

## SEC Amends Form ADV

The Securities and Exchange Commission (SEC) amended Part 2 of Form ADV, which is the form that investment advisers use to register with the SEC and state securities authorities, and related rules under the Investment Advisers Act of 1940 (the Advisers Act), on July 21, 2010. Form ADV consists of two parts, Part 1 and Part 2. Part 1 provides information to the SEC and other regulators for administrative purposes. Part 2, commonly referred to as the “brochure,” provides information to clients for disclosure purposes.

Part 2 was previously organized in a “check-the-box” format, which required advisers to respond to a series of multiple-choice and fill-in-the-blank questions. In early 2008, the SEC proposed replacing the “check-the-box” format with a plain English, narrative brochure describing the adviser’s business, conflicts of interest and background of the advisers and their personnel.

### Form and Content

The amended Part 2 consists of two sections, Part 2A, the firm brochure, and Part 2B, the brochure supplement.

#### *Part 2A: The Firm Brochure*

New Part 2A requires a narrative brochure written in plain English. It consists of 18 separate disclosure items that describe the adviser’s services, fees, business practices and conflicts of interest. An adviser must respond to each item in the brochure and must present the information in the order of the items in the form, using the headings provided by the form, although a summary at the beginning of the brochure is permissible. The detailed disclosure requirements with respect to conflicts of interest are among the more significant aspects of the amendments. Highlights of the amended brochure with respect to conflicts of interest disclosure include:

- > **Soft Dollars.** Advisers are required to detail the benefits obtained and the conflicts that arise from using soft dollars.
- > **Side-by-Side Management.** Firms should consider the conflicts created by simultaneous long/short positions, allocation and aggregation of trades and investment opportunities and performance fees. Firms must disclose the conflicts that may arise in these situations and describe generally how the adviser addresses those conflicts.

- > **Compensation.** Advisers must disclose potential conflicts arising from an adviser's receipt of compensation from issuers of financial products the adviser recommends to its clients.
- > **Client Proxies.** Advisers must disclose potential conflicts of interest related to voting of client proxies.
- > **Participation in Client Transactions.** The brochure must disclose conflicts related to participation by an adviser in client transactions – such as when an adviser has a material financial interest in a transaction in which the client is also participating.
- > **Personal Trading.** The form also requires more detailed disclosures with respect to conflicts presented by personal trading by advisory personnel. The disclosure should include whether advisory personnel are permitted to invest in the same or related securities the adviser recommends to clients and, if so, whether they may invest at or about the same time as the client.
- > **Wrap Fee Programs.** Any adviser who sponsors wrap fee programs must continue to prepare a separate, specialized firm brochure for clients of the wrap fee program in lieu of its standard firm brochure. The items in Appendix 1 to Part 2A contain the requirements for a wrap fee program brochure and are substantially similar to those in current Schedule H, except that an adviser is also required to disclose conflicts of interest with respect to related-person portfolio managers.

#### *Part 2B: The Brochure Supplement*

New Part 2B requires disclosure of information about the advisory personnel on whom clients rely for investment advice. It consists of six items relating to the background, disciplinary record and qualifications of a "supervised person" (*i.e.*, officer, director, partner or employee). The SEC also eliminated Rule 206(4)-4, which required disclosure of certain disciplinary matters and was largely duplicative of the new ADV disclosure. A brochure supplement is generally required for each supervised person who (1) formulates investment advice for that client *and* has direct client contact or (2) makes discretionary investment decisions for that client's assets, even if the supervised person has no direct client contact.<sup>1</sup> An adviser may prepare one supplement for a group of supervised persons or for offices of the adviser, however. Additionally, an adviser is permitted to include the supplement information at the end of its brochure, rather than using a separate supplement.

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## Delivery and Filing

An adviser must provide Part 2A to both prospective and existing clients other than (1) clients who receive only impersonal advice and pay less than \$500 annually or (2) registered investment companies or business development companies.<sup>2</sup> Part 2A must

<sup>1</sup> If investment advice is provided by a team comprising more than five supervised persons, brochure supplements need only be provided for the five supervised persons with the most significant responsibility for the day-to-day advice provided to the client.

<sup>2</sup> Rule 204-3 under the Advisers Act, which governs the ADV delivery requirements, provides that a Form ADV must be delivered to "clients" of the adviser. In the SEC's rule release, it acknowledges that the Court of Appeals for the D.C. Circuit stated that the "client" of an adviser managing a private fund is the fund itself, not investors in the fund. Therefore, private fund managers should not be required to deliver a brochure or brochure supplements to private fund investors, although we note that such delivery is generally considered a "best practice."

be delivered to any prospective client before or at the time of entering into an advisory contract. For existing clients, delivery of Part 2A must be made within 120 days of the end of the adviser's fiscal year.<sup>3</sup> An adviser is only required to deliver an interim update to clients when it amends Part 2A to add or materially change disciplinary information. Additionally, an adviser must update Part 2A at least annually and promptly whenever any information becomes materially inaccurate.

An Adviser must provide applicable Part 2B supplements to both prospective and existing clients other than (1) clients to whom an adviser is not required to deliver a firm brochure, (2) clients who receive only impersonal investment advice, and (3) certain "qualified clients" who also are officers, directors, employees and other persons related to the adviser. The SEC had proposed exempting advisers from delivering the brochure supplement to certain "qualified purchasers" but chose not to because the supplement contains fundamental information about the qualifications of advisers, which sophisticated clients would likely request. Part 2B is not required to be delivered annually. Rather, an adviser is required to deliver Part 2B only on an interim basis to add or materially change disciplinary information or to correct materially inaccurate information.

An adviser is required to file Part 2A (and any amendments) electronically through the Investment Adviser Registration Depository (IARD), and the public can access these documents through the SEC's website. Part 2B is not required to be filed with the SEC, although advisers are required to maintain copies of all brochure supplements and amendments.

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## Compliance

Each registered investment adviser whose fiscal year ends on or after December 31, 2010, must comply with the new Part 2 requirements in its next annual updating amendment to its Form ADV. New applicants for registration after January 1, 2011, must comply with the new brochure requirements as part of the application for registration on Form ADV.

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<sup>3</sup> Advisers may either deliver (1) an updated brochure that includes, or is accompanied by, a summary of material changes, or (2) a summary of material changes that includes an offer to provide a copy of the updated brochure.

## Investment Management Group

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