

# Morgan Lewis

## The New Adviser Disclosure Framework ALI-ABA Investment Adviser Regulation Conference

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# Overview

- New Form ADV Part 2
  - Structure of Part 2
  - Timing of Implementation
  - Delivery and Updating Obligations
  - Substantive Content

# Structure of Part 2

- Narrative Brochure
  - Part 2A – Firm Brochure
    - Old Schedule F
    - 18 disclosure items for SEC registered investment advisers
  - Appendix 1A – Wrap Program Brochure
    - Old Schedule H
    - Stand alone disclosure brochure
    - Incorporation of certain items from Part 2A
  - Part 2B – Brochure Supplement
    - New requirement
    - Disclosure of supervised persons responsible for providing investment advice
- Plain English
- Form ADV disclosure items are not comprehensive
  - To satisfy its fiduciary duty, an adviser “may have to disclose to clients information not specifically required by Part 2 of Form ADV or in more detail than the brochure items might otherwise require.”

# Structure of Part 2

- Part 2B requires disclosure of supervised persons responsible for:
  - Formulating investment advice with direct client contact; and
  - Making discretionary investment decisions for client, even if no direct client contact
- What is “formulating investment advice”?
  - Solicitation
  - Participant education
  - Asset allocation
  - Recommendation of managers
- 2B or not 2B?
  - Marketing personnel
  - Client service personnel
  - Product specialists
  - Traders
  - Research analysts
- Team exception
  - If [discretionary] advice is provide by a team of more than 5 supervised persons, brochure supplements only have to be provided for the 5 supervised persons with the most significant responsibility for the day-to-day [discretionary] advice provided to the client

# Timing of Implementation

- Advisers must transition to Part 2A with their next annual updating amendment
- Extension applies only to Part 2B
- Adviser with fiscal year ends between December 31, 2010 and April 30, 2011
  - File Part 2A electronically with the SEC – within 90 days
  - Begin distributing Part 2A to new clients – within 90 days
  - Deliver Part 2A to existing clients – within next 60 days
  - Four month extension for Part 2B
    - Begin distributing Part 2B to new clients – July 31, 2011
    - Deliver Part 2B to existing clients – September 30, 2011
- Advisers with fiscal year ends after April 30, 2011
  - File Part 2A electronically with the SEC – within 90 days
  - Begin distributing Part 2A and 2B to new clients – within 90 days
  - Deliver Part 2A and 2B to existing clients – within next 60 days
- Different timing for newly registered investment advisers

# Delivery and Updating Requirements

## Part 2A

- Initial delivery – Before or at the time of entering into the advisory contract
- Annual update – Update annually and file with the SEC within 90 days of fiscal year end (unless no material changes)
- Annual delivery – Deliver updated Part 2A or summary of material changes annually within 120 days of fiscal year end (unless no material changes)
  - No more annual offer
- Interim updates – Must update and file with SEC whenever disciplinary information (Item 9) changes or whenever other information in brochure becomes materially inaccurate
- Interim delivery – Must deliver updated brochure to clients promptly in the event of a change to the disciplinary events\*

## Part 2B

- Initial delivery – Before or at the time the supervised person begins to provide advice to the client
  - Temporary coverage
  - Unexpected departures and reassignments
  - Unassigned coverage (call centers)
- Annual update – None
- Annual delivery – None
- Interim updates – Must update whenever disciplinary information (Item 3) changes or whenever other information in brochure becomes materially inaccurate
- Interim delivery – Must deliver updated brochure supplement to clients promptly in the event of a change to the disciplinary events\*

# Delivery and Updating Requirements

- **Interim delivery to existing clients**
  - Advisers may have an obligation to deliver interim updates to existing clients, even if not specifically required by the rule
  - \*As fiduciaries, “advisers have an ongoing obligation to inform their clients of any material information that could affect the advisory relationship”
- **Electronic delivery**
  - Permitted, consistent with SEC electronic media releases
  - No access equals delivery by posting on website

# Substantive Content – Part 2A

- Item 1 – Cover Page
- Item 2 – Material Changes
  - Not applicable for first Part 2A filing
  - In future, summary may appear on cover page, page immediately following cover page or in separate letter
- Item 3 – Table of Contents
  - Items must appear in same order as in form
- Item 4 – Advisory Business
  - Alternative calculation for AUM permitted
- Item 5 – Fees and Compensation
  - Exception for qualified purchasers
- Item 6 – Performance-Based Fees and Side-by-Side Management
- Item 7 – Types of Clients
- Item 8 – Methods of Analysis, Investment Strategies and Risk Factors
  - Describe methods of analysis and investment strategies
  - Explain material risks for significant investment strategies or methods of analysis
  - If you recommend primarily a particular type of security, explain material risks
- Item 9 – Disciplinary Information
  - Incorporation of Rule 206(4)-4
  - Includes “management persons”
  - Rebuttable presumption of materiality



# Substantive Content – Part 2A

- **Item 10 – Other Financial Industry Activities and Affiliations**
  - Between firm or any of its management persons and any related persons
  - Relationships that create conflicts of interest and may impair the objectivity of the investment advice
- **Item 11 – Code of Ethics, Participation or Interest in Client Transactions and Personal Trading**
  - Significant conflicts disclosure
- **Item 12 – Brokerage Practices**
  - Brokerage allocation, soft dollars, client referrals, directed brokerage and aggregation practices
- **Item 13 – Review of Accounts**
- **Item 14 – Client Referrals and Other Compensation**
  - Economic benefit received from non-client in connection with advice
  - Referral fee arrangements
- **Item 15 – Custody**
- **Item 16 – Investment Discretion**
- **Item 17 – Voting Client Securities**
- **Item 18 – Financial Information**
  - Balance sheet requirement for certain prepaid fees
  - Incorporates Rule 206(4)-4 concept of “financial condition”

# Substantive Content – Part 2B

- Item 1 – Name, address, date of supplement, required regulatory legends
- Item 2 – Educational background and business experience
  - Professional designations – sufficient explanation of minimum qualifications
- Item 3 – Disciplinary Information
- Item 4 – Other Business Activities
  - Investment-related
    - Commissions, bonuses or other compensation based on the sale of securities or other investment products
  - Other business or occupation for compensation
    - Disclose if represents substantial source of income or involves a substantial amount of time
    - Less than 10% of time and income is not substantial
- Item 5 – Additional Compensation
  - Economic benefits include sales awards and other prizes, but not regular salary
  - Bonuses based, at least in part, on the number or amount of sales, client referrals or new accounts
- Item 6 – Supervision
  - Identify supervisor