



Legal Risk Management Tip **June 2008**

FORM ADV PART 2 PROPOSED AMENDMENTS

The SEC has recently proposed amendments to Form ADV Part 2, which, if adopted will drastically change the form and content of this important disclosure document (SEC Release IA-2711). Among the major changes from the current form, the new Part 2 will require narrative “plain English” disclosure and will be publicly available on the IARD system. The new Part 2 also requires advisers to provide additional disclosures regarding their business practices, related conflicts of interest and backgrounds of their key advisory personnel.

The proposed amendments are designed to improve the ability of clients and prospective clients to evaluate and understand the types of advisory services provided by the firm, including any conflicts of interest that investment advisers or their personnel face when carrying out advisory services on behalf of clients. Interestingly, as proposed, the new Part 2 does not mandate a particular order in which items must be disclosed, making a true “apples to apples” comparison rather difficult. Nonetheless, the SEC is striving to improve upon its approach to client disclosure; i.e., rather than the current “check the box” method, and the proposed amendments seek to accomplish such disclosure in a narrative format to enable more detailed disclosure content in a uniform filing method.

THE LAYOUT OF THE NEW PART 2

In an effort to further promote effective communication between advisers and clients, the new form will be divided into three sections. As proposed, Form ADV Part 2 will consist of Part 2A, the “Firm Brochure,” Appendix 1 to Part 2A, the “Wrap-Fee Program Brochure,” and Part 2B, the “Brochure Supplement.”

In Part 2A, investment advisers must deliver to clients a Firm Brochure that provides detailed information in plain English so clients can better understand the advisers’ business practices and decide whether to begin or continue using the firm’s advisory services. Part 2A consists of 19 disclosure items, many of which call for clearer, more meaningful disclosures of actual and potential conflicts of interest between the adviser, its advisory personnel and their clients. Part 2A will require advisers to describe how the firm identifies and addresses various conflicts of interest and should enable clients to understand the relevant conflicts, their potential effect on the services provided and any procedures that are in place to minimize potentially adverse effects.

Appendix 1 to Part 2A will apply to sponsors of wrap-fee programs and is substantially similar to today’s Schedule H wrap-fee brochure. Advisers that sponsor wrap-fee programs will be required to prepare a separate, specialized brochure for clients of their sponsored program. One additional item not found in the current form would require disclosure if affiliated persons of the adviser serve as portfolio managers to the wrap-fee program and the adviser must discuss how such persons are selected and reviewed.

One major change from the current form is Part 2B, which requires that firms deliver a Brochure Supplement designed to provide additional information about the adviser’s supervised persons who provide investment advice to clients. Like the brochure itself, the Brochure Supplement

must be in narrative form and written in plain English and should provide investors with detailed information related to the individuals with whom they have direct contact, who formulate investment advice and/or have discretionary authority over the client's assets. Part 2B will contain six disclosure items, relating to the education and business background, disciplinary history and qualifications of relevant supervised persons.

DELIVERY AND FILING REQUIREMENTS OF PROPOSED FORM ADV PART 2

Advisers will have to deliver their brochures to all prospective clients before or at the time of entering into an advisory contract and to all clients every year within 120 days of the adviser's fiscal year-end. To accommodate the costs of complying with the significant changes to Form ADV Part 2, the amendments permit electronic delivery to clients, as long as advisers comply with the SEC's electronic delivery requirements. The Brochure Supplement also may be delivered electronically, but need not be updated unless there have been material changes to the disciplinary information contained therein.

The new filing requirements for Part 2 will require all SEC registered investment advisers to file their new brochures electronically in a PDF format through the IARD system, which will make Part 2A available for public viewing. The brochures filed with the SEC must be kept current, with updating required annually or promptly if any information in the brochure becomes materially inaccurate.

If adopted in its proposed form, the effects of the changes to Form ADV Part 2 will be considerable and widespread. It will be important to consider the implications of the proposed amendments now in order to plan for the substantial modifications to the format, content and filing requirements of Form ADV Part 2. For more information, please contact us at (619) 298-2880.

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