

Proposed Amendments to Part 2 of Form ADV

Item 1: *Cover Page*

Adviser must provide the following on the cover page:

- Name of firm
- Business address and telephone number
- Name and number of a person or service center for client and prospective client to contact for further information
- Web site address if available
- Date of brochure
- A statement that the brochure has not been approved by the SEC or any state securities authority

Item 2: *Material Changes*

- Adviser must provide clients with a summary of any material changes to brochure since the last update
- This update must be on the cover page or the page immediately after it
- Advisers are not required to provide this information to a prospective client or a client who did not previously receive a brochure
- Adviser is not required to file this information with the SEC

Item 3: *Table of Contents*

- Advisers must provide a table of content in their brochures
- Table of content must be detailed enough for clients and prospective clients to locate topics easily

Item 4: *Advisory Business*

Advisers are required to:

- Describe the type of advisory services offered
- State whether it is a specialized type of advisory service
- Disclose specific risks if a specialized advisory service poses those risks
- State the amount of clients' assets under management

Advisers are permitted to choose a different method, other than the method used in Part 1 of Form ADV, to calculate assets under management. However, advisers must keep records describing the method used.

The following two revisions were made to this item in the proposal:

- The SEC is not requiring advisers to list all wrap fee programs they participate in
- Elimination of proposed requirement to list and describe all periodicals and periodic reports that advisers issue about securities

Item 5: *Fees and Compensation*

Adviser is required to:

- Describe how it is compensated for providing advisory services
- Describe the types of other costs such as brokerage, custody fees, and fund expenses
- Disclose fee schedule and whether fees are negotiable

- ❑ Discuss whether the adviser bills clients or deducts fees directly from the client's account
- ❑ Explain how often fees are assessed
- ❑ Explain how it calculates and refunds prepaid fees when a client contract terminates if adviser charges fees in advance
- ❑ Disclose if compensation is attributable to a sale of a security or other investment product, whether there are any conflicts of interest and how those are conflicts are addressed
- ❑ Disclose to clients that they may purchase securities or investment products from brokers that are not affiliated with the adviser
- ❑ If adviser receives more than half of its revenue from commissions and other sales based compensation, adviser would be required to explain that commissions are the firm's primary (or, if applicable, exclusive) form of compensation

The SEC stated that, “[they] are not proposing the requirement that advisers must disclose the amount or range of mutual fund fees or other third-party fees that clients may pay.”

Item 6: *Performance Fees and Side-By-Side Management*

- ❑ Disclose whether adviser charges performance fees or supervises a person who manages an account that charges performance fees
- ❑ Disclose whether adviser manages a non performance fee account side-by-side a performance based fee account and discuss any conflicts that may arise

Item 7: *Types of Clients*

- ❑ Describe the type of advisory clients the firm generally has
- ❑ Describe the firm's requirements for opening or maintaining an account, such as minimum size

Item 8: *Methods of Analysis, Investment Strategies and Risk of Loss*

- ❑ Describe the method of analysis of investment strategies
- ❑ Discuss the risk clients face in following adviser's advice or permitting adviser to manage assets
- ❑ Adviser may simply state that investing in securities involve risk if a variety of strategies are employed by adviser
- ❑ Advisers utilizing multiple strategies would be free to disclose the risks associated with each strategy to those clients to whom such disclosure is relevant
- ❑ Adviser must explain specific material risks involved with investing in detail if a particular method is used or particular type of security is invested in
- ❑ Disclose how strategies involving frequent trading can affect investment performance
- ❑ Discuss practices regarding cash balances in client accounts with respect to situations in which client has not provided specific directions for handling those balances

Item 9: *Disciplinary Information*

- ❑ Disclose in writing any material facts about any legal or disciplinary events that are material for a clients evaluation or adviser
- ❑ The list of presumptive material disciplinary events includes:
 - Any convictions of theft
 - Bribery
 - Forgery
 - Violations of securities laws by the adviser or one of its executives
- ❑ The SEC is asking for comment on additional event to be added and is considering expanding the list to include events such as:
 - Cease and desist order entered against adviser or management person
 - Censure order entered against adviser or management person
 - Arbitration awards, claims and settlements above a specified amount, such as \$10,000
- ❑ Adviser would be permitted to rebut any presumptive material events. If successful, disclosure to clients would not be required
- ❑ The commission had rescinded its proposed requirement that advisers subject to a commission administrative order must provide clients with a copy of the order
- ❑ Four factors advisers should consider when assessing whether presumption can be rebutted are:
 - The proximity of the person involved in the disciplinary event to the advisory function
 - The nature of the infraction that led to the disciplinary event
 - The severity of the disciplinary sanction
 - The time elapsed since the date of the disciplinary event
- ❑ The SEC requires adviser to document and retain records of rebutting a presumption of materiality of disciplinary event
- ❑ The SEC will rescind its Rule 206(4)-4 w, which requires advisers to disclose disciplinary information to clients, if this proposal is adopted
- ❑ For advisers who may have clients to whom they are not required to deliver a brochure, they would be required to continue to disclose to all their clients any disciplinary or legal event as required by Rule 206(4)-4

Item 10: *Other Financial Industry Activities and Affiliations*

- ❑ Describe material relationships or arrangements with a financial industry participant
- ❑ Describe any material conflict of interest the relationship may create and how the conflicts are addressed
- ❑ Disclose any compensation arrangement or business relationship between adviser and other advisers that adviser recommends or select for clients

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

Code of Ethics

- ❑ Describe code of ethics briefly and state that a copy is available upon request

Participation or Interest in Client Transactions

- ❑ Discuss the practice and conflict of interest if adviser or related person recommends buys or sells to clients securities in which adviser or related person has material financial interest
- ❑ An adviser's related person includes:
 - The adviser's officers, partners, or directors (or any person performing similar functions)
 - All persons directly or indirectly controlling, controlled by, or under common control with the adviser
 - All of the adviser's current employees
 - Any person providing investment advice on the adviser's behalf

Personal Trading

- ❑ Disclose whether an adviser or a related person invests for its account in the same security it recommends to its clients or related securities such as options or other derivatives
- ❑ Describe conflict of interest this investment may present and how conflict is addressed
- ❑ Discuss the specific conflicts an adviser has when it or a related person trades in the same securities at or about the same time as a client
- ❑ Adviser may explain how its internal control, including its code of ethics, prevents the firm and its staff from buying or selling securities at the same time as clients

Item 12: *Brokerage Practices*

The proposal specifically mentions: Soft Dollar Practices, Commission Recapture, Broker Referrals and Directed Brokerage. The proposal requires that advisers:

- ❑ Describe how they select brokers for client transactions
- ❑ Describe how they determine the reasonableness of brokers' compensation
- ❑ Disclose how they address conflicts arising from their receipt of soft dollars

The SEC is omitting the proposed requirement that advisers disclose whether they negotiate commissions because they have determined it is not a common practice

Soft Dollar Practices

The SEC noted that “[their] intent is not to create a negative impression regarding soft dollars arrangements, but rather to require full disclosure of arrangements that [They] believe involve significant conflicts of interest”.

The SEC stated that the:

- ❑ Description of soft dollar practices be specific enough for clients and prospective clients to understand the types of products or services the adviser is acquiring and permit them to evaluate conflicts.
- ❑ Disclosure must be more detailed for products or services that do not qualify for the safe harbor under section 28(e) of the Exchange Act.

The proposal requires that advisers:

- ❑ Describe the types of conflicts it has when it accepts soft dollar benefits and to disclose how it addresses those conflicts.
- ❑ Explain whether it uses soft dollars to benefit all client accounts or only those accounts whose brokerage “pays” for the benefits.
- ❑ Explain whether adviser seeks to allocate benefits proportionately to accounts that generate the soft dollar benefits.
- ❑ Explain whether adviser pays more than the lowest available commission rate in exchange for soft dollar products or services.

Commission Recapture

The SEC stated that “[they] have omitted the proposed requirement that advisers disclose whether they participate in commission recapture programs. [They] understand that these programs are not typically sponsored or promoted by advisers, but are more likely driven by client demands.”

Directed Brokerage Programs

The proposal requires advisers that permit directed brokerage to:

- ❑ Explain to clients the consequences of directing brokerage, including the possibility that their accounts will pay higher commissions and receive less favorable execution.
- ❑ Explain that the adviser may be unable to obtain best execution, and that directing brokerage may cost clients more money.

Broker Referrals

The proposal requires that advisers:

- ❑ Disclose whether client commissions are used to reward brokers for client referrals and any conflicts that it may create.
- ❑ Disclose the procedures the adviser used to direct client brokerage to referring brokers during the last fiscal year.

Item 13: *Review of Accounts*

- ❑ Disclose whether client accounts are reviewed
- ❑ Disclose how often account is reviewed
- ❑ Disclose who reviews accounts
- ❑ If account is not reviewed regularly, explain what circumstances trigger account review

Item 14: *Payment for Client Referrals*

- ❑ Describe any cash or other payment that it or a related person makes for client referrals
- ❑ Disclose whether adviser receives any benefits, including sales awards or prizes, from a non-client for providing advisory services to clients

Item 15: *Custody*

- ❑ An adviser who has custody over a client account located with a custodian will only have to explain to clients that they will receive account statements from custodian and should review the statements carefully
- ❑ If a client does not receive account statements from one or more qualified custodian, the adviser would be required to disclose that it has custody and to explain the risks clients will face as a result

Item 16: *Investment Discretion*

- ❑ Disclose whether adviser has discretionary authority over client accounts
- ❑ Disclose any limitations client may place on authority

Item 17: *Voting Client Securities*

- ❑ Disclose if adviser would accept client's authority to vote securities
- ❑ Describe proxy voting policies briefly
- ❑ Describe whether clients can direct the advisers to vote a particular solicitation
- ❑ Describe how adviser addresses conflicts of interest when it votes securities
- ❑ Describe how clients can obtain information from adviser on how the adviser voted
- ❑ Explain that clients may obtain a copy of the adviser's proxy voting policies and procedure upon request
- ❑ Disclose how clients may receive their proxies and other solicitations if adviser does not have the authority to vote securities
- ❑ Disclose third-party proxy voting service adviser routinely uses
- ❑ Describe how a third-party proxy voting service is selected
- ❑ Disclose whether these adviser permits clients to direct the use of a particular proxy voting service with respect to securities held in client's account
- ❑ If a client directs adviser to use a particular proxy voting service, adviser need not disclose unless adviser uses same service for other clients.
- ❑ Describe how the adviser pays for proxy voting services

Item 18: *Financial Information*

- ❑ Advisers that require or solicit prepayments of more than \$1,200 in fees per client and six or more months in advance must provide clients with current audited balance sheet
- ❑ Adviser must disclose any financial condition reasonably likely to impair the adviser's ability to meet contractual commitment if adviser:
 - Has discretionary authority over client assets or
 - Has custody of client funds or securities or
 - Requires or solicits prepayments of more than \$1,200 in fees per client and six or more months in advance
- ❑ Disclose to clients if adviser that has been the subject of bankruptcy during the past ten years

Item 19: Index

- Brochures filed with the SEC would be required to include an index of the items required by part 2A indicating where in the brochure the adviser addresses each item
- Adviser is not required to provide the index to clients

Appendix 1: The Wrap Fee Program Brochure

- Advisers that sponsor wrap fee programs would be required to prepare a separate specialized “wrap program brochure” for clients of the wrap fee program
- Adviser must disclose if any of its related persons are portfolio managers in the program
- Describe any conflicts of interest that may be present with affiliated portfolio managers
- Disclose whether related portfolio managers are subject to the same selection and review as the other portfolio managers who participate in the wrap fee program
- Describe the process for selecting and reviewing non-affiliated portfolio managers if the process is different from selecting affiliated portfolio managers

Delivery and Updating of Brochures

- Advisers must deliver a current firm brochure before or at the time it enters into an advisory contract with the client
- Advisers must deliver current brochure to existing clients at least once a year, no later than 120 days after the end of adviser’s fiscal year
- Advisers are not required to deliver brochures to clients receiving only impersonal investment advice for which adviser charges less than \$500 per year
- Adviser must deliver an interim update to clients only when the adviser amends its brochure to add a disciplinary event, or to materially change information already disclosed, in response to Item 9 of Part 2A
- Advisers must keep the brochures they file with the SEC current by updating them at least annually, and updating them promptly when any information in the brochures becomes materially inaccurate.