



► Compliance Corner

— By Jennifer L. Klass and F. Mindy Lo*

Electronic Delivery of Form ADV

Electronic delivery is not a new topic for investment advisers. In fact, the Securities and Exchange Commission (“SEC”) interpretive guidance that sets forth the framework for electronic delivery dates back to a series of electronic media releases that were published beginning in 1995. Recently, however, many advisers have had occasion to dust off the prior guidance in order to develop tactical solutions to comply with the implementation of new Form ADV, Part 2 delivery obligations that were adopted on July 28, 2010. This article reviews certain common questions about electronic delivery and considerations for advisers that wish to take advantage of electronic communications for purposes of delivering Form ADV.

What are the New Delivery Requirements for Form ADV, Part 2?

Advisers continue to have an obligation to deliver their brochures (Form ADV, Part 2A) at the inception of the investment advisory relationship. However, the most recent amendments to Form ADV added annual and interim delivery obligations that change an adviser’s ongoing delivery obligations in a number of important respects. First, the amendments replaced the passive delivery obligation under which advisers only had to offer to deliver their Form ADV each year with a more active approach under which, subject to certain exceptions, advisers affirmatively must deliver an updated brochure or a summary of material changes to existing clients annually.

Second, the Form ADV amendments

also introduced the concept of a brochure supplement (Form ADV, Part 2B), which discloses information about the background and qualifications of each supervised person of an adviser who: (i) formulates investment advice for the client and has direct client contact; or (ii) makes discretionary investment decisions for the client, even if the supervised person does not have direct client contact. The brochure supplement requires disclosure about the educational background, business experience, disciplinary information, other business activities, additional compensation and supervision of the supervised person. Subject to certain exceptions, the brochure supplements for each supervised person are required to be delivered “before or at the time that supervised person begins to provide advisory services to the client.” This means that in addition to the initial delivery requirement, advisers also will need to send new brochure supplements to existing clients throughout the year in response to changes in the portfolio management personnel or financial advisers responsible for covering particular client accounts.

Third, advisers must deliver updated versions of their brochures and brochure supplements to existing clients promptly whenever there is new disclosure of disciplinary events, or a material change to disciplinary information already disclosed. This interim delivery is required by rule. However, advisers separately may decide to deliver interim versions of their disclosure brochures (or amendments thereto) to existing clients in the case of material changes.

Can Advisers Satisfy Their Delivery Obligations by Simply Posting Their Form ADV, Part 2 to a Website?

No. In connection with the most recent amendments to Form ADV, commenters urged the SEC to take an “access equals delivery” approach under which advisers could satisfy their Form ADV delivery requirements by posting disclosure brochures on the adviser’s web page (or on the SEC’s Investment Adviser Public Disclosure (“IAPD”) website). Commenters also advocated that the SEC take a “notice and access” approach (as it had with securities offering reform and electronic delivery of proxy materials) under which advisers could simply send clients a notice providing a website link to where the Form ADV is posted on the Internet.

Both proposals would have eliminated the requirement to obtain prior consent or evidence of delivery. The SEC declined to accept these proposals reasoning that “an adviser’s fiduciary duties may require it to obtain client consent to many of the disclosures required by Part 2 and . . . electronic access, without evidence that the adviser’s delivery obligation has been met (such as by obtaining the client’s consent to electronic delivery along with appropriate notice and access) would not, in [the SEC’s] judgment, serve to adequately protect client interests.” Accordingly, while advisers may deliver Form ADVs to clients electronically, the SEC made clear that any electronic delivery should be done “in accordance with the Commission’s

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guidelines regarding electronic delivery of information.”

What Are the SEC's Guidelines Regarding Electronic Delivery?

The SEC has issued a series of interpretations on electronic delivery (principally in 1995, 1996 and 2000), through which it has made clear that electronic media may be used to satisfy legal requirements relating to the delivery of disclosure documents and other communications under the federal securities laws. The 1996 Release, in particular, provides guidance to advisers on the use of electronic media to fulfill their obligations under the Investment Advisers Act of 1940 (“Advisers Act”) to deliver information to clients, including Form ADV. Under the SEC’s guidance, an adviser must be able to show that it meets three requirements when effecting delivery electronically: notice, access, and evidence of delivery (or, in lieu of evidence of delivery, informed client consent).

Notice. The SEC stated that advisers providing information electronically should consider the extent to which electronic communication provides timely and adequate notice that the information is available electronically. In this connection, the SEC has reasoned by analogy that the delivery of paper documents puts the client on notice that new information is available. However, where documents are made available electronically through a passive delivery system (e.g., posting a document on a website), a client would not necessarily have notice that a new document is available. In this case, the SEC concluded that separate notice would need to be provided to direct the client’s attention to the receipt of a new document. This means that advisers that elect to post their Form ADVs online would have to send clients a notice, electronically or by paper means, informing them of the Form ADV’s availability and providing the relevant URL.

Access. The SEC guidance specifies that the use of a particular electronic

medium must not be so burdensome that the client cannot effectively access the information provided. If a client must proceed through a confusing series of ever-changing menus to access a required document, the procedure for accessing the information would likely be viewed as unduly burdensome, and delivery of the disclosure documents would not be deemed to have occurred unless delivery could otherwise be established. Further, clients should have access to information delivered electronically that is comparable to what they would receive if information were delivered in paper form. Accordingly, clients should have an opportunity to retain the information that is delivered electronically through the selected medium (e.g., the ability to download or print information) or have ongoing access to the information.

Evidence of Delivery (or Informed Consent). According to the SEC, advisers must have reason to believe that sending the information electronically will result in the satisfaction of their delivery requirements. In the 1996 Release, the SEC stated that an adviser may establish evidence of delivery by: (i) obtaining the client’s informed consent to delivery through a specified electronic medium, and ensuring that the client has appropriate notice and access (discussed above); or (ii) obtaining evidence that the intended recipient actually received the information, such as by e-mail return receipt, or by confirmation that the information was accessed, downloaded or printed.

Do Advisers Need to Obtain Client Consent Before They Can Deliver Their Form ADV, Part 2 Electronically?

The practical answer is yes. Because the SEC guidance provides two alternative approaches to satisfy the evidence of delivery prong, advisers technically have the option of not obtaining prior consent to electronic delivery. In practice, however, this option

is difficult to implement because advisers would have to have a mechanism to document each client’s receipt of the Form ADV, either through an express acknowledgement by the client (e.g., a button “click” for return receipt) or by an electronic audit trail showing receipt. One of the difficulties of this approach, however, is that because they are on notice of whether each client accessed the particular communication, advisers would have to revert to paper delivery of Form ADV for any client for whom the adviser cannot document receipt.

Under the SEC guidance, client consent must be affirmative but that consent may be in writing, electronic or oral (i.e., telephonic consent is permitted) provided that it is obtained in a manner that assures its authenticity. The SEC stated in the 1995 and 2000 Releases that the informed consent should specify:

- The electronic medium (e.g., CD-ROM, e-mail or Internet posting) through which the information will be delivered;
- Any potential cost to the client (e.g., costs for Internet access);
- The period during which the consent will be effective; and
- The information that will be delivered using such electronic means.

Advisers that previously obtained client consent to electronic delivery should ensure that those consents reasonably cover Form ADV or consider whether the consent may be expanded to add Form ADVs to the list of communications that a client has agreed to receive electronically.

Must the Consent be in Electronic Form, or Can Advisers Simply Obtain Written Consent to Electronic Delivery?

Under the SEC guidance, consent to electronic delivery may be in writing. However, advisers that wish to comply

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with E-SIGN (Electronic Signatures in Global and National Commerce Act) are required to obtain or confirm the consent electronically. Enacted on June 30, 2000, E-SIGN establishes that, if a law requires that information be provided to a consumer "in writing," the use of electronic delivery to provide the information satisfies that requirement if three principal requirements are satisfied. Under Section 101(c)(1) of E-SIGN, electronic delivery is valid if a consumer:

- Has affirmatively consented to electronic delivery and has not withdrawn that consent;
- Prior to consenting, is provided with a clear and conspicuous statement that describes the contours of that consent, including the consumer's ability to receive paper copies of electronic information, the right to revoke consent (including how to revoke consent and any consequences flowing from revocation of the consent), the scope of the consent, how to update electronic addresses and a statement of any hardware and software requirements; and
- Consents electronically or confirms his or her consent electronically "in a manner that reasonably demonstrates that the consumer can access information in the electronic form that will be used to provide the information that is the subject of the consent."

How Should an Adviser Handle E-mails that "Bounce Back"?

Advisers Act Rule 204-3 technically requires delivery of Form ADV, not

verification of receipt. Accordingly, advisers relying on informed consent to electronic delivery (rather than evidence of delivery) generally should be deemed to have satisfied their delivery requirements if they timely send the relevant brochure or brochure supplement electronically, so long as they have a reasonable belief that they are sending the information to a valid e-mail address. The question that often arises is how to handle e-mails that are returned as undeliverable. In such a case, advisers typically adopt policies and procedures that are reasonably designed to identify and remediate delivery failures in a timely manner.

Under these procedures, so-called "bounce backs" are captured through a single e-mail box that is monitored on an ongoing basis. The bounce back messages are reviewed and categorized as either "soft failures" (where the e-mail message has been delivered, but the recipient is unavailable or must take some simple and reasonable action to restore e-mail services) or "hard failures" (where automated replies would indicate that the recipient is permanently unable to receive the e-mail) based on the text contained in the automated reply. Hard failures are escalated to a client service or other appropriate representative to contact the client and verify the e-mail address within a stated time period. Once the client is contacted, the e-mail address is updated according to the firm's change of address process and the Form ADV is redelivered. If the e-mail address cannot be corrected within a reasonable amount of time, the adviser delivers the Form ADV via paper delivery.

Conclusion

Although it has been more than a decade since the SEC has issued guidance, electronic delivery remains an efficient and cost-effective alternative to sending disclosure documents to clients. This is particularly so in the context of Form ADV, where the recent SEC amendments have increased the frequency and complexity of delivery requirements.

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IAA International Committee to Meet In-Person

On Tuesday, October 4, the IAA International Committee will hold its next quarterly meeting in person from 10:30 am to 2:30 pm ET at the Army Navy Club

in Washington, DC. Please contact Jennifer S. Choi, IAA Associate General Counsel, at jennifer.choi@investmentadviser.org or at (202) 293-4222 if you are

interested in receiving information about the fall in-person meeting or the International Committee generally. ■