

SEC Amends Form ADV – New Disclosure Requirements for Investment Advisers

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The SEC today posted the following Investor Bulletin on its web site describing for the public its amendments to Form ADV, the new "Part 2." The bulletin, copied below, includes links to the SEC's adopting release (all 174 pages) describing the changes and including the Form ADV's instructions.

The amended rules and forms will be effective 60 days after publication in the *Federal Register*. For most advisers, the new Part 2 must be filed with the SEC as part of your annual updating amendment no later than March 31, 2011. Within 60 days of filing with the SEC, you must deliver it to your existing clients. The SEC expects that most investment advisers will begin distributing and publicly posting their new brochures in the first quarter of 2011.

If you need any assistance in converting the content of your old Form ADV Part II into the new Part 2 format, or if you have any questions about the changes, please do not hesitate to contact a member of our Broker-Dealer and Investment Adviser Practice Group. Here's the SEC's release:

Investor Bulletin: Amendments to Form ADV – New Disclosure Requirements for Investment Advisers

Investment advisers provide a wide range of advisory services and play an important role in helping individuals and institutions make significant financial decisions. 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. That is why the Securities and Exchange Commission (SEC) has adopted amendments to Part 2 of Form ADV to require investment advisers 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 clients with clearly written, meaningful current disclosure of the business practices, conflicts of interest, and background of the investment adviser firm and the firm's employees who provide advice.

What is Form ADV?

Form ADV is the uniform form used by investment advisers to register with both the SEC and state securities authorities. The form consists of two parts. Part 1 requires information about the investment adviser's business, ownership, clients, employees, business practices, affiliations, and any disciplinary events of the adviser or its employees. Part 1 is organized in a check-the-box, fill-in-the-blank format. The

SEC reviews the information from this part of the form to manage its regulatory and examination programs. Although designed for a regulatory purpose, investment adviser filings of Part 1 are available to the public on the SEC's Investment Adviser Public Disclosure (IAPD) web site at www.adviserinfo.sec.gov.

Part 2 requires investment advisers to prepare narrative brochures that include plain English disclosures of the adviser's business practices, fees, conflicts of interest, and disciplinary information. The brochure is the primary disclosure document for investment advisers. Investment advisers are required to deliver to advisory clients their brochures, which will be made available to the public on the IAPD web site.

Amendments to Part 2 of Form ADV

As amended, Part 2 of Form ADV now includes two sub-parts, Part 2A and Part 2B. Part 2A contains 18 disclosure items to be included in the investment adviser's brochure. In addition, investment advisers will now be required to deliver annually to clients a summary of material changes to the brochure along with either a revised brochure or an offer to deliver a copy of the revised brochure. Part 2B is called the "brochure supplement" and includes information about the specific individuals, acting on behalf of the investment adviser, who actually provide the investment advice and interact with the client.

Brochure

Investment advisers must provide their prospective and existing clients with a narrative brochure written in plain English. As amended, Part 2A of Form ADV contains 18 separate items, each covering a separate disclosure topic, to be included in the brochure. To make it easier for investors to compare the brochures of different investment advisers, advisers must respond to each item in Part 2A in the order listed in the form, using the same headings provided by the form. Much of the disclosure required in Part 2A addresses an investment adviser's conflicts of interest with its clients, and is disclosure that an investment adviser, as a fiduciary, must make to clients. The required disclosures include:

- **Advisory business** – An investment adviser must 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.
- **Fees and compensation** – An investment adviser must describe in its brochure how it is compensated for its advisory services, provide a fee schedule, and disclose whether fees are negotiable. The investment adviser must also disclose whether it bills clients or deducts fees directly from clients' accounts, or whether the client may select either method, and how often it assesses fees. In addition, the investment adviser must describe the types of other fees or expenses, such as brokerage, custody fees, and fund expenses that clients may pay in connection with the advisory services provided to them by the investment adviser.

- **Performance-based fees and side-by-side management** – An investment adviser that accepts performance-based fees or that supervises an individual who accepts such fees must disclose this fact. If the investment adviser also manages accounts that are not charged a performance fee, the adviser must explain the conflicts of interest that arise from the simultaneous management of these accounts and must describe how it addresses those conflicts.
- **Methods of analysis, investment strategies, and risk of loss** – Investment advisers must describe their methods of analysis and investment strategies and explain that investing in securities involves risk of loss which clients should be prepared to bear. Investment advisers must also explain the material risks involved for each significant investment strategy or method of analysis they use and for any particular type of security they recommend primarily. Investment advisers must explain those risks in greater detail if the risks are unusual or significant. If the primary strategy involves frequent trading of securities, investment advisers must explain specifically how frequent trading can affect investment performance.
- **Disciplinary information** – An investment adviser must disclose in its brochure material facts about any legal or disciplinary event that is material to a client's evaluation of the advisory business or of the integrity of its management personnel. Certain disciplinary events are presumed to be material if they occurred within the last 10 years. An investment adviser must deliver promptly to clients updated information regarding disciplinary events if it is updating a brochure to add a new event or to change material information about a disciplinary event.
- **Code of ethics, participation or interest in client transactions, and personal trading** – An investment adviser must describe briefly its code of ethics and state that a copy is available upon request. If the investment adviser or a related person recommends to clients, or buys or sells for client accounts, securities in which the adviser or related person has a material financial interest, the adviser must describe this practice and the conflicts of interest presented by such a practice. An investment adviser must also disclose whether it or a related person invests in the same securities that it recommends to clients or in related securities, such as options or other derivatives, and must describe the practice and discuss the conflicts involved and how it addresses those conflicts. In addition, an investment adviser that trades in the recommended securities at or around the same time as the client must describe the practice and discuss the conflicts presented by that practice and how the adviser addresses them.
- **Brokerage practices** – Investment advisers must describe the factors that they consider in selecting or recommending broker-dealers for client transactions and determining the reasonableness of brokers' compensation. Investment advisers must also disclose **soft dollar practices** (research or other products or services, other than execution, provided by brokers or a third party to the investment adviser in connection with client

transactions); **client referrals** (using client brokerage to compensate brokers for client referrals); **directed brokerage** (asking or permitting clients to send trades to a specific broker for execution); and **trade aggregation** (bundling trades to obtain volume discounts on execution costs). Investment advisers are required to explain how they address the various conflicts of interest associated with these practices.

Brochure Supplement

Part 2B of Form ADV is called the "brochure supplement." An investment adviser must give a client a brochure supplement for each individual that it supervises who: (1) formulates investment advice for that client and has direct client contact; or (2) makes discretionary investment decisions for that client's assets, even if the supervised individual has no direct client contact.

The brochure supplements contain information about the educational background, business experience, and any disciplinary history of the specific individuals who provide advisory services to the client. Brochure supplements may be separate documents or incorporated into the firm brochure. An investment adviser must deliver a brochure supplement that provides information about an employee either before or at the time that the employee begins to provide investment advice to a client. The investment adviser must deliver promptly to clients updated information regarding disciplinary events if it is updating a brochure supplement to add a new event or to change material information about a disciplinary event.

Part 2B of Form ADV consists of six items, including:

Educational background and business experience – The brochure supplement must describe the supervised individual's formal education after high school and his or her business experience for the past five years.

Disciplinary information – The brochure supplement must disclose any legal or disciplinary event that is material, and include certain disciplinary events that are presumed to be material to such an evaluation if they occurred during the last 10 years.

Other business activities – The brochure supplement must describe the supervised individual's other business activities and any material conflicts of interest that such participation may create. It must also include information about any compensation – bonus or non-cash – that the supervised individual receives based on the sales of securities or other investment products, as well as an explanation of the incentives this type of compensation creates.

Additional compensation – The brochure supplement must describe arrangements in which somebody other than the client provides the supervised individual an economic benefit, such as a sales award or other prize, for providing advisory services.

Supervision – An investment adviser must explain how it supervises the supervised individual, including how it monitors the advice provided to the client by the supervised individual and must include the name, title, and telephone number of the individual’s supervisor.

If investment advice is provided by a team comprised of more than five supervised individuals, brochure supplements need only be provided for the five supervised individuals with the most significant responsibility for the day-to-day advice provided to the client.

Brochure supplements are not filed with the SEC. However, the public can obtain information about advisory personnel, including disciplinary information, through the IAPD system at www.adviserinfo.sec.gov.

Related Information

[Amendments to Form ADV](#)

[SEC Approves Disclosure Form Changes to Provide Investors Greater Information About Their Investment Advisers](#)

[Speech by SEC Chairman: Opening Statement at the SEC Open Meeting—Form ADV Amendments](#)

<http://www.sec.gov/investor/alerts/bulletin-formadv.htm>

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