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Amendments to Form ADV Part 2 – The Investment Advisor Brochure

On July 21, 2010, the Securities and Exchange Commission (“SEC”) voted unanimously to adopt amendments to Part 2 of Form ADV and related rules under the Investment Advisers Act of 1940 (“Advisers Act”).¹ These amendments to Part 2 of Form ADV are designed to require investment advisors to provide clients with a simple and clear disclosure, in “plain English”, about the investment advisor’s qualifications, business practices and conflicts of interest.²

The amendments entail significant changes to Part 2 of Form ADV’s format, content, and filing requirements:

- The information in Part 2 must now follow a “plain English” narrative format to discuss all disclosure points in a prescribed order.
- Part 2 now includes part 2A (the “Brochure”), Appendix 1 (the “Wrap Fee Brochure”) and Part 2B, (the “Brochure Supplement”).
- The Brochure, and if applicable the Wrap Fee Brochure, must be electronically filed with the SEC via the Investment Advisor Registration Depository (“IARD”) system, which will allow the general public to access detailed information about the advisor’s business.
- The Brochure and the Brochure Supplements must be delivered to clients at the time the relationship with the client is established.

¹ Investment Advisers Act Release No. 3060 (July 28, 2010), available at <http://www.sec.gov/rules/final/2010/ia-3060.pdf>

² Nancy M. Smith, *A Plain English Handbook: How to Create Clear SEC Disclosure Documents* (1998), available at <http://sec.gov/pdf/handbook.pdf>.

- Advisors must provide clients an annual summary of all material changes to information disclosed in Part 2.
- A Brochure Supplement for certain advisory personnel must be delivered to clients who receive investment advice from the personnel.

Advisors currently registered with the SEC must file the new Part 2 Brochure with their next annual Form ADV updating amendment that are due 90 days after the end of the fiscal year, beginning with fiscal years ending on December 31, 2010 . For example, advisors with a fiscal year ending December 31, 2010 must file the new Form on or before March 31, 2011. Advisors must deliver the new Form to its existing clients within 60 days of filing its amendment.

Advisors newly registering with the SEC on or after January 1, 2011, must file the new Form with Part 1 of Form ADV; advisors must then begin to deliver the new Form to new clients and prospective clients.

Part 2A: The Brochure

Part 2 of Form ADV (the “Brochure”) includes information regarding the advisor’s qualifications, business practices, and conflicts of interest. Advisors are required to use “plain English” in responding to the items.

The body of the Brochure contains 18 required disclosure items which apply generally to the advisor; it also includes Appendix 1, which addresses requirements for the wrap fee program brochure. The SEC requires the advisor to follow a specified format for the Brochure; the advisors must respond to each item in the Brochure in the order of the items listed on the form, using the specified headings provided by the form. If an item is not applicable to the advisor, the advisor must still include the item heading along with a brief explanation on why this item is not applicable to the advisor’s business.

Item 1 – Cover Page: The cover page must include the firm’s name, contact information, business address, website address (if applicable), and the date of the Brochure. It must also include certain disclosures addressing that the Brochure was not approved by securities governing authority, and that if the advisor refers to itself as a “registered investment advisor,” it must include a disclaimer that registration does not imply a certain level of skill or training.

Item 2 – Summary of Material Changes: The advisor must disclose any material changes since the last annual update to its Brochure. The summary may be included in the brochure or as a separate document accompanying the Brochure. If the summary is submitted as a separate document, it must be filed with the SEC as an exhibit to Part 2. The SEC emphasizes that this item be a summary with which to inform the clients of the substance of the material changes, and that it not be a lengthy discussion.

Item 3 – Table of Contents: The table of contents must adhere to the uniform format set forth in the instructions to the form.

Item 4 – Advisory Business: The Brochure must include a description of the advisory business, including the types of advisory services offered, whether the advisor holds itself out as specializing in a particular type of advisory service, and the amount of client assets under management. The advisor may use a different method of calculating the amount of client assets managed than what was used in Part 1A of Form ADV to report “assets under management,” but the advisor must keep documentation describing this method.

Item 5 – Fees and Compensation: The advisor must disclose the compensation arrangements, including a fee schedule, all other types of costs (brokerage fees, custody fees, and fund expenses) that clients may pay in connection with the advisory services. The advisor must disclose if fees are negotiable. If the advisor charges a prepaid fee, the Brochure must include an explanation of how the fees may be refunded upon termination. The advisor may omit the fee schedule from the Brochure if the clients receiving this Brochure are “qualified purchasers” as defined by the Advisers Act. The SEC included a requirement that advisors receiving compensation from an affiliated broker from a sale of a security must disclose this, what conflicts of interest it may create, and how the advisor will address these conflicts.

Item 6 – Performance-based Fees and Side-By-Side Management: The advisor must disclose if it charges performance-based fees. If the advisor also manages accounts that do not charge performance based fees, the advisor must disclose any conflicts that may arise from this side-by-side management, and the way the advisor addresses them.

Item 7 – Type of Clients: The Advisor must disclose the types of advisory clients it has, along with the criteria for opening or maintaining an account.

Item 8 – Methods of Analysis, Investment Strategies and Risk of Loss: The advisor must describe its methods of analysis and investment strategies. The advisor must disclose that investing in securities involves a risk of loss, and if the primary strategy involves frequent trading of securities, how the strategy can affect investment performance. The advisor must explain the material risks for each significant investment strategy, with more detail for those with an “unusual” risk.

Item 9 – Disciplinary Information: The advisor must disclose material facts about any legal or disciplinary events that occurred within the previous 10 years, which are “material to a client evaluating the integrity of the advisor or its management personnel.” The instructions to the form include a list of items that are presumed to be material, and must be disclosed, unless the advisor rebuts the presumption. If the advisor rebuts the presumption, no disclosure is required, but the determination must be documented in a memorandum, and retained in the advisor’s records for SEC inspection. Some disciplinary events must be disclosed, even if having occurred

over 10 years ago, if the event was so serious it is still material to the client's evaluation of the integrity of the advisor.

Item 10 – Other Financial Industry Activities and Affiliations: The advisor must disclose material relationships or arrangements the advisor has with related financial industry participants, any material conflicts of interest that may arise, and how these conflicts are addressed. If the advisor selects or recommends other advisors for clients, the advisor must disclose any compensation arrangements or other business relationships between the advisory firms, any conflicts that may arise from this arrangement, and how it will address these conflicts.

Item 11 – Code of Ethics, Participation or Interest in Client Transactions and Personal Trading: The advisor must briefly describe its code of ethics and state that a copy is available upon request. The advisor must provide additional conflict of interest disclosure any if (i) it or a related person recommends to clients, or buys and sells for client accounts, securities in which it has a material financial interest, (ii) invests, or is permitted to invest, in the same securities that it recommends to clients, or (iii) trades in the same securities at or about the same time as a client.

Item 12 – Brokerage Practices: The advisor must disclose how brokers are selected, how it determines the reasonableness of the broker's compensation, and any conflicts of interest that arise from the receipt of soft dollar benefits. The description must be specific enough for clients to understand the types of products or services the advisor is acquiring with soft dollars and permit them to evaluate associated conflicts of interest. Disclosure must be more detailed for products or services that do not qualify for the safe harbor in section 28(e) of the Securities Exchange Act of 1934. Additional disclosures are required regarding (i) the directing of client brokerage to reward brokers for client referrals, (ii) whether the adviser recommends, requests or requires clients to direct the advisor to execute transactions through a particular broker, or (iii) the adviser engages in trade aggregation to save brokerage costs.

Item 13 – Review of Accounts: The advisor must disclose whether, and how often, it reviews client's accounts or financial plans, and identify who conducts the review. The advisor must also disclose what factors trigger an account review if it is done other than periodically.

Item 14 – Client Referrals and Other Compensation: The advisor must disclose any client referral arrangements, along with any arrangement in which the advisor receives any economic benefit from a non-client for providing advisory services, and any conflicts of interest from this arrangement.

Item 15 – Custody: The advisor with custody of client funds or securities must explain that clients will receive account statements directly from the qualified custodian. The advisor must explain to clients that they should carefully review the account statements they receive from the qualified custodian. If the advisor also sends clients account statements, the advisor's explanation must include a statement urging clients to compare the account statements they receive from the qualified custodian with those they receive from the advisor.

Item 16 – Investment Discretion: If the advisor has discretionary authority over client accounts, it must disclose this fact, along with any limitations clients may place on this authority.

Item 17 – Voting Client Securities: The advisor must disclose its proxy voting practices, along with a brief description of voting policies and how conflicts of interest are addressed. Advisors without the authority to vote client securities must disclose how clients will receive their proxies and other solicitations.

Item 18 – Financial Information: The advisor must include an audited balance sheet for its most recent fiscal year if it requires a prepayment \$1,200 or more per client, six or more months in advance. The advisor must also disclose any financial condition reasonably likely to impair the advisor's ability to meet contractual commitments to clients.

Appendix 1: The Wrap Fee Brochure: Advisors who sponsor a wrap fee program must prepare a separate, specialized firm brochure for clients of the wrap fee program in lieu of the sponsor's standard brochure. The advisor must identify if any of its related persons is a portfolio manager in a wrap fee program, and if so, any conflicts that may arise.

Updating the Brochure

Advisors must keep their brochure current by updating it at least annually, and promptly when any information (except the summary of material changes and the amount of assets under management, which only has to be updated annually) becomes materially inaccurate.

Delivery of the Brochure

Initial Delivery: The advisor must deliver a current brochure before or at the time it enters into an advisory contract with the client. The advisor is not required to deliver brochures to certain clients receiving only impersonal investment advice. The advisor does not have to prepare a brochure if it does not have any clients to whom a brochure must be delivered.

Annual Delivery: The advisor must annually provide each client to whom it must deliver a brochure either: (i) a copy of the current (updated) brochure that includes or is accompanied by the summary of material changes; or (ii) a summary of material changes that includes an offer to provide a copy of the current brochure. The advisor must make delivery of the brochure within 120 days after the end of its fiscal year.

Interim Delivery: The advisor must promptly deliver an updated brochure whenever it amends its brochure to add a disciplinary event or to change material information already disclosed in response to Item 9 of Part 2A.

Electronic Delivery: The advisor may deliver the brochure electronically, provided the delivery is in accordance with the SEC’s guidelines regarding electronic delivery of information.³

Part 2B: The Brochure Supplement

Each brochure must be accompanied by brochure supplements providing information about the advisory personnel on whom the particular client receiving the brochure relies for investment advice. The brochure supplement includes information that would not necessarily be included in the firm brochure about supervised persons of the advisor who actually provide the investment advice and interact with the client.

The supplement is not required to be filed electronically, and will not be publicly available; however, it must be preserved by the advisor and made available, if requested, to the SEC for examination.

The supplement must be written in “plain English” and follow a specific format, but the advisor has flexibility to tailor the brochure supplement based on their structure. The advisor may choose to prepare its supplement for each supervised person, or create separate supplements for different groups of supervised persons.

Item 1 – Cover Page: The cover page must include information identifying the supervised person covered by the supplement, as well as the advisory firm (name, business address, and telephone).

Item 2 – Educational Background and Business Experience: The advisor must describe the supervised person’s formal education and his or her business experience for the past 5 years. Advisors may include information about professional designations if they choose; however, if professional designations are disclosed, the supplement must also provide a sufficient explanation of the minimum qualifications required for the designation.

Item 3 – Disciplinary Information: The advisor must disclose any legal or disciplinary event that is material to an evaluation of the supervised person’s integrity. The required disclosures of this Item should parallel the information disclosed in Item 9 of the Brochure. The advisor must disclose any event for which the supervised person had ever resigned or otherwise relinquished a professional attainment, designation, or license in anticipation of it being suspended or revoked (other than for suspensions or revocations for failure to pay membership dues), if the advisor knew or should have known that the supervised person relinquished his or her designation or license. With respect to BrokerCheck of the Investment Adviser Public Disclosure system, the advisor may disclose, in a supplement delivered electronically, that the supervised person has a

³ Investment Advisers Act Release No. 1562 (May 9, 1996), available at <http://www.sec.gov/rules/concept/33-7288.txt>.

disciplinary event and provide a hyperlink to the relevant system with a brief explanation of how the client can access the disciplinary history.

Item 4 – Other Business Activities: The advisor must disclose other business activities of its supervised persons, specifically (i) other capacities in which he or she participates in any investment-related business and any material conflicts of interest that may arise, and (ii) other business activities or occupations that the supervised person engages in if the activities involve a substantial amount of time or pay. The advisor must include any compensation the supervised person receives based on the sale of securities or other investment products, as well as an explanation of the incentives this type of compensation creates.

Item 5 – Additional Compensation: The advisor must disclose any arrangements in which someone other than a client gives the supervised person an economic benefit (such as a sales award or other prizes) for providing advisory services.

Item 6 – Supervision: the Advisor must explain how the firm monitors advice provided by the supervised person addressed in the supplement. The firm must provide the client with the name, title, and telephone number of the person responsible for supervising the advisory activities of the supervised person.

Updating

The advisor must deliver an updated supplement to existing clients only when there is new disclosure of a disciplinary event, or a material change to disciplinary information already disclosed. The advisor must amend the brochure supplement promptly if the information in it becomes materially inaccurate. Any new clients to whom the advisor is obligated to deliver a supplement must be given an amended supplement (or the “old” supplement and a sticker).

Delivery

The advisor must provide a client with a brochure supplement for each supervised person who (i) formulates investment advice for that client and has a direct client contact; or (ii) makes discretionary investment decisions for that client’s assets, even if the supervised person has no direct client contact. This supplement must initially be given to each client at or before the time when the applicable supervised person begins to provide advisory services to such client. If investment advice is provided by a team comprised of more than 5 supervised persons, brochure supplements need only be provided for the 5 supervised persons with the most significant responsibility for the day-to-day advice provided to the client.

The advisor is not required to deliver supplements to three types of clients: (1) clients to whom an advisor is not required to deliver a firm brochure (e.g., registered investment companies and business development companies); (ii) clients who receive only impersonal investment advice; and (iii) certain “qualified clients who also are officers, directors, employees and other persons

related to the advisor. An advisor with no clients requiring supplement delivery is not required to prepare any supplements. Similarly, an advisor will not have to prepare a supplement for any supervised person who does not have clients to whom the advisor must deliver a supplement.

Filing Requirements and Public Availability

Brochures must be filed with the SEC electronically, through the IARD system, in a text-searchable Adobe Portable Document Format (“PDF”). Part 2A will not be completed online; advisors must create their brochure on their own computers, convert it to a PDF, and then attach the completed document to their filing on IARD, much like attaching a document to an e-mail.

The IARD will not accept an annual updating amendment without an updated brochure, a representation by that advisor that the brochure on file does not contain any materially inaccurate information, or a representation that the advisor does not have to prepare a brochure because it does not have to deliver it to any clients (e.g., the advisor’s clients are limited to registered investment companies). The IARD will also not accept an annual updating amendment without a representation that the summary of material changes is attached as an exhibit to, or included in, the updated brochure or a representation that no summary of material changes is required because there have been no material changes to the advisor’s brochure since its last annual updating amendment.

Rule 206(4)-4

The SEC rescinded Advisers Act Rule 206(4)-4, which required that an advisor disclose, to clients, certain material facts involving the advisors financial conditions or disciplinary events, because Part 2A incorporates disciplinary and financial disclosures required by the Rule. This rescission will be effective on the date the advisor is required to deliver its brochure to existing clients, and begins delivering its brochure to prospective clients.

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For more information on the Amendments to Form ADV part 2, please contact:

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