Absent the actions we are taking today, based on our experience with administering the Advisers Act brochure requirement and inefficiencies in the marketplace, we do not believe that advisers have adequate incentives to produce clear and understandable brochures. We expect the amendments we are adopting today, by requiring clearer and more understandable brochures, are likely to increase competition among advisers.

Advisers will file their brochures with us electronically, and we will make them available to the public through our website. Today, while advisers' brochures are "deemed" filed with us, it is difficult for the public to obtain them unless the adviser provides a brochure upon request or makes it available on its own website, which also makes it very difficult for prospective clients to compare more than a few investment advisers. With the public availability through our website 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 and will have an easier time comparing investment advisers. The supplements will allow clients and prospective clients to compare the qualifications and conflicts not only of the advisory firm but also of the personnel that will be providing investment advice to them. By having more information about the individuals and firms providing investment advice to them, as well as the ability to compare advisory firms, a client may be more likely to select initially an appropriate investment adviser for that client, promoting competition

on the basis of improved disclosure of conflicts of interest and business practices and avoiding the burdens and costs associated with switching advisers or supervised persons at a later date, and thereby potentially creating efficiency gains in the marketplace. The availability of this information about advisers and their personnel also may enhance competition if, for example, firms and personnel with better disciplinary records outcompete those with worse records. Secondarily, the electronic filing requirements are expected to expedite and simplify the process of filing firm brochures and amendments for the advisory firms, thus improving the efficiency of advisers that are required to file and update the brochure.

A few commenters stated that certain information required to be disclosed in the brochure is duplicative of information required to be reported in Part 1A of Form ADV and that such information should only be required disclosure in one place in Form ADV.[409] While we are conscious of these commenters' goal of generating efficiency by eliminating duplicative disclosure in Form ADV, we do not believe that it is appropriate to allow disclosure in Part 1A to satisfy disclosure obligations in Part 2B, or vice versa, because, these parts serve different functions and clients and prospective clients access these documents in different ways. Part 1A is used for regulatory purposes and thus the information it collects is that which our examination staff has identified as important for us to have for our examination program and other regulatory functions. While an adviser's responses to Part 1A of Form ADV generally are available to the public through our website, they are not delivered to clients or prospective clients and they are not written in a manner designed to be meaningful to clients or prospective clients – rather they are largely a series of "check-the-box" responses. Part 2A of Form ADV, on the other hand, is disclosure aimed at and delivered to clients and prospective clients. Accordingly, while certain

409 *See, e.g.*, ACLI Letter; IAA Letter.

topics of disclosure may be covered by both parts, we believe the different functions of, and delivery methods for, these two parts justifies the replication of disclosure topics.

On the other hand, the amendments we are adopting today are designed to generate efficiencies and reduce duplicative disclosure by allowing an adviser who sends supplements electronically, and whose supervised persons have disciplinary disclosure available on FINRA's BrokerCheck system or the IAPD system, to respond to those portions of Item 3 of the brochure supplement by including in the brochure supplement (i) a statement that the supervised person has a disciplinary history, the details of which can be found on FINRA's BrokerCheck system or the IAPD, and (ii) a hyperlink to the relevant system with a brief explanation of how the client can access the disciplinary history. In this instance, we believe that permitting cross-referencing is appropriate since it will only be allowed if the supplement is delivered electronically and the disclosure is duplicative. The BrokerCheck and IAPD systems are aimed at investor disclosure and are designed to be user-friendly, and clients will still receive delivery of a supplement which contains the other information (*e.g.*, educational background and other business activities) about that supervised person.

In addition to the competitive impact mentioned above, we believe that the rule amendments may have certain other impacts on competition. The brochure supplement may impose greater costs on larger advisers that have to create systems to track appropriate delivery of supplements that smaller advisers would not need. To the extent these costs are passed on to clients, a client's choice of investment advisers may be impacted. As we noted in the Cost-Benefit Analysis section above, however, many of these systems costs should be mitigated by systems that large advisers already have in place to track Form U4 information for their investment advisory representatives and broker-dealer registered representatives, which these

firms should be able to leverage for use in the brochure supplement context. The rule amendments also may increase compliance costs for investment advisers. Certain of these increased compliance costs may be fixed and thus impose a disproportionate impact on small advisers, which may have anticompetitive impacts on small advisers.

The competitive impacts discussed previously primarily focused on the impact of the rule amendments on investment advisers that are registered with us. We acknowledge that there may also be competitive impacts as a result of the amendments between those persons providing investment advice that are, and those that are not, registered with us as investment advisers. For example, banks, insurance companies, broker-dealers, and exempt advisers provide financial services that may compete, in some cases, for the same clients that would retain SEC-registered investment advisers. We have carefully considered the potential competitive implications of these rule amendments and do not believe that they will put advisers registered with us at a significant competitive disadvantage. Moreover, notwithstanding the potential competitive effect, we believe that the concerns that the amendments are designed to address justify adoption of the rule amendments. Pursuant to Section 23(a)(2) of the Exchange Act, the Commission does not believe that the amendments to Form ADV impose a burden on competition that is not necessary or appropriate in furtherance of the purposes of the Exchange Act.

As stated previously, the rule amendments are designed to provide advisory clients with clearer, more concise and understandable information regarding the business practices and conflicts of interest of investment advisers. Improved disclosure by SEC-registered investment advisers could result in enhanced efficiencies for clients in selecting an investment adviser and improved allocation of client assets among investment advisers. To a more limited extent, if better disclosure increases clients' and prospective clients' trust in investment advisers, it may

encourage them to seek professional investment advice and encourage them to invest their financial assets. This also may enhance capital formation by making more funds available for investment and enhancing the allocation of capital generally. On the other hand, if the rule amendments increase costs at investment advisers and these costs increases are passed on to clients, this may deter clients from seeking professional investment advice and investing their financial assets. This may result in inefficiencies in the market for advisory services and hinder capital formation.

X. STATUTORY AUTHORITY

We are adopting 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)].

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

We are adopting amendments to rule 204-3 under sections 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 adopting 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 removing and reserving 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 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) Form ADV. Subject to paragraph (b), 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. You are not required to file with the Commission the brochure supplements required by Part 2B of Form ADV.

(b) Transition to electronic filing. If you apply for registration after January 1, 2011, you must file a brochure(s) that satisfies the requirements of Part 2A of Form ADV electronically with the IARD, unless you have received a continuing hardship exemption under § 275.203-3.

Note to paragraph (a) and (b): Information on how to file with the IARD is available on the Commission's website at www.sec.gov/iard. If you are not required to deliver a brochure to any clients, you are not required to prepare or file a brochure with the Commission. If you are not required to deliver a brochure supplement to any clients for any particular supervised person, you are not required to prepare a brochure supplement for that supervised person.

* * * * *

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 (c), you must file all amendments to Part 1A of Form ADV and Part 2A of Form ADV electronically with the IARD, unless you have received a continuing hardship exemption under § 275.203-3. You are not required to file with the Commission amendments to brochure supplements required by Part 2B of Form ADV.

(2) If you have received a continuing hardship exemption under §275.203-3, you must, when you are required to amend your Form ADV, file a completed Part 1A and Part 2A of Form ADV on paper with the SEC by mailing it to FINRA.

Note to paragraphs (a) and (b): Information on how to file with the IARD is available on our website at www.sec.gov/iard. For the annual updating amendment: (i) summaries of material changes that are not included in the adviser's brochure must be filed with the Commission as an exhibit to Part 2A in the same electronic file; and (ii) if you are not required to prepare a

summary of material changes or an annual updating amendment to your brochure, you are not required to file them with the Commission. See the instructions for Part 2A of Form ADV.

(c) Transition to electronic filing. If your fiscal year ends on or after December 31, 2010, 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 October 12, 2010) as part of the next annual updating amendment that you are required to file.

* * * * *

4. Section 275.204-2is amended by revising paragraph (a)(14) 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 supplement, that satisfies the requirements of Part 2 of Form ADV [17 CFR 279.1]; any summary of material changes that satisfies the requirements of Part 2 of Form ADV but is not contained in the brochure; and a record of the dates that each brochure and brochure supplement, each amendment or revision thereto, and each summary of material changes not contained in a brochure 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 (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 supplement 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 of Form ADV or Item 3 of Part 2B of Form ADV.

* * * * *

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

§ 275.204-3 Delivery of brochures and brochure supplements.

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

(b) Delivery requirements. Subject to paragraph (g), you (or a supervised person acting on your behalf) must:

(1) Deliver to a client or prospective client your current brochure before or at the time you enter into an investment advisory contract with that client.

(2) Deliver to each client, annually within 120 days after the end of your fiscal year and without charge, if there are material changes in your brochure since your last annual updating amendment:

(i) A current brochure, or

(ii) The summary of material changes to the brochure as required by Item 2 of Form ADV, Part 2A that offers to provide your current brochure without charge, accompanied by the website address (if available) and an e-mail address (if available) and telephone number by which a client may obtain the current brochure from you, and the website address for

obtaining information about you through the Investment Adviser Public Disclosure (IAPD) system.

(3) Deliver to each client or prospective client a current brochure supplement for a supervised person before or at the time that supervised person begins to provide advisory services to the client; provided, however, that if investment advice for a client is provided by a team comprised of more than five supervised persons, a current brochure supplement need only be delivered to that client for the five supervised persons with the most significant responsibility for the day-to-day advice provided to that 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.

(4) Deliver the following to each client promptly after you create an amended brochure or brochure supplement, as applicable, if the amendment adds disclosure of an event, or materially revises information already disclosed about an event, in response to Item 9 of Part 2A of Form ADV or Item 3 of Part 2B of Form ADV (Disciplinary Information), respectively, (i) the amended brochure or brochure supplement, as applicable, along with a statement describing the material facts relating to the change in disciplinary information, or (ii) a statement describing the material facts relating to the change in disciplinary information.

(c) Exceptions to delivery requirement.

(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; or

(iii) Who is an officer, employee, or other person related to the adviser that 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) of this section requires you to deliver to a client or prospective client of the wrap fee program must be a wrap fee program brochure containing all the information required by Part 2A, Appendix 1 of Form ADV. Any additional information in a wrap fee program brochure must be limited to information applicable to wrap fee programs that you sponsor.

(2) You do not have to deliver a wrap fee program 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 required by Part 2A, Appendix 1 of Form ADV.

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

(e) 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.

(f) Other disclosure obligations. Delivering a brochure or brochure 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.

(g) Transition rule.

(1) Within 60 days after the date by which you are first required by § 275.204-1(c) to electronically file your brochure(s) 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(s) 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.

(h) 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.

* * * * *

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 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.

* * * * *

By the Commission.

Elizabeth M. Murphy
Secretary

July 28, 2010

Appendix A

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, or 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 your *advisory affiliates*.

- 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. You must submit your summary of material changes required by Item 2 of Part 2 either in the *brochure* (cover page or the page immediately thereafter) or as an exhibit to your *brochure*.

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 (except 9.A.(2), 9.B.(2), and 9.(E)), 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 (see note below for exceptions).

Notes: Part 1: If you are submitting an other-than-annual amendment, you are not required to update your responses to Items 2, 5, 6, 7, 9.A.(2), 9.B.(2), 9.E., 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.

Part 2: You must amend your *brochure supplements* (see Form ADV, Part 2B) promptly if any information in them becomes materially inaccurate. If you are submitting an other-than-annual amendment to your brochure, you are not required to update your summary of material changes as required by Item 2. You are not 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.

- 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 are required to file your *brochure* amendments and *brochure supplement* amendments with the appropriate *state securities authorities 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 January 1, 2011, your application for registration must include a narrative *brochure* prepared in accordance with the requirements of (amended) Part 2A of Form ADV. See SEC rule 203-1. After that date, the SEC will not accept any application that does not include a *brochure*(s) that satisfies the requirements of (amended) Part 2 of Form ADV.

- Until that date, you may (but are not required to) include in your application a narrative *brochure* that meets the requirements of (amended) Part 2A 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:

- If your fiscal year ends on or after December 31, 2010, you must amend your Form ADV to add a narrative *brochure* that meets the requirements of (amended) Part 2A of Form ADV when you file your next *annual updating amendment*.

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

Note: Until you are required to meet the requirements of (amended) Part 2, you can satisfy the requirements related to "old" Part II by updating the information in your "old" Part II whenever it becomes materially inaccurate. You must deliver "old" Part II or a brochure containing at least the information contained in "old" 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* or check <http://www.nasaa.org> for more information about the implementation deadline for the amended Part 2.

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/GetStarted.asp>. 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: FINRA Entitlement Group, 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.

Note: The amount of assets under management that determines whether you register with the SEC or states will change in 2011 as a result of amendments to the Investment Advisers Act.

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).

Note: The amount of assets under management that determines whether you register with the SEC or states will change in 2011 as a result of amendments to the Investment Advisers Act.

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 all 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, Washington, DC 20549; Attn: Branch of Registrations and Examinations.

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, Items 7, 11, DRPs; 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 you must provide to ***clients*** and prospective ***clients***. See SEC rule 204-3; Form ADV, Part 2A. *[Used in: General Instructions; Used throughout Part 2]*

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]*

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; DRPs]

8. **Custody:** Custody means holding, directly or indirectly, client funds or securities, or having any authority to obtain possession of them. You have custody if a related person holds, directly or indirectly, client funds or securities, or has any authority to obtain possession of them, in connection with advisory services you provide to clients. Custody includes:

   - Possession of client funds or securities (but not of checks drawn by clients and made payable to third parties) unless you receive them inadvertently and you return them to the sender promptly but in any case within three business days of receiving them;

   - Any arrangement (including a general power of attorney) under which you are authorized or permitted to withdraw client funds or securities maintained with a custodian upon your instruction to the custodian; and

   - Any capacity (such as general partner of a limited partnership, managing member of a limited liability company or a comparable position for another type of pooled investment vehicle, or trustee of a trust) that gives you or your supervised person legal ownership of

or access to client funds or securities. *[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, 11; Part 2B, Instructions]*

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: General Instructions, Part 1A, Item 1, Schedules A, B, C, D, DRPs; 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 may be required to register 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: General Instructions; Part 1A, Item 7; 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, Items, 7, 11, DRPs; Part 1B, Item 2; Part 2A, Items 9 and 19; Part 2B, Items 3, 4 and 7]*

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, Items 9 and 19; Part 2B, Items 3 and 7]*

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 and 19]

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; Form ADV-W, Item 8]*

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: 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; Part 2A, Items 6 and 19]*

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"), sole proprietorship, 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, Items 10, 11, 12, 14; Part 2A, Appendix 1, Item 6]*

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, Items 9 and 19; Part 2B, Items 3 and 7]*

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 throughout Part 2]*

39. **Wrap Brochure** or **Wrap Fee Program Brochure:** The written disclosure statement that ***sponsors*** of ***wrap fee programs*** must 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 the 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.

Read all the instructions, including General Instructions for Form ADV, General Instructions for Part 2 of Form ADV, Instructions for Part 2A of Form ADV, Instructions for Part 2B of Form ADV, and (if you are preparing or updating a *wrap fee program brochure*) Instructions for Part 2A Appendix 1 of Form ADV, before preparing or updating your *brochure* or *brochure supplements*.

1. Narrative Format. Part 2 of Form ADV consists of a series of items that contain disclosure requirements for your firm's *brochure* and any required supplements. The items require narrative responses. You must respond to each item in Part 2. You must include the heading for each item provided by Part 2 immediately preceding your response to that item and provide responses in the same order as the items appear in Part 2. If an item does not apply to your business, you must indicate that item is not applicable. If you have provided information in response to one item that is also responsive to another item, you may cross-reference that information in response to the other 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. The brochure should discuss only conflicts the adviser has or is reasonably likely to have, and practices in which it engages or is reasonably likely to engage. If a conflict arises or the adviser decides to engage in a practice that it has not disclosed, supplemental disclosure must be provided to clients to obtain their consent. If you have a conflict or engage in a practice with respect to some (but not all) types or classes of clients, advice, or transactions, indicate as such rather than disclosing that you "may" have the conflict or engage in the practice.

   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 1-800-732-0330.

3. Disclosure Obligations as a Fiduciary. Under federal and state law, you are a fiduciary and must make full disclosure to your *clients* of all material facts relating to the advisory relationship. As a fiduciary, you also must seek to avoid conflicts of interest with your clients, and, at a minimum, make full disclosure of all material conflicts of interest between you and your *clients* that could affect the advisory relationship. This obligation

requires that you provide the client with sufficiently specific facts so that the client is able to understand the conflicts of interest you have and the business practices in which you engage, and can give informed consent to such conflicts or practices or reject them. To satisfy this obligation, you therefore may have to disclose to *clients* information not specifically required by Part 2 of Form ADV or in more detail than the brochure items might otherwise require. 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 using the text-searchable Adobe Portable Document Format ("PDF"). 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 *state securities authorities*, you must file a copy of the *brochure supplement* for each *supervised person* doing business in that 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) and similar state rules.

   If you are registered with the SEC, 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 the 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) and similar state rules.

   - Each year you must (i) deliver, within 120 days of the end of your fiscal year, to each *client* a free updated *brochure* that either includes a summary of material changes or is accompanied by a summary of material changes, or (ii) deliver to each *client* a summary of material changes that includes an offer to provide a copy of the updated *brochure* and information on how a *client* may obtain the *brochure*. See SEC rule 204-3(b) 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 document describing the material facts relating to the amended disciplinary event. See SEC rule 204-3(b) 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 such information 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 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 are filing our *annual updating amendment*. The last *brochure*(s) that we filed does not contain any materially inaccurate information. Do we have to prepare a summary of material changes? No, as long as you

have not filed any interim amendments making material changes to the *brochure* that you filed with last year's *annual updating amendment*. If you do not have to prepare a summary of material changes, you do not have to deliver a summary of material changes or a *brochure* to your existing *clients* that year. See SEC rule 204-3(b). If you are a state-registered adviser, you should contact the appropriate *state securities authorities* to determine whether you must make an annual offer of the brochure.

6. Do we need to include the summary of material changes that we prepare in response to Item 2 with *our annual updating amendment* filing on IARD? Yes, you need to include the summary in your *annual updating amendment*. Item 2 permits you to include the summary as part of the *brochure* (on the cover page or the page immediately following the cover page) or to create a separate document containing the summary. If you include the summary as part of your *brochure,* the summary will be part of the *annual updating amendment* filing that you submit on IARD. If your summary of material changes is a separate document, you must attach the summary as an exhibit to your *brochure* and upload your *brochure* and the summary together in a single, text-searchable file in Adobe Portable Document Format on IARD for your *annual updating amendment*.

   Note: If you include the summary of material changes in your *brochure*, and you revise or update your *brochure* between *annual updating amendments*, you should consider whether you should update the summary as part of that other-than annual amendment to avoid confusing or misleading *clients* reading the updated *brochure*.

7. We have determined that we have no *clients* to whom we must deliver a *brochure*. Must we prepare one? No, but see note to Instruction 1 above.

8. May we include a summary of the *brochure* at the beginning of our *brochure*? Yes. Although it is not required, you may choose to include a summary of the *brochure* at the beginning of your *brochure*. Such summary, however, may not substitute for the summary of material changes required by Item 2 of Part 2A.

9. We offer several advisory services. May we prepare multiple firm *brochures*? 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* sent to your *clients* who invest only in the United States can omit information about your advisory services and fees relating to offshore investments. See SEC rule 204-3(e) 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.

10. 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* 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 fee program brochure(s)*. See SEC rule 204-3(d) and similar state rules.

11. 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 *brochure* prepared in accordance with Part 2A (not Appendix 1) to your wrap fee *clients*. You also must deliver to these *clients* any *brochure supplements* required by Part 2B of Form ADV.

12. 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.

13. 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.

14. 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.

15. 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, contact information, website 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 statement or other clear and concise language conveying the same information, and identifying the document as a "brochure":

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 us at [telephone number and/or email address]. 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 SEC's website 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 you are amending your *brochure* for your annual update and it contains material changes from your last annual update, identify and discuss those changes on the cover page of the *brochure* or on the page immediately following the cover page, or as a separate document 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 separately 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. Your *brochure* must follow the same order, and contain the same headings, as the items listed in Part 2A.

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 an SEC-registered adviser, you

must identify intermediate subsidiaries that are publicly held, but not other intermediate subsidiaries. If you are a state-registered adviser, you must identify all 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 90 days 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.

Note: If you are an SEC-registered adviser, you do not need to include this information in a *brochure* that is delivered only to qualified purchasers as defined in section 2(a)(51)(A) of the Investment Company Act of 1940.

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 asset-based sales charges or service 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 asset-based distribution 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 or markups, disclose whether you reduce your advisory fees to offset the commissions or markups.

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-Based Fees* and Side-By-Side Management

If you or any of your *supervised persons* accepts *performance-based 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-based 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-based 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. For each significant investment strategy or method of analysis you use, explain the material 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 material risks involved. If the type of security involves significant or unusual risks, discuss these risks in detail.

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 presumed to be 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) you have rebutted the presumption of materiality to determine that 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 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, perjury, 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: You may, under certain circumstances, rebut the presumption that a disciplinary event is material. 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* to determine whether it is appropriate to rebut the presumption of 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 has been 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 that creates a material conflict of interest, or if you have other business relationships with those advisers that create a material conflict of interest, describe these practices and discuss the material 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 or similar state rules. 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, describe your practice and discuss the conflicts of interest it presents. Describe generally how you address conflicts that arise.

   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 an 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. You do not have to provide disclosure in response to Item 11.B, 11.C, or 11.D with respect to securities that are not "reportable securities" under SEC rule 204A-1(e)(10) and similar state rules.

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 most favorable 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 most favorable 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 most favorable 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 most favorable 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 your *clients* only have directed brokerage arrangements subject to most favorable execution of *client* transactions, you do not need to respond to the last sentence of Item 12.A.3.a. or to the second or third sentences of Item 12.A.3.b.

B. Discuss whether and under what conditions you aggregate the purchase or sale of securities for various *client* accounts. If you do not aggregate orders when you have the opportunity to do so, explain your practice and describe the costs to *clients* of not aggregating.

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 *supervised persons* 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 *Client* Referrals and Other Compensation

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, explain the conflicts of interest, and describe how you address the conflicts of interest. For purposes of this Item, economic benefits include any sales awards or other prizes.

B. If you or a *related person* directly or indirectly compensates any *person* who is not your *supervised person* 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*

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. If your *clients* also receive account statements from you, your explanation must include a statement urging *clients* to compare the account statements they receive from the qualified custodian with those they receive from you.

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 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 of the independent public accountant and any accompanying independent public 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 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 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.

If you are registering or are registered with one or more *state securities authorities*, you must respond to the following additional Item.

Item 19 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*

Read all the instructions, including General Instructions for Form ADV, General Instructions for Part 2 of Form ADV, Instructions for Part 2A of Form ADV, and the instructions below, before preparing or updating 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 fee program 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 fee program brochure* that includes all the information required in your *wrap brochure,* you do not have to create or deliver a separate *wrap fee program brochure.*

   A *wrap fee program 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(d) and similar state rules.

2. When must a *wrap fee program brochure* be delivered?

   - You must give a *wrap fee program brochure* to each *client* of the *wrap fee program* before or at the time the *client* enters into a *wrap fee program* contract. See SEC rule 204-3(b) and similar state rules.
   - Each year you must (i) deliver, within 120 days of the end of your fiscal year, to each *client* a free updated *wrap fee program brochure* that either includes a summary of material changes or is accompanied by a summary of material changes, or (ii) deliver to each *client* a summary of material changes that includes an offer to provide a copy of the updated *wrap fee program brochure* and information on how a *client* may obtain the *wrap fee program brochure*. See SEC rule 204-3(b) 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 document describing the material facts relating to the amended disciplinary event. See SEC rule 204-3(b) 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 such information 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. When must we update our *wrap fee program brochure*? You must update your *wrap fee program brochure*: (i) each year at the time you file your *annual updating amendment*, and (ii) promptly whenever any information in the *wrap fee program brochure* becomes materially inaccurate. You are not required to update your *wrap fee program brochure* between annual amendments solely because your fee schedule has changed. However, if you are updating your *wrap fee program brochure* for a separate reason in between annual amendments, and your fee schedule listed in response to Item 4.A has become materially inaccurate, you should update that item as part of the interim amendment. All updates to your *wrap fee program 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.

4. May we deliver our *wrap fee program 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>.

5. What if we *sponsor* more than one *wrap fee program*? You may prepare a single *wrap fee program brochure* describing all the *wrap fee programs* you *sponsor*, or you may prepare separate *wrap fee program 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.

6. We provide portfolio management services under a *wrap fee program* that we *sponsor*. Must we deliver both our *wrap fee program brochure* and our firm *brochure* to our *wrap fee program clients*? No, just the *wrap fee program brochure*. If you or your *supervised persons* provide portfolio management services under a *wrap fee program* that you also *sponsor*, your *wrap fee program brochure* must describe the investments and investment strategies you (or your *supervised persons*) will use as portfolio managers. This requirement appears in Item 6.C of this Appendix.

7. We provide other advisory services outside of our *wrap fee programs*. May we combine our *wrap fee program brochure* into our firm *brochure* for *clients* receiving these other services? No. Your *wrap fee program brochure* must address only the *wrap fee program*s you *sponsor*. See SEC rule 204-3(d)(1) and similar state rules.

8. Must we also deliver *brochure supplements* to *wrap fee program clients*? Yes. A *wrap fee program brochure* does not take the place of any supplements required by Part 2B of Form ADV.

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, contact information, web site address (if you have one), and the date of the *wrap fee program 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 fee program brochure*.

B. Display on the cover page of your *wrap fee program brochure* the following (or other clear and concise language conveying the same information) and identifying the document as a "wrap fee program brochure":

This wrap fee program 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 us at [telephone number and/or email address]. 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 SEC's website at www.adviserinfo.sec.gov.

D. 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 you are amending your *wrap fee program brochure* for your annual update and it contains material changes from your last annual update, identify and discuss those changes on the page immediately following the cover page of the *wrap fee program brochure* or as a separate document accompanying the *brochure*. You must clearly state that you are discussing only material changes since the last annual update of the *wrap fee program brochure*, and must provide the date of the last annual update to the *wrap fee program brochure*.

Notes: You do not have to provide this information to a *client* or prospective *client* who has not received a previous version of your *wrap fee program brochure*.

Item 3 Table of Contents

Provide a table of contents to your *wrap fee program brochure*.

Note: Your table of contents must be detailed enough so that your *clients* can locate topics easily. Your *wrap fee program brochure* must follow the same order, and contain the same headings, as the items listed in this Appendix 1.

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 *supervised persons* covered under your investment adviser registration, act as a portfolio manager for a *wrap fee program* described in the *wrap fee program brochure*, respond to Items 4.B, 4.C, 4.D (Advisory Business), 6 (*Performance-Based 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 (*Client* Referrals and Other Compensation), and 18 (Financial Information) of Part 2A of Form ADV, as applicable to your wrap fee *clients*.

If you are registered or are registering with one or more *state securities authorities*, you must respond to the following additional Item.

Item 10 Requirements for State-Registered Advisers

Respond to Item 19.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. In addition, if discretionary advice is provided by a team comprised of more than five *supervised persons*, *brochure supplements* need only be provided for the five *supervised persons* with the most significant responsibility for the day-to-day discretionary advice provided to the *client*. See SEC rule 204-3(b) and similar state rules.

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 three 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 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; or

   (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, if you are an SEC-registered adviser, you 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>. If you deliver a supplement electronically, you may disclose in that supplement that the *supervised person* has a disciplinary event and provide a hyperlink to either the BrokerCheck or the IAPD systems.

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 supplement information is included in the firm *brochure*, however, the supplements must be included at the end of the brochure. In addition, each supplement must follow the same order as the supplement items listed in Part 2B, and contain the same headings.

   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.

9. Are we required to file the *brochure supplements*? If you are registered or are registering with the SEC, you are not required to file your *brochure supplements*, but you are required to maintain copies of all supplements and amendments to supplements in your files. See SEC rule 204-2(a)(14)(i). If you are registered or are registering with one or more *state securities authorities*, you must file through IARD a copy of the *brochure supplement* for each *supervised person* doing business in that state.

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, and identifying the document as a "brochure supplement:"

This brochure 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 SEC's website at www.adviserinfo.sec.gov.

Note: 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*. The above information must be on the cover page of the supplement but need not be the only information on the cover page of the supplement. If other information is included on the cover page of the supplement, the above information must be on the top of the first page of the supplement.

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 (including an identification of the specific positions held) for the preceding five years. If the *supervised person* has no high school education, no formal education after high school, or no business background, disclose this fact. You may list any professional designations held by the *supervised person*, but if you do so, you must provide a sufficient explanation of the minimum qualifications required for each designation to allow *clients* to understand the value of the designation.

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 presumed to be 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) you have rebutted the presumption of materiality to determine that 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.

If you deliver a supplement electronically and if a particular disclosure required below for the *supervised person* is provided through either the Financial Industry Regulatory Authority's (FINRA) BrokerCheck system or the IAPD, you may satisfy that particular disclosure obligation by including in that supplement (i) a statement that the *supervised person* has a disciplinary history, the details of which can be found on FINRA's BrokerCheck system or the IAPD, and (ii) a hyperlink to the relevant system with a brief explanation of how the *client* can access the disciplinary history. The BrokerCheck link is www.finra.org/brokercheck; the IAPD link is www.adviserinfo.sec.gov.

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, perjury, 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* (and the adviser knows, or should have known, of such resignation or relinquishment), disclose the event.

Note: You may, under certain circumstances, rebut the presumption that a disciplinary event is material. If an event is immaterial, you are not required to disclose it. When you review a legal or disciplinary event involving the *supervised person* to determine whether it is appropriate to rebut the presumption of 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 has been overcome, you must prepare and maintain a file memorandum of your determination in your records. See SEC rule 204-2(a)(14)(iii) and similar state rules.

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. If the other business activities represent less than 10 percent of the *supervised person's* time and income, you may presume that they are not substantial.

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 registered or are registering 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.