

May 16, 2008

Via Electronic Filing

Nancy M. Morris
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090

**Re: Amendments to Form ADV, Rel. No. IA-2711; 34-57419; File
No. S7-10-00**

Dear Ms. Morris:

The Investment Adviser Association (IAA)¹ appreciates the opportunity to comment on the SEC's re-proposed amendments to Form ADV Part 2.² We support this important Proposal, with the modifications suggested herein.

Introduction and Summary

In April 2000, the SEC proposed a wholesale revision to Parts 1 and 2 of Form ADV and established the Investment Adviser Registration Depository (IARD), an electronic filing system for investment advisers.³ The 2000 Proposal included substantial Form ADV Part 2 amendments that would have required investment advisers to provide clients and prospective clients with a narrative brochure written in plain English describing the adviser's business, conflicts of interest, and disciplinary history in lieu of the current check-the-box brochure format. The SEC also proposed to require advisers to provide clients with a brochure supplement that would have set forth additional

¹ The IAA is a not-for-profit association that exclusively represents the interests of investment adviser firms registered with the SEC. Founded in 1937, the Association's membership consists of more than 500 firms that collectively manage in excess of \$9 trillion in assets for a wide variety of institutional and individual clients, including pension plans, trusts, investment companies, endowments, foundations, and corporations. For more information, please visit our web site: www.investmentadviser.org.

² *Amendments to Form ADV*, Rel. Nos. IA-2711, 34-57419; File No. S7-10-00 (Mar. 3, 2008), available at <http://www.sec.gov/rules/proposed/2008/ia-2711.pdf> (the "Proposal").

³ *Electronic Filing by Investment Advisers; Proposed Amendments to Form ADV*, Rel. Nos. IA-1862, 34-42620 (Apr. 5, 2000) (the "2000 Proposal").

information regarding specific employees of the firm. The IAA submitted extensive comments on the 2000 Proposal and incorporates those comments herein by reference.⁴ In September 2000, the SEC adopted the proposed Part 1 amendments and implemented IARD filing for Part 1, but deferred consideration of the proposed Part 2 amendments. The SEC issued the current proposal in March 2008.

We applaud the Commission for taking steps to modernize the registration process and enhance the information that investment advisers provide to their existing and prospective clients. As Chairman Cox noted recently, the current format of Form ADV is outdated, and difficult to read and understand.⁵ We continue to strongly endorse the Commission's goal of making advisory brochures more useful to clients by requiring 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 their advisory personnel.

We truly appreciate the Commission's serious consideration of our comments on the 2000 Proposal and adoption of many of our recommendations, particularly with respect to the length and detail of brochure disclosure, and the brochure and supplement delivery and interim update requirements. As noted below, we have a number of additional recommendations that would further enhance the utility of the brochure and supplement for clients.

We encourage the SEC to: (1) take additional steps to streamline the brochure by eliminating unnecessary and duplicative disclosure requirements and providing additional flexibility regarding disclosure content; (2) further revise the supplement delivery requirements so that qualified clients are exempted from those requirements; and (3) adopt an access-equals-delivery model for the brochure and clarify the brochure and brochure supplement electronic delivery requirements.

Below is an overview of our recommendations regarding the Proposal. For ease of reference, we have set forth our specific item-by-item comments with respect to Part 2A and Part 2B in a separate Appendix. We encourage the Commission to act promptly to implement the Proposal, with the suggested modifications.

⁴ Letter regarding *Release Nos. IA-1862; 34-42620; File No. S7-10-00; Electronic Filing by Investment Advisers; Proposed Amendments to Form ADV*, from Karen Barr, IAA General Counsel, to Jonathan G. Katz, Secretary, Securities and Exchange Commission (June 13, 2000) ("June 2000 Letter") and supplemental letter regarding *Release Nos. IA-1862; 34-42620; File No. S7-10-00; Electronic Filing by Investment Advisers; Proposed Amendments to Form ADV*, from Karen Barr, IAA General Counsel, to Jonathan G. Katz, Secretary, Securities and Exchange Commission (May 24, 2001).

⁵ Chairman Cox's remarks, *Amendments to Form ADV Open Meeting*, Washington, DC (Feb.13, 2008), available at <http://sec.gov/news/speech.shtml#chair> ("Open Meeting").

1. The Commission Should Further Streamline the Brochure

The Commission made significant changes to the brochure disclosure requirements in response to concerns expressed by the IAA and other commenters that the 2000 Proposal contained too many items and required too much detailed information. In the Proposal, the Commission: (1) revised the instructions to clarify that an adviser must respond only to items that apply to its business; (2) revised some of the items to omit certain unnecessary information; and (3) revised several items to require advisers to explain how they address the conflicts of interest they identify instead of requiring them to disclose their policies and procedures. The IAA commends the SEC for taking these steps to improve the proposed brochure disclosure.

Under the Proposal, advisers would be required to provide narrative disclosure on nineteen separate items. At a minimum, they would be required to provide conflicts of interest disclosure regarding fees and compensation, performance fees and side-by-side management, other financial industry activities and affiliations, participation or interest in client transactions and personal trading, brokerage practices (including soft dollars, brokerage for client referrals and directed brokerage), and voting client securities.⁶ We suggest that the SEC further streamline the brochure by eliminating unnecessary and duplicative disclosure requirements and providing additional flexibility regarding disclosure content.⁷ This will allow clients to focus attention on the more important items, including material conflicts of interest, disciplinary history, and investment style. We continue to believe that a narrative brochure written in plain English that is not overly long or complex would significantly improve disclosure to clients and prospective clients.

To that end, we urge the SEC to eliminate or narrow a number of disclosure items, including the following (see the Appendix for a more complete discussion of these items):

- **Duplicative Disclosure:** A number of items call for disclosure that is duplicative of requirements covered in other items, in Part 1A, or in client contracts. For example, the disclosure in Item 4 regarding firm ownership already is provided in response to

⁶ According to the SEC, additional disclosure could be necessary, in the brochure, or elsewhere. Proposed Instruction 3 to Part 2 provides that, “You therefore may have to disclose to *clients* information not specifically required by Part 2 of Form ADV. You may disclose this additional information to *clients* in your *brochure* or by some other means.” In addition, Proposed Rule 204-3(g) provides that delivery of a brochure or supplement in compliance with [Rule 204-3] does not relieve an adviser of any other disclosure obligations it may have to its advisory clients or prospective clients under any federal or state laws or regulations.

⁷ The Commission recently took similar action to simplify mutual fund disclosure. The Commission issued a summary mutual fund prospectus proposal intended “to improve mutual fund disclosure by providing investors with key information in plain English in a clear and concise format.” See *Enhanced Disclosure and New Prospectus Delivery Option for Registered Open-End Investment Companies*, Rel. Nos. 33-8861; IC-28064; File No. S7-28-07, available at <http://www.sec.gov/rules/proposed/2007/33-8861.pdf> (“Summary Prospectus Proposal”).

Part 1A of Form ADV and does not need to be repeated in the brochure.⁸ Similarly, performance fee disclosures required by Item 6 already would be required in response to Item 5 and are more specifically addressed in contracts with clients. The disclosure regarding discretionary authority in Item 16 is duplicative because advisers already describe their discretionary authority not only in client contracts but also in response to Item 4. The Item 17 requirement that advisers disclose whether they pay for proxy voting services with soft dollars is subsumed within the Item 12 requirement to discuss “all soft dollar benefits you receive.” Similarly, in the unusual event that an adviser passes on the cost of proxy voting services to the client through a supplemental fee (Item 17B), that fee would be disclosed to clients under Item 5. These duplicative items should be eliminated.

- **Nonessential Disclosure:** Certain of the proposed disclosures call for narrative disclosure that would not provide particularly meaningful information to clients. For example, the Commission could eliminate disclosure regarding third-party proxy voting services. Clients already receive disclosure regarding the adviser’s proxy voting policies and procedures, which include whether the adviser uses third-party services to address conflicts. We do not believe clients are interested in the details regarding how these service providers are selected. The Commission could also eliminate much of the boilerplate disclosures that seem more suited for a mutual fund prospectus than for an investment adviser brochure, such as certain statements on the cover page and in the Item 8 risk disclosure section. Other items, if not clarified or narrowed, may result in information that is too generalized to be of significant assistance to clients, such as the Item 8 disclosures regarding risks of various types of securities and the cash balance practices of advisers. Similarly, if not narrowed, the Item 10 disclosure of material relationships with accountants or lawyers would increase the length of the brochure without providing critical information to clients.
- **Inflexible Disclosure:** A number of items call for disclosure that is inflexible or rigid. These items could be streamlined or revised to provide more flexibility in disclosure. For example, the Commission could eliminate certain of the specific required statements in Item 12 on brokerage practices in favor of discussing general principles and permitting advisers to disclose conflicts of interest in this area more flexibly.⁹ This approach would have the additional advantage of avoiding some of the negative implications of these statements, as we discuss in the Appendix. In addition, the Commission could more consistently apply its approach of requiring

⁸ We respectfully suggest that the Commission: (1) eliminate proposed Part 2 disclosure that is duplicative of the current Part 1 disclosure; and (2) harmonize the Part 1 and proposed Part 2 requirements, including with respect to calculation of assets under management and custody requirements, as noted herein.

⁹ Proposed Item 12, for example, would require an adviser to “explain that when you use client brokerage commissions . . . to obtain research or other products or services, you receive a benefit because you do not have to produce or pay for that research, product or services” and “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 receive best execution.”

disclosure of conflicts and how they are addressed rather than detailed policies and procedures. To that end, the Commission should eliminate the Item 12 requirement for advisers to “explain the procedures you used during your last fiscal year to direct client transactions to a particular broker-dealer in return for the soft dollar benefits you received” and “in return for client referrals” and the Item 11 requirement to disclose “procedures for disclosing conflicts to clients.” Further, the Commission could provide more flexibility regarding the risk disclosures in Item 8 so that firms could tailor these disclosures to their clientele more appropriately in the brochure or elsewhere.

Streamlining the required disclosure and eliminating the unnecessary information will help advisers provide a user-friendly document for clients and prospective clients, in accordance with the SEC’s goals. In order to further improve disclosure to clients, we repeat our suggestion for the SEC to supplement and explain information presented in firm brochures by preparing an educational brochure for advisory clients, discussing in plain English potential conflicts of interest and suggesting questions to ask advisers or prospective advisers.

We also encourage the Commission to provide greater flexibility regarding the content of the disclosures required. The brochure is the adviser’s narrative disclosure document and is intended to give advisers the flexibility to provide clients with a general understanding of how a firm addresses its conflicts. The Proposal, however, includes certain requirements that dictate the language of the brochure.¹⁰ Mandating specific disclosure statements limits advisers’ flexibility to draft the brochure in a manner that will provide disclosure most appropriate for their clients, taking into account the conflicts that may arise given the nature of their business and operations. Such prescriptive language is unlikely to result in the most material and relevant disclosure for clients. Instead, advisers should have flexibility to present clear and meaningful disclosure to their clients. Providing such flexibility will make it more likely that the revised Form ADV will remain relevant in a dynamic market over the course of time.

Simplifying the brochure would also address some of our concerns regarding the time estimates referenced by the SEC in connection with the “collection of information” requirements under the Paperwork Reduction Act of 1995. Drafting the brochure will be an enormous undertaking for investment advisers. Moving from the current check-the-box format to a new narrative, plain English format will be time consuming and expensive, even with the modifications suggested.

The time estimates set forth in the Proposal are clearly unrealistic and understated, given the nature and complexity of the brochure. In the Proposal, the Commission estimates that the average initial annual burden associated with Form ADV may range from as little as 5 hours for smaller advisers with 10 or fewer employees, to

¹⁰ See proposed Items 5E, 6, 8A, 12A, 17C.

approximately 50 hours for medium-sized advisers with 11 to 999 employees, to as much as nearly 3,300 hours for larger advisers with 1,000 or more employees. The Proposal estimates that it will take the average adviser 22.25 hours to complete Parts 1 and 2 of revised Form ADV. Although we appreciate that this estimate is an average, we believe it vastly underestimates the amount of time it will take advisers to comply with the Proposal. Even for advisers that already include most of the proposed disclosure topics in their current Part II, re-drafting each item in the plain English manner contemplated by the Commission alone will take significant time and effort. While each individual disclosure item might seem reasonable, taken as a whole, the disclosure currently proposed will result in a detailed, lengthy document that will be time consuming to draft.¹¹ Further, because of the potential liability implications inherent in Form ADV, many advisers, including small and medium sized advisers, will hire outside counsel to review or even draft their Part 2 brochures, incurring additional time and expense.

The Commission should strive to strike the appropriate balance between meaningful disclosure and too much disclosure in the final rule. Unnecessary disclosure not only obscures information that is important to clients, but it causes investment advisers to spend more time meeting disclosure obligations and less time managing client assets. In addition, we encourage the Commission to recognize the importance of this balance as its staff reviews brochures in the examination and enforcement programs.

2. Qualified Clients Should Be Exempted from the Brochure Supplement Delivery Requirements

The Commission has proposed that adviser brochures be accompanied by brochure supplements that provide information about the advisory personnel who provide clients with investment advice. Pursuant to the Proposal, a brochure supplement would provide information about the educational background, business experience, and relevant disciplinary history of the supervised person who provides advisory services to that client.

The IAA supports the Commission's desire to enable clients to assess the background and experience of the investment advisory personnel who have responsibility for the investment advice those clients receive. We also recognize that investment advisers typically provide this information to clients and prospective clients in the usual course of marketing their expertise, experience, and educational qualifications in managing investments.

The IAA appreciates that the Commission made significant changes to the proposed supplement in response to concerns raised by the IAA and other commenters regarding the expense, burden, and complex logistics of the 2000 Proposal and the difficulties that advisers would have complying with the requirements. In particular, the

¹¹ An informal survey of our members taken last month indicated that the length of the average brochure would increase by more than fifty percent in response to the Proposal.

SEC took significant steps to modify the delivery requirements, clarify the format of the supplement, and limit the information that would have to be included in the supplement. We appreciate and support these significant revisions.

We also acknowledge that the Proposal contains significant revisions related to the types of clients to whom advisers would be required to provide supplements and we respectfully urge the Commission to expand the exceptions to include all qualified clients of the investment adviser.

Pursuant to the Proposal, advisers would be required to provide a brochure supplement for each supervised person who formulates investment advice for that client and has direct client contact or who makes discretionary investment decisions for that client's assets, even without direct client contact. A supplement would not be required for a supervised person who has discretionary authority only as part of a team and has no direct client contact. The following types of clients would be exempted from the supplement delivery requirements: (1) clients to whom an adviser is not required to deliver a brochure; (2) clients who receive only impersonal investment advice; (3) clients who are "qualified purchasers"; and (4) certain "qualified clients" who are also officers, directors, employees, and other persons related to the adviser.

"Qualified purchasers" are defined under the Investment Company Act of 1940 to include natural persons who own \$5 million or more in investments and persons who manage \$25 million or more in investments for their account or accounts of other qualified purchasers. "Qualified clients" are defined in Rule 205-3 of the Advisers Act as natural persons who have a net worth of \$1.5 million or \$750,000 in assets under management with the adviser. We respectfully submit that all qualified clients should be exempted from the delivery requirements for the same reasons that the SEC has proposed to exempt qualified purchasers from the delivery requirements. Qualified clients, like qualified purchasers, do not need the protections of the brochure supplement requirement because they are in a position to obtain, and frequently do obtain, information about the advisory personnel on whom they rely for investment advice, including specific and extensive information regarding firm employees or categories of employees.

Further narrowing the range of clients to whom the brochure supplement must be delivered would make the requirements less costly and burdensome while targeting retail clients who may be less likely to have received the information set forth in the supplement from a separate source. Retail clients are less likely to affirmatively request specific information from advisers regarding advisory personnel, and they are more likely to benefit from receiving plain English disclosure regarding who is formulating advice for them. On the other hand, mandated disclosures about advisory personnel are not necessary for more sophisticated clients. The Rule 205-3 standard is very familiar to advisers, who apply it in the context of determining whether their employees are investment adviser representatives and in responding to questions in Form ADV, Part 1.

Advisers also apply the qualified client standard when making determinations with respect to performance fee thresholds.¹²

3. The Commission Should Adopt an Access-Equals-Delivery Model for the Brochure and Clarify the Electronic Delivery Requirements for the Brochure and Brochure Supplement

Pursuant to the Proposal, brochures would be delivered to clients before or at the time that an adviser enters into an advisory agreement with a client. Similarly, brochure supplements would be delivered to clients before or at the time that the supervised person begins to provide advisory services to the client. Updated brochures would be delivered to existing clients at least once each year, no later than 120 days after the end of the adviser's fiscal year. Annual delivery of the brochure supplement is not required. The Proposal also sets forth specific delivery requirements for interim updates of the brochure and brochure supplement if there are certain disciplinary history changes. We commend the SEC for proposing annual delivery of the firm brochure and we support adoption of that requirement with the modifications suggested herein. This approach is a significant improvement from the "sticker" delivery requirements suggested in the 2000 Proposal. Annual delivery, with the electronic delivery modifications suggested below, will help to ensure that clients are provided with current, updated information about the advisory firm in a cost-effective manner.

In addition to these changes, however, we strongly urge the Commission to expand and clarify the electronic delivery requirements for initial and interim delivery of the brochure and brochure supplement, as well as annual updates of the firm brochure. Specifically, we encourage the Commission to: (a) adopt an access-equals-delivery model with respect to the brochure delivery requirements so that filing the brochure with the SEC on the IARD constitutes delivery of the brochure to clients; (b) issue updated electronic delivery guidance; and (c) at a minimum, provide more information in the instructions to clarify certain aspects of electronic delivery.

a. The Commission Should Adopt an Access-Equals-Delivery Model

We urge the Commission to adopt an access-equals-delivery model so that posting a brochure on the IARD would constitute delivery to clients. In the eight years that have passed since the revisions to Form ADV were first proposed, Internet access and computer usage have increased exponentially.¹³ Access-equals-delivery, or a

¹² Clients who are sophisticated enough to understand performance fees certainly are sophisticated enough to request specific information about advisory personnel.

¹³ Increased Internet access was noted in the Summary Prospectus Proposal at 87 ("In recent years, access to the Internet has greatly expanded, and significant strides have been made in the speed and quality of Internet connections.")

variation thereof, is a format that has been adopted successfully by the Commission in other contexts, including with respect to the delivery of proxy materials and final prospectuses, and proposed with respect to the summary mutual fund prospectus.¹⁴ Access-equals-delivery is user-friendly for investment advisory clients, as well as cost-effective, efficient, and environmentally responsible for investment advisers.

The access-equals-delivery model presumes that investment advisory clients have access to the Internet and can access the brochure electronically. According to statistics cited by the SEC in the Proxy Release, at that time, 80% of investors in the United States had access to the Internet in their homes.¹⁵ More recent statistics indicate that 95% of the households that own mutual funds have Internet access.¹⁶ We believe that investment advisory clients generally are as sophisticated as mutual fund owners, if not more so. Indeed, in the Proposal, the Commission references the benefits of public access to brochures posted on the IARD.¹⁷ During the open meeting, Chairman Cox noted that a brochure filed electronically with the Commission would be available to the public via the Internet twenty-four hours a day. He also stated that the Proposal is “a further step by the Commission to harness the benefits of information technology.”¹⁸ Adoption of an access-equals-delivery model for brochure delivery, so that posting a brochure on the IARD would constitute delivery to clients, would provide clients with easy access to the brochures while simplifying and clarifying the electronic delivery requirements for investment advisers.

b. The Commission Should Issue Electronic Delivery Guidance

In the Proposal, the SEC confirms that brochures and brochure supplements may be delivered electronically.¹⁹ The proposed instructions, however, reference interpretive

¹⁴ See *Securities Offering Reform*, Rel. Nos. 33-8591; 34-52056; IC-26993; File No. S7-38-04 (July 19, 2005), available at <http://www.sec.gov/rules/final/33-8591.pdf>, and *Internet Availability of Proxy Materials*, Rel. Nos. 34-55146; IC-27671; File No. S7-10-05 (Jan. 22, 2007), available at <http://www.sec.gov/rules/final/2007/34-55146.pdf> (“Proxy Release”). See also Summary Prospectus Proposal *supra* n.7.

¹⁵ See Proxy Release at 8.

¹⁶ *Investor Views of U.S. Securities and Exchange Commission’s Proposed Summary Prospectus*, ICI Report (Mar. 14, 2008) at 18. According to the Report, ninety percent of the investors surveyed “agree or strongly agree with the statement that ‘getting investment information online is the wave of the future’”. *Id.* at 19. See also *2007 ICI Fact Book* (indicating that more than nine in ten households owning mutual funds have Internet access).

¹⁷ In the Proposal, the Commission states, “By requiring advisers to file their brochures (and any amendments) with the Commission electronically using IARD, the proposal would make full use of existing and new information technologies to aid the Commission staff in its oversight efforts and provide ready public access to advisers’ brochures.” Proposal at 105. (Emphasis added)

¹⁸ See Open Meeting *supra* n.5.

¹⁹ See Proposed Instruction 3 to Part 2A and Proposed Instruction 5 to Part 2B.

guidance on electronic delivery from 1996.²⁰ We respectfully request that the SEC issue electronic delivery guidance in conjunction with the revisions to Form ADV. Updated guidance is long overdue considering that twelve years have passed since the SEC last issued interpretive guidance. The widespread Internet usage and computer access that exist today were not even contemplated twelve years ago and thus the guidance issued in 1996 has limited relevance today. Indeed, many advisers have been reluctant to electronically deliver documents due to lack of clarity regarding the notice, access, and consent requirements, even though it would be much more efficient and cost-effective for those advisers to do so.

c. At a Minimum, The Commission Should Clarify The Electronic Delivery Instructions

At a minimum, the Commission should provide additional information with the electronic delivery instructions in Part 2 to assist advisers in achieving the economic, efficiency, and environmental benefits of electronic delivery options. For example, the Commission should clarify that the consent aspects of the 1996 Interpretive Guidance are still valid after the Electronic Signatures in Global and National Commerce (E-SIGN) Act was enacted by Congress in 2000. Specifically, the Commission should confirm that advisers can obtain consent to delivery electronically and that advisers can deliver brochures or brochure supplements electronically in PDF format or by providing a link to the document. In addition, the Commission should clarify that negative consent or consent implied through course of business would be acceptable forms of consent. For example, consent to electronic delivery should be implied from a client's use of electronic communication with his or her adviser via e-mail or the adviser's web site.²¹ Clarifying the consent requirements, as a preliminary matter, would better enable investment advisers and their clients to utilize the benefits of electronic delivery. We would be pleased to work with the Commission on the proposed clarifications.

²⁰ See *Use of Electronic Media by Broker-Dealers, Transfer Agents, and Investment Advisers for Delivery of Information*, Investment Advisers Act Rel. No. 1562 (May 9, 1996) (publishing Commission interpretive guidance with respect to use of electronic media to fulfill investment advisers' disclosure delivery obligations) ("1996 Interpretive Guidance").

²¹ Electronic communication is the typical course of communication for institutional clients, for example.

Ms. Nancy M. Morris

May 16, 2008

Page 11

Conclusion

We commend the Commission for re-issuing this important proposal and we urge the Commission to act promptly to implement the Proposal, with the modifications suggested herein. We would appreciate the opportunity to meet with the Commission to discuss our comments. In the meantime, please do not hesitate to contact us if we may provide additional information or clarification to the Commission or its staff regarding these matters.

Sincerely,

/s/ Karen L. Barr

Karen L. Barr
General Counsel

/s/ Valerie Baruch

Valerie Baruch
Assistant General Counsel

Cc: The Honorable Christopher Cox
The Honorable Paul S. Atkins
The Honorable Kathleen L. Casey

Appendix

Specific Comments on Part 2A

Item 1 Cover Page

- B and C. The Commission could eliminate much of the cover page disclosures that provide information about the brochure and an investment adviser's SEC registration. The required language seems more suited for a mutual fund prospectus than for an investment adviser brochure.

- B. The SEC should eliminate the requirement to reference a specific contact person or service center. For a number of advisory firms, it is difficult to select a single contact that would be applicable to all clients that receive the brochure; many firms have different client management or relationship teams for various clients or types of clients. In addition, firms with a global business may have different contact persons or teams for different countries. Except for the largest advisers, most firms do not have a service center. The proposed disclosure could cause confusion among clients who are dealing personally with a specific person or client management team at the adviser.

- C. The Proposal discusses the need for advisers to disclose that registration does not imply a certain level of skill or training when an adviser "holds itself out" as registered in "marketing" materials. The actual form, however, imposes the disclosure when a firm "refer(s)" to itself as "registered." Many clients require a representation in the contract that the adviser is registered and such statement is often a standard part of advisory contracts. Under the proposed instruction, most advisers would have to make this boilerplate disclosure even though they are not using registration as a marketing point.

Item 2 Material Changes

- We commend the SEC for providing advisers with the flexibility to provide the summary of material changes to existing clients in a separate document.

- The Commission should clarify what it considers to be a "material change." We suggest that "material changes" be defined as changes that would significantly affect a reasonable client's decision to hire an adviser or a client's decision to retain its adviser.

Item 4 Advisory Business

- A. The Commission could eliminate the disclosure regarding firm ownership. This information already is provided in response to Part 1A of Form ADV and does not need to be repeated in the brochure.
- B. The Commission should clarify the disclosure required for advisers “holding [themselves] out as specializing in a particular type of advisory service.” It is not clear what the Commission means by “specialized” services. The Commission also should clarify what it means to “provide investment advice only with respect to limited types of investments.”
- E. We continue to believe that the Commission should require all firms to use the same date and method of calculating assets under management as set forth in Item 5.F. in Part 1A. Different standards create inconsistencies that will result in confusion for clients. Such inconsistency easily could be eliminated, particularly if the SEC expects only a very small percentage of investors to use the different methodology.

Item 5 Fees and Compensation

- The Commission should consider providing flexibility regarding the fee schedule requirement under certain circumstances, as long as the fee is fully disclosed in the investment advisory contract. In the institutional marketplace, for example, clients typically hire an adviser for a particular style or asset class and are interested only in that fee. Even then, the fee is often subject to negotiation. In such circumstances, the complete fee schedules are not relevant for those clients. We understand that for larger firms, inclusion of an entire set of fee schedules may add up to twenty pages to their current Part II. Although advisers are permitted under the proposal to prepare multiple firm brochures, it may not be feasible for many firms to do so.

Item 6 Performance Fees and Side-by-Side Management

- The Commission should not include a separate item in the brochure regarding performance fee disclosure. Firms already would be required to disclose performance fee information in response to Item 5 and in contracts with clients. While we agree that conflicts related to performance fees should be disclosed, we are concerned that including this disclosure as a specific Part 2A requirement places undue emphasis on performance fees and side-by-side management relative to other potential conflicts of interest.
- The Commission should clarify the circumstances under which supervised persons would accept performance fees. Typically, the firm would receive the performance fees, not the supervised person individually.

Item 8 Method of Analysis, Investment Strategies and Risk of Loss

- A. The Commission should not require advisers to state that investing in securities involves risk of loss that clients should be prepared to bear. This mutual fund prospectus-like disclosure seems out of place in a brochure discussing advisory services.
- B. The Proposal notes that multi-strategy advisers must already disclose the risks associated with the strategies they recommend to clients and that requiring advisers to list the risks involved in each type of security or trading strategy would lengthen the brochure unnecessarily. We commend the Commission's approach with respect to multi-strategy advisers and suggest that the Commission adopt the same approach with respect to all advisers. In addition, the scope of the terms "primary strategy" and "particular method of analysis or strategy" is not clear. For example, an adviser may focus on a particular sector across many different markets with significant risk disparity, but could still potentially be considered to be an adviser that focuses on a "primary strategy." The SEC should consider providing some examples to clarify the scope of this item.
- B. Although we appreciate the potential limitations of defining the term "frequent trading of securities," it remains unclear what the SEC intends to cover with this required disclosure. As noted previously, this term could be defined to mean day-trading, short-term trading (within 90 days), turnover of more than 100% per year, etc. The term "frequent" is also relative to the type of client and the security traded.
- C. It is not clear what the Commission means for an adviser to "recommend primarily a particular type of security." If a "particular type of security" is equity securities or debt securities, for example, then many advisers would include broad and general risk disclosure in their brochures, which does not appear to be the Commission's intent. If this item is not eliminated or more specifically circumscribed, advisers may feel compelled to describe the risks for various types of securities in which they could invest, resulting in a lengthy prospectus-like disclosure that clients will not read.
- D. We continue to recommend the elimination of the cash balance requirement. Practices regarding cash balances in client accounts do not belong in the brochure. Cash balances are invested pursuant to an adviser's fiduciary duty to his or her clients. Practices regarding cash balances typically are addressed in advisory agreements and such practices do not involve conflicts of interest. Such practices are client-specific and vary significantly depending on the types of client accounts. This disclosure is unnecessary and likely to be so general that it would not be helpful to clients.

Item 9 Disciplinary Information

- We commend the Commission’s decision to continue to exclude disclosure of arbitration awards or claims for the reasons stated in our June 2000 Letter. We also appreciate the Commission’s flexibility in allowing advisers to overcome the presumption of materiality.
- The Commission should clarify or narrow the definition of “involved.” As currently drafted, the definition is very broad and vague with respect to management persons. The Commission should clarify that disclosure is required only if there is a formal final or pending action against the management person.

Item 10 Other Financial Industry Activities and Affiliations

- C. The Commission should clarify what a “material” relationship or arrangement and a “material conflict of interest” mean. We suggest that the Commission define “material conflict of interest” as a conflict that would significantly affect a reasonable client’s decision to hire an adviser or a client’s decision to retain its adviser. At a minimum, it would be helpful for the Commission to provide examples in the adopting release of what it considers to be “material.”
- C. The Commission should not require advisers to disclose relationships with accountants or lawyers. Requiring disclosure regarding accountants or lawyers (as opposed to their firms) could cover in-house relationships, which are not relevant to clients. At a minimum, the Commission should clarify that material relationships do not include related persons in their capacity as employees.

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

- The Commission should eliminate the proposed requirement to disclose “procedures for disclosing conflicts to clients.” The disclosure is somewhat confusing because typically the brochure itself is the procedure for disclosing conflicts to clients. We commend the Commission for generally taking the approach in the Proposal of requiring advisers to describe the nature of the conflicts they face and how they address such conflicts. We believe the Commission should consistently follow that approach in this item as well. As long as the conflicts are disclosed, advisers should not need to disclose the procedures for disclosing those conflicts.

Item 12 Brokerage Practices

- A. Although the SEC states that it does not intend to create a negative impression regarding soft dollar arrangements, the disclosure required, when viewed as a whole, does create a negative impression, even when an adviser is adhering to the guidelines set forth by the SEC.¹ For example, the disclosure regarding whether the adviser seeks to allocate soft dollar benefits to client accounts proportionately to the soft dollar credits those accounts generate may erroneously imply that the adviser should be allocating benefits proportionately.
- A. The Commission should eliminate the requirement for advisers to “explain the procedures you used during your last fiscal year to direct client transactions to a particular broker-dealer in return for the soft dollar benefits you received” and “in return for client referrals.” We commend the Commission for generally taking the approach in the Proposal of requiring advisers to describe the nature of the conflicts they face and how they address such conflicts. We believe the Commission should consistently follow that approach in this item as well. Firms should have the flexibility to describe how they address the conflicts raised by directing brokerage in return for referrals or soft dollar benefits rather than providing a mandated description of policies and procedures. As the Commission recognized in the Proposal, a detailed description of procedures may unnecessarily lengthen the brochure without enabling clients to understand how advisers address conflicts.²
- B. The Commission should not require advisers to explain why orders are not always bunched or the costs to clients of not bunching. Such disclosure suggests that advisers should always bunch orders when there is an opportunity to do so. Advisers, however, may decide that under certain circumstances (for example with respect to multiple high volume trades with a large market impact) bunching trades would not be in clients’ best interests. Such disclosure may be confusing to clients and leave a misleading impression.

Item 15 Custody

- B. The Commission should clarify the inconsistency between Item 9 of Part 1A of Form ADV and this item. If an adviser deducts advisory fees directly from client accounts but does not otherwise have custody of client funds or securities, it may answer “no” to Item 9A.(1) and 9A.(2). Similarly, the Commission should add a note to this item clarifying that an adviser should not respond to this item if the only reason it has custody is because it deducts fees.

¹ See *Commission Guidance Regarding Client Commission Practices Under Section 28(e) of the Securities Exchange Act*, Rel. No. 34-54165 (July 18, 2006). In addition, in that guidance the Commission referred to “client commission practices or arrangements” “to avoid confusion that may arise over the usage of the phrase ‘soft dollars.’” The Commission, however, continues to use the term “soft dollars” in the Proposal.

² See Proposal at 10.

Item 16 Investment Discretion

- The Commission should not require advisers to provide separate disclosure regarding discretionary authority. Such disclosure is duplicative because advisers already describe their discretionary authority not only in client contracts but also in response to Item 4B regarding advisory services offered. Further, advisers will be required to disclose the amount of assets they manage on a discretionary basis in response to Item 4E. In addition, whether clients may impose such restrictions is already addressed in response to Item 4C. Moreover, it is not clear what the Commission means by “any limitations clients may (or customarily do) place on this authority.” Most investment advisers have discretion to manage client accounts subject to limitations that are imposed contractually by clients, or that are imposed legally (e.g., by states or municipalities). Because there are countless limitations that clients “may” place on an adviser’s discretionary authority, such disclosure would not be meaningful.

Item 17 Voting Client Securities

- B. The Commission should eliminate the proposed disclosure regarding third-party proxy voting services. In accordance with the proxy voting rule, advisers already provide a description of their proxy voting policies and procedures and an explanation of how clients may obtain information about those policies and procedures. We support these requirements. We do not believe, however, that a list of third-party proxy voting services and a description of how they are selected would provide important information to clients. The item may also play undue emphasis on proxy voting service providers relative to other types of service providers.
- B. The Commission also should not require advisers to disclose whether they pay for proxy voting services with soft dollars. Such disclosure is redundant, since Item 12 asks for disclosure and discussion of “all soft dollar benefits you receive.” Similarly, in the unusual event that an adviser passes on the cost of proxy voting services to the client through a supplemental fee, that fee would be disclosed under Item 5.

Item 19 Index

- The index required is duplicative of the table of contents. In addition, the requirement for advisers that omit an item from the brochure to note that fact and the reason it is not included in the index runs counter to the SEC’s approach of requiring advisers to only include disclosure that is applicable to them. We therefore strongly suggest the elimination of the index. In the alternative, given that the purpose of the index is “to facilitate review by [SEC] staff for compliance with the requirements of Part 2A,” we suggest that the index should be maintained separately from the brochure, for Commission review, and not filed publicly.

Specific Comments on Part 2B

Item 3 Disciplinary Information

- We appreciate that the SEC limited the disclosure required regarding suspension or revocation proceedings for professional designations or licenses. We seek clarification, however, regarding the SEC’s definition of “a violation of rules relating to professional conduct.”
- The Commission should not require an adviser to disclose whether a supervised person resigned or relinquished his or her designation or license in anticipation of suspension or revocation proceedings. An adviser would not be in a position to know or assess an employee’s intention or state of mind when that employee resigns or relinquishes a designation or license.

Item 4 Other Business Activities

- A. We appreciate the Commission’s clarification with respect to “investment-related” businesses or occupations.
- B. The Commission should not require an adviser to disclose business activities that provide a substantial source of the supervised person’s income or that involve a substantial amount of the supervised person’s time. The time that a supervised person spends in other business activities is not relevant to his or her competence as an adviser. Likewise, the amount of money that a supervised person makes in another business or occupation is irrelevant to his or her competence as an adviser.

Item 6 Supervision

- The Commission should eliminate the disclosure regarding supervision of the supervised person. This disclosure does not make sense, particularly for small firms in which the person providing the investment advice is a principal of the firm. For larger firms, clients assume that the supervised person’s advice is being monitored and are not likely to be interested in the details regarding supervision.

Instruction 3 to Part 2B: Supplement Delivery

- We commend the SEC for making the brochure supplement delivery requirements more reasonable. We recommend, however, that the SEC further modify the delivery requirement to allow for a transition period if a new supervised person begins to provide advisory services to a client. The instruction provides that an adviser “must deliver the supplement for the supervised person before or at the time that supervised person begins to provide advisory services to a client.” We respectfully suggest that the Commission modify the instruction to provide for a reasonable transition period for a newly identified supervised person providing services to a client with an ongoing relationship with the firm.

- Similarly, some firms have large investment teams for certain strategies to which supervised persons are added periodically. The members of these teams may have direct client contact, thereby requiring delivery of supplements or a group of supplements to clients. For accounts managed by teams, information about added team members is less important than for accounts managed by one supervised person. The Commission should consider an alternative approach to delivery of brochure supplements to existing clients where a supervised person is added to the client's investment team. We would be pleased to work with the Commission on potential approaches to these issues.
- The Commission should revise the instruction, "You may have a supervised person deliver supplements (including his own) on your behalf" to state, "You may have a supervised person deliver supplements (including his own)." Including an instruction that a supervised person would deliver supplements on an adviser's behalf is confusing because an advisory firm acts through its employees. Similarly, the instructions should clarify that a brochure supplement could be delivered to wrap fee clients by the wrap program sponsor.