

NEW REQUIREMENTS FOR ADV PART 2: DISCLOSING ADVISER INFORMATION IN A DIFFERENT WAY.

by

Geoffrey T. Chalmers, Esq. and Dalkis D. Muir, Esq.

The Securities and Exchange Commission on July 28, 2010 issued its Final Rule, adopting amendments to Form ADV, in particular, Form ADV Part II. This is now known as ADV Part 2, composed of Part 2A, Brochure, and Part 2B, Brochure Supplement. Each Part requires advisers to provide specific disclosures about their business and their personnel in the brochure to be delivered under SEC Rule 204-3 (the "Brochure Rule"). The Form imposes expanded disclosure requirements. To some it may appear unduly burdensome. Further information and the text of the Form can be found at <http://www.sec.gov/rules/final/2010/ia-3060.pdf>.

The good news is Regulatory Compliance can help you meet the new requirements of the Rule. And we can start by imparting some basic information to you that we believe you should know.

Important Dates

- October 12, 2010: The amended rules and forms become effective. Advisers may begin to use the forms on this date.
- January 1, 2011: All advisers seeking to register with the SEC after this date must file their Brochure on the Investment Adviser Registration Depository (IARD) system's website, <http://www.iard.com>, and comply with the Brochure and Brochure Supplement delivery requirements.
- March 31, 2011: The date by which all currently registered advisers, having a fiscal year end of December 31 (90 days), must file their Brochure and the required annual updating amendment of Form ADV at <http://www.iard.com>.
- May 31, 2011: The designated date for advisers to deliver the Brochure and the Brochure Supplement to existing clients.

For information concerning annual deliveries of the Brochure and Brochure Supplement see below under *Brochure Delivery* and *Brochure Supplement Delivery*.

Plain English. The Brochure must be written in narrative form and in “plain English.” In its A Plain English Handbook, the SEC explains that plain English means “analyzing and deciding what information investors need to make informed decisions, before words, sentences, or paragraphs are considered. A plain English document uses words economically and at a level the audience can understand. Its sentence structure is tight. Its tone is welcoming and direct. Its design is visually appealing. A plain English document is easy to read and looks like it’s meant to be read.” You may visit <http://www.sec.gov/pdf/handbook.pdf> for more information on how to create clearer disclosure documents.

The Brochure: Part 2A (Brochure) and Part 2B (Brochure Supplement). The Brochure is divided in two parts: Part 2A, Brochure and Part 2B, Brochure Supplement. Each Part provides distinct types of disclosures concerning the adviser.

Brochure. The required disclosures in the Brochure provide an insight into who the adviser is and how the adviser conducts its business. After reading the disclosures, prospective and existing clients should have a good understanding of the internal operations of the adviser, products and/or services offered, and most importantly, the disclosures should awaken the instincts of the prospective or existing client to reach a preliminary determination on the question: *Is this an adviser I can trust?*

It is important that an adviser presents itself well in its Brochure, especially because the disclosures are now presented in a more uniform fashion. This provides clients with an easier way to compare advisers. *Will they choose you?*

Part 2 ADV contains 18 questions that each adviser must address in its Brochure. The adviser must not change the sequence or paraphrase the questions. The adviser should answer “inapplicable” in response to questions that are outside the scope of the adviser’s business. The Adviser may cross-reference its response where there is disclosure overlap.

The questions pertain to the following areas of the advisory firm:

1. General Information
2. Material changes
3. Advisory business
4. Fees and compensation
5. Performance-based fees and “side-by-side” management
6. Types of clients
7. Methods of analysis, investment strategies and risk of loss
8. Disciplinary information
9. Other financial industry activities and affiliations
10. Code of ethics, participation or interest in client transactions and personal trading
11. Brokerage practices
12. Review of accounts

13. Client referrals and other compensation
14. Custody
15. Investment discretion
16. Voting client securities
17. Financial information
18. Requirements for state-registered advisers.

The new requirements also mandate a cover page and a disclaimer. The disclaimer warns prospective and existing clients that the “brochure has not been approved by the Securities and Exchange Commission or any state securities authority.” In addition, the adviser should include a statement that registration does not imply a certain level of skill or training if the adviser describes it self as a “registered investment adviser” or as being “registered.”

Keep Brochure Current. Advisers are required to act immediately to update disclosures in the Brochure that become materially inaccurate. All changes to the Brochure are to be made on the adviser’s own computer system. The adviser is then required to file the amended Brochure in PDF format on the IARD system.

SEC Review. The SEC does not formally review and approve Part 2A. Once it is filed it may be used. However, and particularly with “first time” filers, the SEC may issue a comment letter on the disclosures. In certain cases it may be advisable to obtain assurance from the SEC before use, in order to avoid embarrassment.

Brochure Delivery. New Clients: The adviser must make an initial delivery of its current Brochure before or at the time the client enters into the advisory contract with the adviser.

The Brochure delivery requirements do not apply to advisers whose clients are investment companies registered under the Investment Company Act of 1940, or who provide impersonal investment advice to clients at an annual fee of less than \$500.00.

Existing Clients. The adviser must provide annual delivery of the Brochure. Under the amendment the delivery must be made within 60 days from the March 31, 2010 date. Going forward, after this initial 60 days delivery period, for subsequent fiscal years advisers must deliver the Brochure to clients within 90 to 120 days following their fiscal year end. The adviser has a choice with respect to annual delivery. The adviser may deliver (a) a current copy of the Brochure and summary of material changes, or (b) a summary of material changes that includes an offer to provide a current copy of the Brochure. In its offer, the adviser must include a website address, telephone number, and an e-mail address for obtaining information about the adviser or its personnel on the IARD system. Advisers are authorized to deliver an annual Brochure electronically in accordance with requirements of Investment Advisers Act Release No. 1562, May 9, 1996, Use of Electronic Media for Delivery Purposes, <http://www.sec.gov/rules/final/33-7289.txt>.

Interim Brochure deliveries are required upon amendments to Item 9 of the Brochure to add or change material information regarding a disciplinary event, or amend material information previously disclosed. When such amends are made, the adviser is required to file a summary of material changes describing their interim amendments along with an updated Brochure. The summary must also accompany the annual amendment filing, and must be delivered to the clients.

Advisers are free to create their own Brochure provided the sequence and form of questions remain the same.

Advisers are required to file the Brochure and interim amendments thereto, and the required annual amendment of Form ADV, on the IARD system.

Brochure Supplement. Part 2B of Form ADV now requires that a Brochure Supplement be delivered to the client with respect to each “supervised person” who provides investment advice and interacts with the clients, or makes discretionary investment decisions with respect to the client’s assets.

Advisers are not required to file either the Brochure Supplement or the Brochure Supplement amendments on the IARD system. Advisers are, however, required to maintain copies of each.

The Brochure Supplement, like the Brochure, must have a cover page. The cover page must contain certain information such as name of adviser, name of supervised person, and notice to the client that the Brochure Supplement provides information about the supervised person. The adviser may prepare a Brochure Supplement for each supervised person or one Supplement for a group of supervised persons that provide the designated services. The adviser may also include the Part 2B Brochure Supplement disclosures in the Part 2A Brochure.

The required disclosure topics for each supervised person in a Brochure Supplement are as follows:

- a. Educational background and business experience
- b. Disciplinary information
- c. Other business activities
- d. Additional compensation
- e. Supervision

Brochure Supplement Delivery. Initial delivery of the Brochure Supplement to the client must be made at or before the time when the supervised person begins to provide advisory services to the client. Interim deliveries are promptly required when there is new disclosure of a disciplinary event, or a material change to disciplinary information already disclosed in the Brochure Supplement, Item 3. Advisers are not required to make annual delivery of the Brochure Supplement to existing clients. Electronic delivery of the Brochure Supplement is permitted, subject to the standards

provided for in the SEC's Use of Electronic Media for Delivery Purposes Release, a copy of which advisers may access at <http://www.sec.gov/rules/final/33-7289.txt>.

BrokerCheck or IPAD Systems: Advisers that make reference to the FINRA BrokerCheck or Investment Adviser Public Disclosure (IAPD) system in their Brochure Supplement with regard to disciplinary actions of supervised persons and that deliver Brochure Supplements electronically to clients must include hyperlinks to the disciplinary information in the BrokerCheck or IAPD system. The adviser is also required to make electronic delivery of updated Brochure Supplements to clients when the BrokerCheck or IAPD information concerning the supervised person has been updated. The updated Brochure Supplement must provide a hyperlink to the BrokerCheck or IAPD system.

Our Services. The adviser should consider using a deliberate process when preparing its Brochure. This means giving careful attention to each question and formulating a response that represents the way in which the adviser actually conducts its advisory business. Regulatory Compliance can help you with the deliberate process, but you must contact us today to ensure compliance with the new requirements on the effective date. We have an on-line question and answer system that allows you to generate a Brochure, which is accurate and complies with the new requirements of the Rule. Be ready! Make a plan now, while the holiday season, end of year requirements and tax season are still months away. Making time today will reduce your stress tomorrow.