

**MEMO# 11893**

May 19, 2000

## **INSTITUTE DRAFT LETTER ON SEC'S PROPOSED REVISIONS TO FORM ADV**

% See Memorandum to Investment Advisers Committee No. 12-00, dated April 7, 2000.  
[11893] May 19, 2000 TO: INVESTMENT ADVISERS COMMITTEE No. 15-00 RE: INSTITUTE  
DRAFT LETTER ON SEC'S PROPOSED REVISIONS TO FORM ADV

As we previously advised you, last month the Securities and Exchange Commission proposed significant revisions to Form ADV and new rules under the Advisers Act relating to the form. In response to the discussion of the Commission's proposal at the April meeting of the Investment Advisers Committee and comments from members, the Institute has prepared the attached draft comment letter. The letter is supportive of the Commission's proposal and the implementation of the Investment Adviser Registration Depository ("IARD"). Notwithstanding our overall support for the proposal, the Institute recommends various revisions to the proposal, which are discussed below. Comments are due to the Commission no later than June 13th. Please provide your comments on the Institute's draft letter to the undersigned no later than Wednesday, May 31st. Comments may be provided by phone (202-326-5825), fax (202-326-5839) or e-mail (tamara@ici.org).

I. The Need for Flexibility The Institute's letter discusses the need for the Commission to provide greater flexibility to advisers under the brochure rule (Rule 204-3 under the Advisers Act). In recognition of the wide variety of types of advisers that are subject to the Investment Advisers Act of 1940, as well as the wide variety of their services and types of clients, and the evolving nature of the industry, the Institute's letter recommends that the Commission build additional flexibility into the brochure rule. In particular, we recommend that the rule be revised to permit advisers to use multiple brochures, which may be targeted at specific types of clients or related to specific types of services, so long as the brochure the client receives complies with the disclosure requirements of proposed Part 2 of Form ADV. In addition, we recommend that the rule be revised to permit advisers to omit from their brochures any information that would be irrelevant to the client receiving the brochure. The ability of an adviser to omit irrelevant information is a necessary adjunct to the rule permitting advisers to produce multiple brochures tailored to specific clients or services. The Institute also recommends that the Commission clarify the level of detail of the information that is required to be included in the brochure.

II. Comments on Specific Disclosure Items of Proposed Part 2A Proposed Part 2A of Form ADV would list the nineteen items of disclosure that must appear in an adviser's narrative brochure, which must be written in plain-English. Our recommended revisions to the various proposed disclosure items (in the order in which they appear in Part 2A) are as follows:

- ! Item 4 -- Advisory Business. The Institute recommends that the Commission eliminate the requirement that an adviser's brochure include a list and description of each of the periodicals or periodic reports about securities that the adviser publishes.
- ! Item 5 -- Fees and Compensation. The

Institute recommends that the Commission clarify the additional fees that would need to be disclosed pursuant to this item and eliminate the requirement that an adviser disclose the "amount or range" of mutual fund expenses. ! Item 8 -- Disciplinary Information. The Institute strongly opposes the requirement that an adviser deliver to clients and prospective clients, for a period of one year, a copy of any Commission order resulting from an administrative proceeding involving the adviser. The letter states that such a requirement should remain an issue of negotiation between the adviser and the Commission in an administrative proceeding. In addition, the letter recommends that the Commission clarify that the brochure disclosure of disciplinary information should be a succinct summary of any such proceedings and not include the level of detail set forth on the proposed Disclosure Reporting Pages of Part 1A of the form. ! Item 9 -- Other Financial Activities and Affiliations. The Institute recommends that, in disclosing the internal procedures the adviser uses to address conflicts of interest, an adviser not be required to disclose their "procedures for disclosing conflicts to clients." ! Item 11 -- Brokerage Practices; Soft Dollars. The Institute's letter opposes requiring advisers who receive soft dollar benefits to disclose (1) that they have an incentive to select certain broker-dealers based on the adviser's interest in receiving soft dollars rather than in the client's interest in getting best execution at the lowest available commission rate and (2) whether the adviser seeks to allocate the benefits to client accounts proportionately to the brokerage credits those accounts generate. ! Item 14 -- Custody. The Institute's letter recommends that Item 14 be revised to expressly permit an adviser to satisfy the disclosure requirements of Rule 206(4)-2, relating to custody or possession of customer funds or securities, through this item of the brochure. ! Item 16 -- Proxy Voting. The Institute's letter recommends that the Commission clarify that an adviser that is an investment manager to an ERISA plan may satisfy its disclosure requirements under this item by simply stating that it will vote proxies on behalf of any such plan in accordance with the requirements of ERISA. ! Item 17 -- Investment Performance. The Institute recommends that this item, which would require an adviser that advertises or reports its investment performance to describe any standards it uses to calculate or present such performance, permit advisers to provide such disclosure in either the brochure or in the document containing the performance information. ! Item 19 -- Index. The Institute recommends that the index that must be provided to the Commission (but not to clients) pursuant to Item 19, which would detail where in the adviser's brochure each of the required disclosure items appear, be made uniform and not left to the discretion of each adviser. In particular, the Institute recommends that the index be modeled after that of Schedule H of the current Form ADV, which lists each of the required disclosure items and requires the adviser to insert next to each item the page number of the brochure where such disclosure appears. III. Comments on Proposed Part 2B, the Brochure Supplement Under the proposal, a brochure supplement must be prepared for each supervised person who on a regular basis communicates investment advice to a client. The Institute's letter questions how this requirement would apply when the activities of the person communicating with the client are more akin to those of marketing or solicitation and such person has no involvement in the rendering of the investment advice. In those instances, the Institute recommends that the Commission not require such persons to deliver a brochure supplement about themselves, inasmuch as it would likely consist of information that is irrelevant to the client. (The letter also notes that the rule would not require brochure supplements to be prepared for third-party solicitors.) Should the Commission determine, however, that a disclosure document on these supervised persons is necessary, we recommend that the required disclosure be limited to only information about the supervised person that may be relevant to the client. With respect to the specific items of disclosure under proposed Part 2B of the form, the Institute's letter recommends the following: ! Item 1 -- Cover Page. The letter recommends that the Commission clarify

that the name and contact information on the supervised person's supervisor (which is required by Item 6 of Part 2B) may be placed on the cover page. ! Item 3 -- Disciplinary Information. The Institute recommends that the required disciplinary disclosure not go beyond the disclosure currently required pursuant to Form U- 4, the Uniform Application for Securities Industry Registration. ! Item 6 -- Investment Advice and Supervision. The Institute's letter recommends that the Commission clarify that this item, which requires disclosure of the name, title, and telephone number of the supervised person's supervisor, does not require an adviser to list multiple supervisors of the supervised person, but rather, the person or persons who, in the view of the adviser, are the appropriate contact person(s). ! Item 7 -- Financial Information. The Institute recommends that the Commission eliminate, as unduly prejudicial or invasive, the requirement that a supervised person disclose any personal bankruptcies. IV. Comments on the Revisions Proposed by the Commission to the Brochure Rule The Institute's letter recommends that the Commission clarify two issues relating to an adviser's duty to promptly update clients when information in the brochure or brochure supplement becomes materially inaccurate. First, the Institute seeks clarification that "promptly," as used in the brochure rule, may mean, for those advisers that deliver quarterly statements, at the time of the next statement. Second, if the information in the brochure that has become materially inaccurate would only be relevant to certain of the adviser's clients, the Institute recommends that the prompt updating requirement of the rule apply only to those clients and that all other clients may be informed of such change during the annual brochure update. In addition, the Institute strongly opposes the Commission deeming a brochure filed with the Commission in order to permit states to require their filing. As discussed in the letter, if the Commission does not deem it necessary to require federally registered advisers to file with the Commission their narrative brochures in hard copy between the time such brochures are required to be created and the time their filing may be accommodated by the IARD, it does not seem necessary for states to be able to require the filing of such brochures. The Institute's letter notes that, in the absence of the states being able to require the routine filing of the brochures, states may obtain them when investigating or bringing an enforcement action with respect to fraud or deceit. V. Comments on the Registration Portion of Form ADV Part 1A of Form ADV would be the portion of the form that advisers must file with the Commission to obtain or maintain registration. The Institute recommends that the disciplinary information that must be disclosed pursuant to Item 11 of Part 1A be revised to eliminate disclosure relating to certain "advisory affiliates" unless: (1) such person is required to be listed on Schedule A or B of the form; (2) such person is affiliated with the adviser in a managerial or supervisory capacity; or (3) such person is not covered by (1) or (2) but the disciplinary information would be material to the Commission's evaluation of the adviser's advisory business or the integrity of management. To determine the materiality of the disciplinary information for persons in category (3), the Institute recommends that the Commission use the same standards set forth in Item 8 of Part 2B of the proposed form. In addition, the Institute recommends that advisers that have not been the subject of any regulatory proceedings for at least ten years be relieved of having to disclose, pursuant to Items 11(C)- (G) of Part 1A, any proceedings that occurred more than ten years previously. VI. Comments on the IARD The Institute's letter expresses support for the Commission's development and implementation of the IARD. To ensure maximum utility of the system, the Institute supports requiring those states that impose notice filing requirements on federally-registered advisers to receive them electronically through the IARD system.

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