

SEC AMENDS ADVISERS ACT REGISTRATION FORM

August 18, 2010

To Our Clients and Friends:

On July 28, 2010, the Securities and Exchange Commission (the “SEC”) adopted amendments (the “Amendments”) to Part 2 of Form ADV (“Part 2”), and to related rules under the Investment Advisers Act of 1940 (the “Advisers Act”), to require registered investment advisers to provide their clients and prospective clients with a narrative “brochure.”¹ The Amendments are of interest not only to investment advisers that are currently registered, but also those that will be required to register as a result of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

Form ADV is the Advisers Act registration form. Part 2 sets forth the requirements for a narrative “brochure” describing business practices, conflicts of interest and other matters relating to the investment adviser, that the investment adviser must provide to clients prior to entering into an advisory agreement and thereafter offer to clients on an annual basis. Part 2 also includes disclosure requirements for state-registered advisers, which are not addressed in this memorandum.

FORM ADV

Form ADV is divided into two parts. Part 1 of Form ADV, which provides regulators with information to process registrations and to manage their regulatory and examination programs, remains unchanged by the Amendments. Part 2 contains the requirements for the disclosure “brochure.” An adviser must update its Form ADV and deliver its updated brochure, or a summary of material changes to the “brochure” accompanied by an offer to deliver the full “brochure,” to its existing clients at least annually.

The Amendments not only change the format of Part 2, but highlight the importance that the SEC places on disclosures related to conflicts of interest. Prior to the Amendments, Part 2 had been in a largely check-the-box and fill-in-the-blank format, supplemented by a narrative elaborating on certain issues. The Amendments divide the revised Part 2 into two subparts: Part 2A contains 18 disclosure items that must be included in a narrative brochure. Part 2B, the “brochure supplement,” provides clients with information about the advisory

¹ *Amendments to Form ADV, SEC Rel. No. IA-3060 (July 28, 2010) (available at <http://sec.gov/rules/final.shtml>) (the “Adopting Release”).*

personnel on whom the client relies for investment advice. (The Appendix to this memorandum contains a brief summary of the disclosures required by Part 2.)

A MATTER OF STYLE

The Amendments are designed to result in a “plain English” brochure that will facilitate the ability of clients to understand the services provided by the adviser and compare the services offered by competing firms. Several format requirements are designed to achieve these objectives:

- **Plain English Narrative.** The brochure must be written in “plain English,” taking into account the client’s level of financial sophistication. The Form’s instructions advise that this means, among other things, that the brochure should (i) be concise and direct; (ii) use short sentences and the active voice; (iii) use “definite, concrete, everyday words” and avoid the use of “legal jargon” or highly technical legal terms; (iv) use tables or bullet lists for complex material, whenever possible; and (v) avoid multiple negatives.
- **Uniform Format.** The disclosures in the brochure must follow the order prescribed by the Form.
- **Summary of Material Changes.** Part 2 must now include a summary of the material changes that have been made to the brochure since the last annual update (the “Material Change Summary”). The Material Change Summary must be delivered to existing clients on an annual basis, along with an offer to provide the entire brochure upon request.
- **Tailored to the Client.** Investment advisers may create separate brochures for different types of advisory clients. That being said, an investment adviser must always comply with its duty of full and fair disclosure. Therefore, certain disclosure, such as information about material legal and disciplinary events, must be disclosed to all advisory clients.

A MATTER OF SUBSTANCE: CONFLICTS OF INTEREST DISCLOSURE

Part 2 is designed to elicit disclosures concerning conflicts of interest faced by the investment adviser in serving its clients. The SEC identified several areas where it views the potential for conflicts of interest to be particularly meaningful. Among the areas that require specific conflicts of interest disclosure are:

- **Referral Arrangements and Quid Pro Quos:** any arrangement under which the adviser or its related persons compensate, or receive compensation or any economic benefit

from, another person for client referrals or receive benefits from a non-client for providing advisory services to clients.

- **Brokerage Practices:** soft dollar arrangements (*i.e.*, arrangements where the adviser uses credits generated by client brokerage commissions to acquire research and other services) as well as arrangements where the adviser or its personnel receive compensation attributable to the sale of a security or other investment product that it recommends (*e.g.*, brokerage commissions).
- **Management Fee Differentials:** fee arrangements that may provide an adviser with an incentive to prefer one group of clients over another. The SEC is concerned about the risk that an adviser may direct the best investment opportunities to the accounts for which it receives a performance fee.
- **Personal Trading, Participation in Client Transactions and Proxy Voting:** personal trading activities of firm employees and participation in client transactions by the firm. Conflicts of interest may be present if firm personnel are permitted to invest in the same securities that the firm recommends to its clients. Conflicts may also be present if the adviser has a financial interest in the transactions it recommends to its clients or if it has the authority to vote client shares.

In each of the above instances, the adviser also must describe how it addresses the potential or existing conflicts.

In addition, an instruction to the Form reminds investment advisers that they are fiduciaries and must make full disclosure to clients “of all material facts relating to the advisory relationship” and “seek to avoid conflicts of interest with . . . clients, and, at a minimum, make full disclosure of all material conflicts of interest . . . that could affect the advisory relationship,” including disclosure concerning conflicts that is not specifically required by Part 2.

PUBLIC AVAILABILITY AND ISSUES FOR PRIVATE FUND SPONSORS

Part 2 is not currently filed with the SEC. As a result of the Amendments, advisers will be required to file Part 2 electronically with the SEC through the Investment Adviser Registration Depository system (“IARD”).

Commenters on the proposed amendments expressed concern that the public availability of the brochure would be viewed as a “general solicitation” that might jeopardize the reliance of private funds on the private offering exemption in the Securities Act of 1933 (the “Securities Act”). A similar concern was expressed as to whether public availability of the

brochure would be viewed as “directed selling efforts” in the United States, which would be inconsistent with the rules that provide a safe harbor for offshore transactions from the registration provisions in Section 5 of the Securities Act. The SEC attempted to put such concerns to rest in the Adopting Release, confirming that it believes registrants can provide information required by Part 2 without jeopardizing reliance on those exemptions. The SEC warned, however, that the inclusion of private fund information beyond that required by Part 2 (such as performance information or financial statements) could jeopardize such reliance.

The Amendments confirm that a private fund manager need not deliver its brochure or Material Change Summary to an investor in a private fund managed by the adviser unless the manager provides advisory services to the investor separate and apart from the private fund. Given the nature of certain of the disclosures, however, a private fund sponsor may want to consider incorporating the disclosures that appear in its brochure in its private placement memoranda or providing the brochure to fund investors.

FINANCIAL DISCLOSURE

Part 2A is also designed to elicit financial and fee information that may be relevant to an adviser’s clients, so as to enable clients to compare and contrast fees charged by various advisers. Under some circumstances, the adviser must provide an audited balance sheet. For example, if the adviser requires clients to prepay more than \$1,200 in fees per client six months or more in advance, the adviser must provide an audited balance sheet. This is intended to disclose any financial condition reasonably likely to impair the adviser’s ability to meet contractual commitments to clients. Private fund sponsors should review their management fee arrangements to determine whether they will trigger the audited balance sheet requirements.

THE BROCHURE SUPPLEMENT

The Part 2B brochure supplement is designed to elicit information pertaining to advisory personnel. The brochure supplement is to include information about the individuals who provide advisory services to the client, such as their educational background, business experience and disciplinary history. The brochure supplement must provide conflicts of interest disclosure with respect to the personnel providing advisory services to the client. A client must receive a brochure supplement for each supervised person who advises that client or makes discretionary investment decisions for that client’s assets.²

² *If investment advice is provided by a team of more than five supervised persons, Brochure Supplements should be provided for the five persons with the most significant responsibility for the day-to-day advice provided to the client.*

COMPLIANCE DATES

An investment adviser applying for registration with the SEC after January 1, 2011 must file a brochure that meets the requirements of the Amendments. An investment adviser registered with the SEC, whose fiscal year ends on or after December 31, 2010, must include a brochure that meets the requirements of the Amendments with its next annual updating amendment to its Form ADV.

While registered investment advisers will not be required to comply with the Amendments until 2011, they should begin preparations for compliant registration under the Advisers Act as soon as possible.

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Please feel free to contact us with any questions.

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APPENDIX

The following is a summary of the disclosure requirements of Part 2 of the amended Form ADV.

PART 2A: STANDARD BROCHURE DISCLOSURE

Item 1 – Cover Page. The cover page must include the date of the brochure and basic identifying information concerning the investment adviser. It must also state that the brochure has not been approved by the SEC or any state securities authority. If the adviser refers to itself as a “registered investment adviser,” it should include a disclaimer that registration does not imply a certain level of training.

Item 2 – Material Changes. This section is a summary of the material changes since the last annual update of the brochure.

Item 3 – Table of Contents. A reasonably detailed table of contents is required.

Item 4 – Advisory Business. The adviser must describe its advisory business, including the types of advisory services it offers, whether it holds itself out as specializing in a particular type of advisory service, and the amount of client assets that it manages. The item also requires that the firm’s principal owners be identified.

Item 5 – Fees and Compensation. The adviser must describe how it is compensated. If the adviser has a fee schedule, it must be disclosed, along with a statement whether fees are or are not negotiable. The disclosure must also include a summary of the types of costs (*e.g.*, brokerage commissions and custody fees) that clients may pay in connection with the advisory services provided to them by the adviser.³ As noted above, the brochure must also disclose arrangements under which the firm or its personnel receive other types of compensation (*e.g.*, brokerage commissions) and the related conflicts of interest that arise from such arrangements.

Item 6 – Performance-Based Fees and Side-By-Side Management. This item requires disclosure of performance fee arrangements and, as discussed above, disclosure of related conflicts of interest.

Item 7 – Types of Clients. This item requires a summary of the types of clients the adviser has and the requirements for opening an account, such as minimum account size.

³ This information may be omitted in brochures provided only to “qualified purchasers” (as defined by Section 2(a)(51)(A) of the Investment Company Act of 1940).

Item 8 – Methods of Analysis, Investment Strategies and Risk of Loss. The adviser must describe its methods of analysis and investment strategies and the related investment risks.

Item 9 – Disciplinary Information. The brochure must include material facts about any legal or disciplinary event that is material to a client's evaluation of the integrity of the investment adviser. The form identifies certain disciplinary events that, if they occurred during the prior ten years, are presumptively material. If the adviser concludes that the presumption can be rebutted, it need not be disclosed. However, the firm must maintain a memorandum that documents that determination. Certain events, even if not of the type identified, may be sufficiently material to require disclosure.

Item 10 – Other Financial Industry Activities and Affiliations. This section must include a description of material relationships or arrangements with related financial industry participants, any material conflicts of interest these relationships may create, and how the adviser addresses such conflicts.

Item 11 – Code of Ethics, Participation or Interest in Client Transactions and Personal Trading. The adviser must describe its code of ethics (*i.e.*, the code that sets forth the standard of business conduct that the firm requires of its employees and addresses personal trading policies) and state that a copy of the code of ethics is available upon request. As noted above, the adviser must also describe conflicts of interest related to personal trading policies and similar matters.

Item 12 – Brokerage Practices. The adviser must describe the factors that it considers in selecting or recommending broker-dealers for client transactions and determining the reasonableness of their compensation (*e.g.*, commissions). Disclosure must be provided with respect to various factors that might be related to the selection of brokers (*i.e.*, soft dollars, client referrals and client-directed brokerage), the conflicts that these factors may present, and the manner in which they are addressed. The adviser must also disclose whether it aggregates client trades to obtain volume discounts.

Item 13 – Review of Accounts. The adviser must disclose whether, and how often, it reviews clients' accounts or financial plans, and who conducts the reviews. If a review is not performed regularly, the adviser must describe the factors that trigger a review.

Item 14 – Client Referrals and Other Compensation. As noted above, the adviser must describe client referral and compensation arrangements and related conflicts of interest.

Item 15 – Custody. An adviser with custody of client funds or securities must explain that the client will receive account statements directly from the qualified custodian, and that clients should carefully review their statements and compare them to any statements they receive from the adviser.

Item 16 – Investment Discretion. An adviser who has discretionary authority over client accounts must disclose this fact and any limitations clients may place on this authority.

Item 17 – Voting Client Securities. The brochure must include certain disclosures concerning the adviser’s proxy voting policies (if it has the authority to vote client securities). The adviser must also describe how it addresses conflicts of interest with respect to voting their securities.

Item 18 – Financial Information. The brochure must include an audited balance sheet of the adviser if the adviser requires clients to prepay more than \$1,200 in fees per client six months or more in advance. The adviser also must generally disclose any financial condition reasonably likely to impair the adviser’s ability to meet contractual commitments to clients.

PART 2A, APPENDIX 1: WRAP FEE BROCHURE

Wrap fee programs are arrangements under which advisory clients pay a specified fee for investment advisory services and the execution of transactions. Often, the wrap fee program sponsor will assist the client in selecting other investment advisers to manage the client’s portfolio.

An adviser that sponsors a wrap fee program must provide a separate, specialized firm brochure for clients of the wrap fee program in lieu of the sponsor’s standard brochure. The wrap fee brochure must contain much of the same basic information as the standard brochure as well as additional disclosures specifically designed to address wrap fee programs. The wrap fee brochure must address:

- how the adviser selects and reviews portfolio managers, and its basis for selecting or recommending the replacement of portfolio managers for particular clients;
- whether any of the adviser’s affiliates acts as a portfolio manager and the related conflicts of interest and how they are addressed;
- the information about clients that is provided to portfolio managers; and
- any restrictions placed on clients’ ability to contact and consult with their portfolio managers.

PART 2B: THE BROCHURE SUPPLEMENT

The brochure supplement provides information about the adviser's personnel (the "supervised person") who will be dealing with the client. The brochure supplement requires the following information:

Item 1 – Cover Page. The name and contact information of the supervised person and the firm, the date of the supplement and certain information about the standard brochure.

Item 2 – Educational Background and Business Experience. Biographical information about the supervised person, including his or her age, formal education after high school, and business background (including an identification of the specific positions held) for the preceding five years.

Item 3 – Disciplinary Information. Any material facts relating to disciplinary matters material to a client's evaluation of the supervised person (similar to Item 9 of Part 2A).

Item 4 – Other Business Activities. Information concerning the supervised person's activities in other investment-related businesses (*i.e.*, if the supervised person is a registered representative of a broker-dealer) and any conflicts those activities may create (*i.e.*, if the supervised person receives commissions from the securities or products that it recommends to clients). In addition, the supplement must contain information about the supervised person's other business activities if they provide a substantial source of the supervised person's income or involve a substantial amount of the supervised person's time.

Item 5 – Additional Compensation. Any arrangement that involves the receipt by the supervised person of an economic benefit from someone who is not a client for providing advisory services. Economic benefits include sales awards and other prizes as well as any bonus that is based, at least in part, on the number or amount of sales, client referrals, or new accounts.

Item 6 – Supervision. The adviser must explain how it supervises the supervised person, including how it monitors the advice the supervised person provides to clients.