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‘ADVancing THE BALL’ TOWARD COMPLETING PLAIN ENGLISH BROCHURES UNDER AMENDED FORM ADV

While it took years for Form ADV to be revised,¹ an investment adviser registered, or required to be registered, under the Investment Advisers Act of 1940 (“Advisers Act”) does not have even one year to comply with the amendments to Form ADV, and certain related Advisers Act rules, that were promulgated by the U.S. Securities and Exchange Commission (“SEC”) on July 28, 2010. In light of this timing, an investment adviser planning on registering, or one that is registered and has in the past begun its Form ADV updating process in the first calendar quarter, would be well-served to begin thinking now about the requirements under amended Form ADV.²

Amended Form ADV, Part 2A, requires the use of a narrative brochure(s) containing disclosures about the investment adviser and replaces former Form ADV, Part II, and Schedule F. For most investment advisers, utilizing a narrative brochure(s), rather than the check-the-box and supplemental Schedule F disclosure approach utilized under Form ADV, Part II, will be a new experience. Amended Form ADV, Part 2B, requires use of brochure supplements containing disclosures regarding an investment adviser’s advisory personnel (or supervised persons). Appendix I to amended Form ADV, Part 2A, continues to require the use of a wrap fee brochure containing enhanced disclosures regarding sponsors and their wrap fee programs, and replaces existing Form ADV, Part II, Schedule H.³

Now that Form ADV has been amended, an investment adviser needs to determine, among other things, whether it is required to, or otherwise will, prepare and file one or more plain English brochures and/or prepare brochure supplements, and then draft and review the plain English brochures and brochure supplements against the requirements of amended Form ADV, Part 2A and Part 2B. An investment adviser that acts as a sponsor of a wrap fee program will need to prepare and file a separate wrap fee program brochure that meets the enhanced requirements of Appendix 1 to amended Form ADV, Part 2A, in lieu of its brochure (but not any required brochure supplements). Some of the more significant requirements under amended Form ADV, Part 2, and the related Advisers Act rules (which are discussed in more detail below) include, for example:

- A plain English, narrative brochure in a specified format generally must be prepared and filed in compliance with amended Form ADV, Part 2A. The requirements for the wrap fee program brochure are specified in Appendix 1 to Part 2A.
- One or more plain English, narrative brochure supplements in a specified format generally must be prepared in compliance with amended Form ADV, Part 2B, and may be included in sequence at the end of the brochure; if an investment adviser is registered or registering with one or more state securities authorities, brochure supplements for each supervised person doing business in that state(s) must be filed with the state(s).
- A brochure must be delivered before or at the time of entering into an advisory contract with a client or prospective client (rather than 48 hours in advance or at time of entering into advisory contract with five business-day termination right).
- A brochure supplement for a supervised person of an investment adviser is required to be delivered to a client at the time that the supervised person begins to provide investment advisory services to that client (there are special rules for advisory services provided by a portfolio management team).
- If there are material changes since an investment adviser’s last annual updating amendment, an updated brochure that includes or is accompanied by a summary of material changes, or a summary of material changes with an offer to provide an updated brochure (along with certain access information), is required to be delivered annually to each client within 120 days after the investment adviser’s fiscal year end. An investment adviser is not required to deliver brochure supplements to existing clients annually.

- When an investment adviser amends its brochure or brochure supplements to add a disciplinary event or to change material information already disclosed in response to Item 9 of amended Form ADV, Part 2A, or Item 3 of amended Form ADV, Part 2B (relating to disciplinary information), the investment adviser is required to promptly deliver to each client (on an interim basis) either an updated brochure or brochure supplements (as applicable) along with a statement describing the material facts, or a statement describing material facts, relating to a change in disciplinary information.
- There are certain types of clients (e.g., registered investment companies, business development companies, and clients receiving certain impersonal investment advice, among others) to which an investment adviser is not required to deliver its brochure(s), brochure supplements and amendments thereto.
- Brochures (but not brochure supplements) are required to be filed electronically with the SEC in a single, text-searchable Adobe Portable Document Format ("PDF") using the Investment Adviser Registration Depository ("IARD") system, and will be publicly available through the Investment Adviser Public Disclosure ("IAPD") system at www.adviserinfo.sec.gov.
- Among other new recordkeeping requirements, copies of each brochure (and summary of material changes if not included in a brochure), brochure supplement, and amendment to a brochure or brochure supplement, and a record of the dates on which any of the foregoing was provided to any client or prospective client, must be retained in an investment adviser's books and records in the same manner, and for the same period of time, as other books and records required to be maintained under Rule 204-2 under the Advisers Act.

After a review of the relevant compliance deadlines, this summary reviews the Form ADV and related Advisers Act rule amendments, and discusses some practical considerations for investment advisers preparing their brochure(s) and brochure supplements.

The full adopting release (*Amendments to Form ADV*, SEC Release No. IA-3060 (July 28, 2010) ("Adopting Release")) for amended Form ADV is available at <http://www.sec.gov/rules/final/2010/ia-3060.pdf>. The full proposing release (*Amendments to Form ADV*, SEC Release No. IA-2711 (March 3, 2008) ("Proposing Release")) is available at <http://www.sec.gov/rules/proposed/2008/ia-2711.pdf>.

Compliance Deadlines

The Form ADV amendments become effective October 12, 2010, and compliance is required as follows:

Registered Advisers. An investment adviser that is already registered with the SEC, has a fiscal year end on or after December 31, 2010, and is required to file a brochure, must include its brochure(s) in its next annual updating amendment to its Form ADV (i.e., by March 31, 2011). Brochure supplements are not required to be filed with the SEC; if an investment adviser is registered or registering with one or more state securities authorities, filing of brochure supplements is required for each supervised person doing business in that state(s). An investment adviser must deliver its brochure(s) and brochure supplements to existing clients within 60 days of filing its brochure(s). In addition, an investment adviser must start delivering its brochure(s) and brochure supplements to new and prospective clients after the initial filing of its brochure(s). (See "Initial Delivery and Subsequent Delivery/Updating Considerations" below for more information.)

New Advisers. An investment adviser that applies for registration with the SEC after January 1, 2011, must file its brochure(s) as part of its application for registration on Form ADV. Once registered, such an investment adviser must deliver its brochure(s) and brochure supplements to clients and prospective clients. (See "Initial Delivery and Subsequent Delivery/Updating Considerations" below for more information.)

General Objectives

In adopting the Form ADV amendments, the SEC intends that each registered investment adviser provide plain English, clearly written, meaningful, narrative, current disclosures regarding the business practices, conflicts of interest and background (including disciplinary history) of the investment adviser and its advisory personnel (or supervised persons).⁴ The SEC also reminded investment advisers in the Adopting Release that, as fiduciaries, they have an obligation to disclose material information (including material conflicts of interest, material legal events, or a precarious financial condition) to their clients regardless of the requirements of amended Form ADV. The SEC made clear in the Adopting Release that Form ADV sets forth the minimum requirements for disclosures to be included in an investment adviser's brochure(s), and that delivering a brochure that

complies with Form ADV may not fully satisfy an investment adviser's disclosure obligations under the Advisers Act.

An investment adviser should prepare and review its brochure(s) and brochure supplements with these general objectives in mind. For example, if an investment adviser intends to borrow from its existing Form ADV, Part II, Schedule F disclosure (or, for an investment adviser that acts as a sponsor of a wrap fee program, from its existing Schedule H brochure), it may want to consider re-writing and/or supplementing such disclosure to achieve these general objectives. Preparing a brochure under amended Form ADV also affords an investment adviser another opportunity to consider whether there is material information (particularly, but not limited to, conflicts of interest) that, while not required to be disclosed under revised Form ADV, should nevertheless be disclosed to fulfill the investment adviser's obligations as a fiduciary under the Advisers Act.

Threshold Considerations

At the outset, an investment adviser must first make certain threshold determinations when considering how to comply with amended Form ADV. For example:

Is the Investment Adviser Required To Prepare and File a Brochure?

An investment adviser that does not have any clients or prospective clients to whom a brochure is required to be delivered under amended Rule 204-3 is not required to prepare or file a brochure with the SEC. A brochure is not required to be delivered to a client or prospective client that is a registered investment company under the Investment Company Act of 1940 ("1940 Act") or a business development company under the 1940 Act, provided that the advisory contract with that client meets the requirements of section 15(c) of the 1940 Act. A brochure also is not required to be delivered to a client or prospective client that receives only impersonal investment advice for which the investment adviser charges less than \$500 per year.⁵ Thus, for example, an investment adviser that only serves as an investment adviser to mutual funds (i.e., registered investment companies) is not required to prepare a brochure.

Should the Investment Adviser Still Prepare a Brochure if One is Not Required?

An investment adviser that is not required to prepare a brochure may nevertheless want to consider preparing and delivering, and even filing, a brochure that complies with amended Form ADV. Among other potential reasons, preparing and updating a brochure can be useful in reviewing an investment advisers practices, seeking to comply with applicable legal requirements and conducting annual compliance reviews under Rule 206(4)-7 under the Advisers Act. A brochure also can be the vehicle used by an investment adviser to fulfill its independent obligation as a fiduciary to disclose material information (including material conflicts of interest, material legal events or a precarious financial condition) about the investment adviser to its clients. An investment adviser may elect to prepare and file its brochure to facilitate the public availability of its brochure. From a practical perspective, having a brochure prepared can be useful if the investment adviser decides to pursue business from clients for which a brochure would be required.

An investment adviser also should consider whether its past practices with respect to disclosure of its Form ADV, Part II, and Schedule F to clients or investors in funds have created (1) an expectation that a brochure would continue to be provided after compliance with the amendments to Form ADV is required, or (2) potential risks to the investment adviser if it does not provide a brochure. For example, in the Adopting Release, the SEC indicates that it decided not to clarify that hedge fund advisers do not have to deliver a brochure to hedge fund investors because Rule 204-3 requires only delivery to "clients," and that the federal courts have stated that the "client" of a hedge fund adviser is the hedge fund itself, not the investors in the hedge fund. Many registered hedge fund managers, however, already have a practice of delivering their brochure to investors in their hedge funds. In many cases, this was based on a determination that the types of disclosures in Form ADV, Part II, and Schedule F, could be material to hedge fund investors. This view became more prevalent after the adoption of Rule 206(4)-8 under the Advisers Act, which specifically prohibits deceptive and manipulative practices that operate as a fraud upon private fund investors (notwithstanding that the private fund is the "client"). For those hedge fund managers already delivering a brochure to hedge fund investors, determining that it is reasonable to stop making the disclosures, especially if there are any conflicts of interest addressed in the brochure that are not addressed in the hedge fund's offering memorandum, would likely not be without some risk. For those hedge fund managers who have not yet delivered such disclosures, trends in enhanced due diligence by investors may, as a practical matter, make it necessary or desirable to deliver a brochure. A brochure can be useful in responding to due diligence requests from clients or investors in funds advised by the investment adviser. For

example, in addition to the hedge fund manager example above, an investment adviser to a mutual fund, or a sub-adviser to a mutual fund (if the sub-advisory relationship is not structured in a manner so as to require the preparation, filing and delivery of a brochure to the investment adviser to the mutual fund), could provide its brochure to the board of directors/trustees of a mutual fund as part of the review and approval process mandated by section 15 of the 1940 Act. Certain clients or potential clients also simply may require a brochure to be delivered in response to a “request for proposal” or other due diligence inquiry.

How Many Brochures Should the Investment Adviser Prepare?

An investment adviser required to prepare a brochure may want to consider whether it will prepare different brochures for different types of advisory clients. Some investment advisers may use multiple disclosure brochures today, and may wish to continue this practice. Other investment advisers may elect to begin using multiple brochures to increase the brevity and improve the clarity of each individual brochure, among other reasons. Under amended Rule 204-3(e), if an investment adviser provides substantially different advisory services to different clients, the investment adviser may (but is not obligated to) provide its clients or prospective clients with different brochures, so long as each client or prospective client receives all information about the services and fees that are applicable to that client or prospective client. If multiple brochures are prepared, each brochure generally may omit any information required by amended Form ADV, Part 2A, if the information does not apply to the clients and prospective clients that receive that brochure. An investment adviser may not omit any information required by Item 9 of Part 2A (Disciplinary Information) from any brochure. Each brochure also must be filed with the SEC. (See “Operational and Technology Considerations: Filing Requirements” below.)

Is the Investment Adviser Required To Prepare Brochure Supplements?

An investment adviser that does not have any clients or prospective clients to which a brochure supplement is required to be delivered is not required to prepare any brochure supplements. Brochure supplements are not required to be delivered to: (1) clients or prospective clients to whom the investment adviser is not required to deliver a brochure; (2) clients or prospective clients that receive only impersonal investment advice; and (3) any officer, employee, or other person related to the investment adviser that is a “qualified client” under Rule 205-3 under the Advisers Act. Thus, for example, an investment adviser that only serves as an investment adviser to mutual funds (i.e., registered investment companies) is not required to prepare any brochure supplements. An investment adviser also does not have to prepare a brochure supplement for any supervised person who does not have clients to whom the investment adviser must deliver a supplement.⁶

Should the Investment Adviser Still Prepare Brochure Supplements if Not Required?

For reasons similar to those relevant when an investment adviser considers whether to prepare a brochure when not required to do so under amended Form ADV and Rule 204-3, an investment adviser that is not required to prepare any brochure supplements may nevertheless want to consider preparing and delivering brochure supplements.

For Whom Must Brochure Supplements be Prepared?

Under amended Form ADV and Rule 204-3, an investment adviser generally must prepare a brochure supplement for each supervised person who provides advisory services to a client, unless such investment advice is provided by a team comprised of more than five supervised persons. In that case, a brochure supplement need only be prepared for the five supervised persons with the most significant responsibility for the day-to-day advice provided to its client. A supervised person is considered to be providing advisory services to a client if the supervised person will: (1) formulate 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 person has no direct client contact. As noted above, an investment adviser does not have to prepare a brochure supplement for any supervised person who does not have clients to whom the investment adviser must deliver a supplement.

To comply with these requirements, an investment adviser will need to determine which of its supervised persons provides “advisory services” (within the meaning of amended Form ADV and Rule 204-3) to which of its clients. While this may seem straightforward, questions can arise with respect to certain categories of supervised persons. For example, it may be difficult to determine whether certain sales representatives or affiliated solicitors who have direct contact with clients are formulating investment advice for clients. Such sales representatives and affiliated solicitors may be treated as supervised persons of the investment adviser (among other reasons) because they

are employees of the adviser or otherwise provide advice on behalf of the investment adviser. An investment adviser will need to closely review the activities of each supervised person to determine whether a brochure will need to be prepared and delivered for the supervised person. For larger investment advisers, this requirement could prove burdensome.

Additional Considerations for Wrap Program Sponsors

If an investment adviser is acting as a sponsor of a wrap fee program, the investment adviser must deliver a separate wrap fee program brochure that meets the enhanced requirements of amended Form ADV in lieu of the brochure. Under amended Rule 204-3(d), a wrap program sponsor is required to deliver the brochure to each client or prospective client of the wrap fee program, unless another sponsor of the wrap fee program delivers the required brochure. If appropriate arrangements do not already exist, an investment adviser that sponsors a wrap fee program with multiple sponsors should take steps to ensure that the responsibilities for delivering the wrap fee program brochure are clearly delineated, including in any applicable contracts for the program. The wrap fee program brochure also does not replace the requirement to deliver brochure supplements under amended Rule 204-3(b). Accordingly, an investment adviser that acts as a sponsor of a wrap fee program will need to address the preparation and delivery of brochure supplements as well.

Formatting and Content Considerations

Formatting Requirements

In a departure from the existing “check-the-box” and supplemental Schedule F disclosure approach under Form ADV, Part II, amended Form ADV requires that a brochure include plain English disclosures written in a narrative format and organized in a specified order. Under amended Form ADV, Part 2A, an investment adviser must (1) respond to each brochure item specified (including, if the item is inapplicable, by including an explanation that the information is inapplicable), (2) present the information in the order prescribed therein, and (3) use the headings prescribed therein. An investment adviser with a more complex business model may want to consider including a summary in the beginning of its brochure, which is permitted by the instructions to amended Form ADV, in order to facilitate readability and comprehension.

Under amended Form ADV, Part 2B, supplemental brochures also must be written in plain English, organized in the order prescribed therein, and contain the headings prescribed therein. Investment advisers may elect to prepare a brochure supplement for each supervised person, or brochure supplements may be prepared for different groups of supervised persons (such as supervised persons working in a particular office or group). Investment advisers also may elect to include brochure supplements in sequence in (i.e., at the end of) their brochures.

A wrap fee program brochure must be formatted in a similar fashion as required under Appendix 1 to amended Form ADV, Part 2A.

Where information is responsive to more than one disclosure item, cross-references to other sections of a brochure or brochure supplement are permitted.

Content Requirements

An investment adviser should review carefully the Adopting Release and amended Form ADV, including the instructions thereto, before drafting and reviewing any brochure(s) or brochure supplements. There are 18 separate disclosure items that a federally registered investment adviser (19 separate disclosure items that a state-registered investment adviser) is required to address in its brochure(s) under amended Form ADV, Part 2A. There are six separate disclosure items that a federally registered investment adviser (seven for a state-registered investment adviser) is required to address in each brochure supplement. There are nine separate disclosure items that a federally registered investment adviser that serves as sponsor of a wrap fee program (10 separate disclosure items that such a state-registered investment adviser) is required to address in its wrap fee program brochure(s) under Appendix 1 to amended Form ADV, Part 2A.

As a general matter, an investment adviser should include disclosure in its brochure(s) only about the practices that it currently engages in or is reasonably likely to engage in, or about conflicts of interest that it currently has or is reasonably likely to have, in the operation of its business. In the Adopting Release, the SEC indicated that, if an investment adviser decides to engage in a practice, or if a conflict arises that the investment adviser has not disclosed, it would need to provide supplemental information to its clients. An investment adviser should keep this SEC guidance in mind when

determining which disclosures to include in its brochure(s) and supplemental brochures, and when updating Form ADV in connection with implementing new business lines or practices.

Regarding conflicts of interest specifically, the instructions to amended Form ADV, Part 2, provide that, as a fiduciary, an investment adviser is required to provide a client with sufficiently specific facts so that the client (1) is able to understand the conflicts of interest that the investment adviser has and the business practices in which it engages, and (2) can give his, her or its informed consent to the transaction or practice that gives rise to the conflict or to reject the transaction or practice. The instructions also make clear that, given this requirement, an investment adviser may have to disclose more information to clients than what is specifically required by amended Form ADV, and that an investment adviser may disclose any such additional information to clients either in its brochure or by some other means. An investment adviser that serves as a sponsor to a wrap fee program also is required to: (A) identify in the wrap fee program brochure whether any of its related persons is a portfolio manager in the wrap fee program, and, if so, (B)(i) describe whether such related persons are subject to the same selection and review criteria as other portfolio managers who participate in the wrap fee program (and, if not, how they are selected and reviewed) and (ii) describe associated conflicts of interest (such as the incentive to select the related person as a portfolio manager for client assets based on the affiliation, rather than on expertise, performance or the best interests of the client).

Regarding the specific requirements of amended Form ADV, many of the requirements are the same as or similar to requirements under the existing Form ADV, Part II, or under other required disclosures (e.g., Form U-4), but there also are various new and enhanced requirements. While a discussion of each disclosure item is beyond the scope of this summary, the following is a summary of some of the more significant items required to be addressed in the brochure (amended Form ADV, Part 2A):

- Amended Form ADV, Part 2A, contains three new disclosure items: (1) the summary of material changes in Item 2; (2) a performance fee (and related conflict of interest) disclosure requirement in Item 6; and (3) a custody disclosure requirement in Item 15.
- Specific disclosures required on the cover page under Item 1, including basic contact information (including a general telephone number), a specified disclaimer, and other disclosures (Item 1).
- A table of contents (rather than an index) under Item 3.
- As part of describing its business under Item 4, an investment adviser may compute its assets under management using a method that differs from the method used to calculate its assets for purposes of Form ADV, Part 1A (for example, an investment adviser that provides model portfolios to third-party overlay managers for use in managing the overlay managers' clients' accounts can include those assets in its assets under management disclosed under Item 4 of amended Form ADV, Part 2A, even though it does not include those assets in its assets under management for purposes of Form ADV, Part 1A, because it is not providing discretionary advice and does have trading responsibility with respect to those client assets).
- Under Item 8, an investment adviser must describe its methods of analysis and investment strategies, disclose that investing in securities involves a risk of loss that clients should be prepared to bear, disclose how strategies involving frequent trading can effect investment performance, and explain material risks involved for each significant investment strategy or method of analysis used, and particular security type that the investment adviser recommends. An investment adviser also must disclose its practices regarding managing cash balances if the omission of such disclosure would not be in the best interests of clients or otherwise breach the investment adviser's fiduciary duty to clients.
- Under Item 10, if an investment adviser recommends other investment advisers to clients, it must disclose any compensation arrangements or other business relationships between the advisory firms that create material conflicts of interest and explain how it addresses such conflicts.
- Under Item 11, detailed disclosures are required concerning (among other things) the personal trading policies and practices of an investment adviser and its related persons, including conflicts of interest that arise if it or its related persons are permitted to invest in the same securities that it recommends to its clients, and how it addresses such conflicts.
- Under Item 12, detailed disclosures are required concerning (among other things) the soft dollar practices of the investment adviser, including the types of conflicts of interest that arise when soft dollars are utilized, and how the investment adviser addresses those conflicts of interest.
- Under Item 17, if an investment adviser does not accept authority to vote securities, it must disclose how clients receive their proxies and other solicitations.

Given the new and enhanced disclosure requirements under amended Form ADV, if an investment adviser intends to borrow from its existing Form ADV, Part II, Schedule F disclosures (or, for an investment adviser that acts as a sponsor of a wrap fee program, from its existing Schedule H brochure), the investment adviser will likely need to supplement its existing disclosure with new disclosure to satisfy the requirements of amended Form ADV. Given that brochures will be publicly available, an investment adviser also should be mindful not to disclose confidential or proprietary information regarding the investment adviser, its affiliates, its service providers, its products or other third-parties in its brochure(s). This would include not disclosing information that can jeopardize a product's exemption(s) under applicable federal securities laws. For example, in the Adopting Release, the SEC indicated that inclusion of certain additional information about a private fund (the shares of which are privately offered and not registered under the Securities Act of 1933) in an investment adviser's brochure (such as subscription instructions, performance information, and financial statements) may jeopardize the private offering exemption relied upon by the private fund.

Initial Delivery and Subsequent Delivery/Updating Considerations

Once an investment adviser initially prepares, files (as necessary), and delivers its brochure(s) and brochure supplements as described under "Compliance Deadlines" above, an investment adviser has ongoing initial delivery requirements to new clients and prospective clients, and subsequent delivery and updating requirements to its existing clients, under amended Rule 204-3.

An investment adviser should begin to consider now how it intends to satisfy these ongoing and subsequent delivery requirements. For example, will the investment adviser provide required disclosures electronically? (See "Operational and Technology Considerations: Other Operations-Related Considerations" below for a discussion of electronic delivery considerations.) Investment advisers that sponsor, or serve as portfolio managers in, wrap fee programs will need to confirm arrangements and responsibilities for the delivery of wrap fee program brochures and sponsor brochure supplements, as well as the brochure(s) (or summaries of material changes) and brochure supplements of the investment advisers that serve as portfolio managers in the wrap fee program. This will likely include amending numerous contracts related to each wrap fee program to clearly delineate the responsibilities for the initial and ongoing/subsequent delivery of required disclosures.⁷ All investment advisers will need to modify their compliance policies and procedures to conform to the new requirements of amended Form ADV and the related Advisers Act rules.

Initial Delivery Requirements

Under amended Rule 204-3(a), a registered investment adviser generally is required to deliver a brochure and one or more brochure supplements containing all information required by amended Form ADV, Part 2, to each client or prospective client to which a brochure is required to be provided. Under amended Rule 204-3(b)(1) and (3), a registered investment adviser (or its supervised person acting on its behalf) is required to deliver: (1) its current brochure to each client or potential client (to which the brochure is required to be provided) before or at the time the investment adviser enters into an investment advisory contract with that client, and (2) a current brochure supplement for each supervised person before or at the time that supervised person begins to provide investment advisory services to that client (for which a brochure supplement is required to be provided), unless investment advice for the client is provided by a team comprised of more than five supervised persons, in which case a 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.⁸ (See "Threshold Considerations" above for more information on the types of clients to which a brochure or brochure supplement is not required to be provided and on when a supervised person is considered to be providing investment advice.) For an investment adviser that acts as a sponsor of a wrap fee program, amended Rule 204-3(d) requires that a wrap fee program brochure containing all the information required by Appendix 1 to amended Form ADV, Part 2A, be provided by the investment adviser (or another sponsor of the wrap fee program) in lieu of the brochure required under amended Rule 204-3(b)(1).

Annual Delivery Requirements

Under amended Rule 204-3(b)(2), if there are material changes in an investment adviser's brochure since its last annual updating amendment, the registered investment adviser (or its supervised person acting on its behalf) is required to provide an annual update to its clients. The annual update must be delivered (without charge) within 120 days of the end of the investment adviser's fiscal year to each client to whom a brochure is required to be delivered.⁹ The annual update can take the form of either (1) the investment adviser's current (updated) brochure (which can include or

be accompanied by a summary of the material changes as required by Item 2 of Form ADV, Part 2A) or (2) a summary of the material changes to the investment adviser's brochure as required by Item 2 of Form ADV, Part 2A, that offers to provide its current (updated) brochure without charge, accompanied by the website address (if available), an e-mail address (if available) and telephone number by which a client may obtain the current (updated) brochure from the investment adviser, and the website address for obtaining information about the investment adviser through the IAPD system. (See "Threshold Considerations" above for more information on the types of clients to which a brochure or brochure supplement is not required to be provided.) An investment adviser is not required to deliver brochure supplements annually.

If an investment adviser does not make any interim amendments since its last annual updating amendment, and if its brochure remains accurate in all material respects, it is not required to prepare or deliver a summary of material changes to its clients or to prepare and file an updated brochure as part of its annual updating amendment. Otherwise, an investment adviser is required to file a summary of material changes describing any interim amendments along with an updated brochure as part of its annual updating amendment. As noted above, under amended Rule 204-1, an investment 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 page), must file its summary as an exhibit with its brochure when it files its annual updating amendment with the SEC, so that the summary of material changes is available to the public through the IAPD system.

Interim Updating/Delivery Requirements

Under amended Form ADV, a registered investment adviser is required to update its brochure(s) at least annually and its brochure and brochure supplements when information in its brochure(s) (except the summary of material changes¹⁰ and amount of assets under management¹¹) or brochure supplements becomes materially inaccurate.

Under amended Rule 204-3(b)(4), if a registered investment adviser amends its brochure or a brochure supplement (as applicable) to add disclosure of an event, or materially revises information already disclosed about an event, in response to Item 9 of amended Form ADV, Part 2A, or Item 3 of amended Form ADV, Part 2B (relating to disciplinary information), the investment adviser must provide an interim update to each client to whom a brochure is required to be delivered. The interim update must be provided promptly after such a brochure amendment is made. The interim update can take the form of either (1) the amended brochure or brochure supplement (as applicable), along with a statement describing the material facts relating to the change in disciplinary information, or (2) a statement describing the material facts relating to the change in disciplinary information. (See "Threshold Considerations" above for more information on the types of clients to which a brochure or brochure supplement is not required to be provided.)

In discussing the updating requirements for brochure supplements, the SEC indicated in the Adopting Release that an investment adviser's fiduciary duty may require it to inform a client of material changes to the investment adviser's disclosures even if amended Rule 204-3 does not require delivery of an updated supplement to clients. One could reasonably anticipate that the SEC staff would take a similar position with respect to an investment adviser's disclosures in its brochure.

Operational and Technology Considerations

Investment advisers also should begin to consider whether there are operational or technology matters that they will need to address in order to comply with amended Form ADV and the related rules under the Advisers Act. While the considerations for each investment adviser will differ, the following is a discussion of certain filing, recordkeeping and other matters that an investment adviser should consider.

Filing Requirements

Under amended Rule 203-1, unless an investment adviser has obtained a hardship exemption from the SEC under Rule 203-3 under the Advisers Act, an investment adviser applying for registration as an investment adviser under the Advisers Act with the SEC must file Form ADV, Part 1A, and any brochure(s) required by amended Form ADV, Part 2A, electronically through the IARD system. Under amended Rule 204-1, unless an investment adviser has obtained a hardship exemption, a registered investment adviser is required to file its initial brochure(s) (but not brochure supplements¹²), and all amendments to its Form ADV, Part 1A, and its brochure(s) (i.e., amended Form ADV, Part 2A) (but not brochure supplements), with the SEC using the IARD system.¹³ As noted above, under amended Rule 204-1, an investment adviser that does not include, and therefore file, its summary of material

changes as part of its brochure must file its summary as an exhibit to its brochure in the same electronic file when it files its annual updating amendment with the SEC, so that the summary of material changes is available to the public.

Required filings must be made in a single, text-searchable PDF. An investment adviser is expected to prepare its brochure(s), and make amendments, in a source file on its own computer systems, and then attach the revised documents to its IARD filing. In the Adopting Release, the SEC indicated that FINRA will assist an investment adviser with converting its brochure(s) into the required electronic format using software available to the investment adviser or, if necessary, by providing the investment adviser with PDF conversion software.

As discussed in the Adopting Release, the IARD system will not accept an annual updating amendment without either (1) an updated brochure, (2) a representation by the investment adviser that the brochure on file does not contain any materially inaccurate information, or (3) a representation by the investment adviser that it does not have to prepare a brochure because it does not have to deliver it to any clients. If there have been material changes to a brochure, a representation that a summary of material changes is attached as an exhibit to or included in the updated brochure also will be required by the IARD system. An investment adviser that uses multiple brochures will be able to eliminate any brochure that it no longer uses.

An investment adviser needs to understand, and assess and possess (or, if necessary, obtain), the technology needed to comply with the amended filing requirements. It seems likely that most investment advisers will already possess the necessary software or be able to obtain it without much effort. An investment adviser also may want to consider implementing an internal certification process as backup for (or modifying its existing process to cover) the certifications it must make before the IARD system will accept a filing.

Recordkeeping Requirements

Under amended Rule 204-2, an investment adviser is required to maintain in its books and records copies of each brochure (and summary of material changes if not included in a brochure), brochure supplement, and amendment to a brochure or brochure supplement. An investment adviser also is required to maintain a record of the dates on which any of the foregoing was provided to any client or prospective client. If the method used to compute managed assets for purposes of Item 4.E in amended Form ADV, Part 2A, differs from the method used to calculate "assets under management" in Form ADV, Part 1A, documentation describing the method used to compute managed assets for purposes of Item 4.E of Form ADV, Part 2A, must be prepared and retained. Under amended Rule 204-2, a memorandum describing any legal or disciplinary event listed in Item 9 of amended Form ADV, Part 2A, or Item 3 of amended Form ADV, Part 2B (relating to disciplinary information), and presumed to be material, must be prepared and retained if the event involved the investment adviser or any of its supervised persons and is not disclosed in the investment adviser's brochure or relevant brochure supplement (as applicable). These required records must 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 under the Advisers Act. An investment adviser should amend its policies and procedures to take into account these recordkeeping requirements.¹⁴

Other Operations-Related Considerations

In the Adopting Release, the SEC indicated that an investment adviser may deliver a brochure (including a summary of material changes), a summary of material changes, supplemental brochures, or other required disclosures, to clients electronically, if the investment adviser complies with the SEC's guidance regarding electronic delivery of information.¹⁵ Under the instructions to amended Form ADV, Part 2B, an investment adviser is permitted to disclose in a brochure supplement delivered electronically that a supervised person has a disciplinary event and provide a hyperlink to either the BrokerCheck or IAPD systems. In such a case, if the BrokerCheck or IAPD systems are updated with new disclosure of a disciplinary event or a material change to disciplinary information previously disclosed, and such disciplinary event or change is required to be disclosed under Item 3 of amended Form ADV, Part 2B (relating to disciplinary information), the SEC indicated in the Adopting Release that the investment adviser would be required to deliver an updated brochure supplement (or sticker) indicating that the disciplinary information for the relevant supervised person has changed, and provide a hyperlink to the BrokerCheck or IAPD systems.

In addition to ensuring that the investment adviser implements an adequate process, and has sufficient resources (e.g., personnel, technological support, etc.) dedicated to initially preparing, filing (as necessary) and delivering its brochure(s) and supplemental brochures, the investment adviser

should consider the processes required and resources necessary to maintain, review and update, and, as required, file and deliver, its brochures and brochure supplement after they are initially prepared, filed (as necessary), and delivered to clients and prospective clients. For example, given the requirement for a summary of material changes, an investment adviser should have a process for identifying and keeping track of any material changes to its brochure(s).

Amendments to Form ADV Instructions and Glossary

In adopting amended Form ADV, Part 2A (including Appendix 1 to Part 2A) and Part 2B, the SEC also adopted various amendments to the General Instructions and Glossary of Terms for Form ADV. For example, the brochure filing requirements are included in the General Instructions, definitions of the terms “brochure,” “brochure supplement,” “investment adviser representative,” “supervised person” and “wrap brochure or wrap fee program brochure” have been added to the Glossary of Terms, and various cross-references in the Glossary of Terms have been revised. The SEC updated the definition of “Non-Resident” in the Glossary of Terms to make it consistent with Rule 0-2 under the Advisers Act by changing an “and” to an “or.” The SEC pointed out that, although technical in nature, this change may potentially result in an increased number of corporate entities qualifying as non-resident general partners or managing agents of SEC-registered investment advisers, which would require certain entities to file Form ADV-NR with the SEC.

Rule 206(4)-4 Withdrawn

Given that Item 9 and Item 18 of amended Form ADV, Part 2A, include the disciplinary event and financial information disclosures required by Rule 206(4)-4, the SEC rescinded Rule 206(4)-4, effective with respect to any particular investment adviser as of the date by which the investment adviser is required to deliver its brochure to existing clients, and begin delivering its brochure to new clients and prospective clients. In the Adopting Release, the SEC noted that, if an investment adviser is providing services (e.g., impersonal investment advice or advice to registered investment companies or business development companies) for which it is not required to deliver a brochure, its fiduciary duty to make full and fair disclosure to its clients would continue to require it to disclose to all of its clients any material disciplinary or legal events, or the inability to meet contractual commitments (even though Rule 206(4)-4 is withdrawn).

Conclusion

The amendments to Form ADV, and the related Advisers Act rules, impose new disclosure requirements on registered investment advisers. As discussed above, these requirements will require an investment adviser to make certain determinations, adopt or revise certain policies, procedures, practices and arrangements, and devote more resources and time to preparing, filing (as necessary) and delivering the required brochure(s) and brochure supplements. As you begin to digest these requirements and determine what your organization will need to do to comply with them, Reed Smith’s Investment Management Group can assist you with that analysis and the drafting and review of your brochure(s) and brochure supplements.

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- 1 See *Electronic Filing by Investment Advisers; Proposed Amendments to Form ADV*, SEC Release No. IA-1862 (Apr. 5, 2000).
 - 2 While Form ADV is used to register federally with the SEC and on the state level with state regulatory authorities, this summary generally speaks only to the requirements imposed on investment advisers registered, or required to be registered, under the Advisers Act. The Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”) recently adjusted the rules for when an investment adviser is eligible to register with the SEC. In summary, under the Advisers Act, as amended by the Dodd-Frank Act, an investment adviser that does not advise a registered investment company or business development company may not register with the SEC if it (a) has between \$25 million and \$100 million in assets under management, unless it would be required to register as an investment adviser with 15 or more states (in which case the investment adviser may register with the SEC), or (b) has less than \$25 million in assets under management. The Dodd-Frank Act also eliminated the “private adviser” exemption under the Advisers Act and replaced it with certain new, narrower exemptions. Therefore, many investment advisers (such as hedge fund managers located in the United States and abroad) that relied on the “private adviser” exemption for an exemption from Advisers Act registration, will be required to register under the Advisers Act by July 21, 2011. Since there are specific requirements in amended Form ADV that apply only to state-registered advisers (e.g., Item 19 of amended Form ADV, Part 2A), investment advisers transitioning to federal registration with the SEC, or from federal registration to state registration, should be mindful of the requirements of amended Form ADV that apply to federal versus state registered investment advisers.
 - 3 Under amended Rule 204-3(h)(3), a “sponsor” of a wrap fee program includes “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.” Under amended Rule 204-3(h)(5), a “wrap fee program” includes “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 investment advisers) and the execution of client transactions."

- 4 The instructions to amended Form ADV provide that an investment adviser, among other things, should use short sentences; concrete everyday words; and the active voice. The SEC's Office of Investor Education and Advocacy has published *A Plain English Handbook* that an investment adviser may find useful in preparing its brochure(s) and brochure supplements. The handbook can be found on the SEC's website at www.sec.gov/news/extra/handbook.htm. Under amended Rule 204-3(h)(4), a "supervised person" includes any of an investment adviser's officers, partners or directors (or other persons occupying a similar status or performing similar functions) or employees, or any person who provides investment advice on the investment adviser's behalf.
- 5 Under amended Rule 204-3(h)(1), "impersonal investment advice" includes "investment advisory services that do not purport to meet the objectives or needs of specific individuals or accounts."
- 6 Brochure supplements are not required to be filed with the SEC; if an investment adviser is registered or registering with one or more state securities authorities, filing of brochure supplements with the state(s) is required for each supervised person doing business in that state(s).
- 7 In the Adopting Release, the SEC confirmed that a sponsor of a wrap fee program may deliver the brochure(s) and brochure supplements of an investment adviser that serves as a portfolio manager in the sponsor's wrap fee program, and that the sponsor may maintain certain records (e.g., records relating to evidencing the delivery of the brochure(s) and brochure supplements) as long as the sponsor, upon request of the SEC's staff, will produce the records for the SEC's staff at the appropriate office of the investment adviser or sponsor. The SEC noted that this delegation from investment adviser to sponsor does not relieve the investment adviser of its legal delivery obligation, and that the investment adviser should take steps to assure itself that the sponsor is performing the tasks the investment adviser has delegated. Given this SEC guidance, an investment adviser that serves as a portfolio manager in wrap fee programs should consider whether its contracts with sponsors clearly delineate these responsibilities, seek to amend its contracts as necessary, and confirm its existing procedures (or implement new procedures) (such as periodic certifications or due diligence visits) designed to confirm that sponsors are performing these disclosure delivery and recordkeeping tasks.
- 8 Under amended Rule 204-3(h)(2), a "current brochure" or "current brochure supplement" are defined as "the most recent version of the brochure or brochure supplement, including all amendments to date."
- 9 The 120-day period is intended to provide investment advisers with 30 days after the filing of their annual updating amendment, which is required to be filed within 90 days after the investment adviser's fiscal year end under Rule 204-1 under the Advisers Act, to satisfy the required annual delivery requirements. It also is intended to give investment advisers the flexibility to include their updated disclosures with other quarterly reports that are mailed or otherwise delivered to their clients.
- 10 In the Adopting Release, the SEC indicated that, if an investment adviser includes the summary of material changes in its brochure, and the investment adviser amends its brochure on an interim basis between annual updating amendments, the investment adviser should consider whether it should update its summary of material changes to avoid confusing or misleading clients reading the updated brochure.
- 11 In the Adopting Release, the SEC indicated that, if an investment adviser is amending its brochure for another reason between annual updating amendments, and the amount of assets under management has materially changed such that it is materially inaccurate, the investment adviser should amend the amount of assets under management to make it materially accurate.
- 12 In the Adopting Release, the SEC noted that, because brochure supplements are not filed with the SEC, they would not be deemed filed and would not be required as part of any state notice filing.
- 13 Information regarding filing through the IARD system is available on the SEC's website at www.sec.gov/iard.
- 14 See also Footnote 6 above for a discussion of the SEC's guidance on an investment adviser's ability to delegate maintenance of required records to a sponsor of a wrap fee program and related considerations.
- 15 This SEC guidance generally requires, among other things, that a client receive certain disclosures and provide an affirmative consent to the receipt of specified types of disclosures electronically. See, e.g., *Use of Electronic Media by Broker-Dealers, Transfer Agents, and Investment Advisers for Delivery of Information*, SEC Release No. IA-1562 (May 9, 1996).

About Reed Smith

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