**THOMPSON  
HINE**

August 2010

**INVESTMENT MANAGEMENT  
UPDATE****SEC Adopts Amendments to Form ADV Part 2**

On July 21, the Securities and Exchange Commission (SEC) adopted amendments to Part 2 of Form ADV and related rules under the Investment Advisers Act of 1940 (the “Advisers Act”) to require investment advisers registered with the SEC to deliver to clients and prospective clients a narrative brochure written in plain English.<sup>1</sup> Much of the required disclosure in the brochure concerns conflicts between an adviser’s own interests and the interests of its clients, and generally is disclosure that an adviser already makes to its clients.<sup>2</sup> The brochure replaces the current Form ADV Part 2 format, which consists of a series of multiple choice and fill-in-the-blank questions organized in a “check-the-box” format, supplemented with brief narrative responses. Advisers will file their brochures with the SEC electronically and the brochures will be available to the public through the SEC’s website. In addition, advisers are now required to deliver to each client a brochure supplement that provides information about advisory personnel who provide services to that particular client.<sup>3</sup>

In light of the changes to Form ADV Part 2, the SEC is withdrawing Rule 206(4)-4 under the Advisers Act, which requires disclosure of certain disciplinary and financial information. This information is now disclosed in the brochure and the brochure supplement.

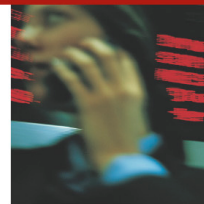
New applicants for registration filing after January 1, 2011, including advisers to private funds who are now required by the Dodd-Frank legislation to register, must include a brochure as part of their initial registration. Existing advisers with fiscal years ending on or after December 31, 2010 must comply with the amendments no later than March 31, 2011.

**PART 2A: THE FIRM BROCHURE**

Registered advisers are now required to provide to prospective and existing clients a narrative brochure written in plain English. The brochure should describe an adviser’s services, fees, business practices and conflicts of interest with clients.<sup>4</sup> Advisers will file the brochure electronically through the Investment Adviser Registration Depository (IARD) and the public will be able to access each adviser’s brochure through the SEC’s website.

***Brochure Items***

Part 2A contains 18 separate items, each covering a different disclosure topic.<sup>5</sup> An adviser must respond to each item in the brochure, and must present the information in the order the items appear in Form ADV, using the headings provided by the form. If an item is inapplicable to an adviser, the adviser must include the heading and an explanation that the information is inapplicable. An adviser does not need to repeat information in the brochure simply because the



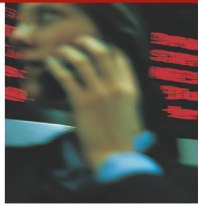
information is responsive to more than one item. Rather, the adviser may cross-reference the information in the other item.

An adviser that offers substantially different services to different advisory clients can prepare separate brochures, each of which omits information that does not apply to the advisory fees and services it describes. However, an adviser may not omit any of the disciplinary history of the adviser or its management personnel in any brochure provided to any client.

Finally, advisers are required to explain succinctly how conflicts of interest are addressed, rather than disclosing lengthy, technical policies and dense procedures. Advisers can include a summary of their business practices and the advisory services they offer in the beginning of the brochure, followed by a more detailed discussion of each item in the brochure.<sup>6</sup>

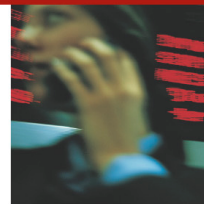
The following items comprise proposed Part 2A of Form ADV:

- *Item 1: Cover Page.* The cover page must disclose the adviser's name, business address and telephone number; the telephone number and/or email address that a client or prospective client can call for further information; and the date of the brochure. The cover page also must include a statement that the brochure has not been approved by the SEC or any state securities authority. If the adviser holds itself out as being "registered," the cover page must explain that registration with the SEC does not imply that the adviser possesses a certain level of skill or training.
- *Item 2: Material Changes.* An adviser is required to provide clients with a summary that identifies and discusses any material changes to its brochure since the last annual update. The summary may appear on the cover page of the brochure or the following page, or it can be included in a separate communication that would accompany the brochure. An adviser is not required to provide the summary of material changes to clients or prospective clients who have not received a previous version of the adviser's brochure. In addition, the summary is not required to be filed with the SEC and, if included in a separate communication with the client, will not be available on the SEC's website.<sup>7</sup>
- *Item 3: Table of Contents.* An adviser is required to include a table of contents in its brochure that is detailed enough to permit clients and prospective clients to locate topics easily.
- *Item 4: Advisory Business.* This item requires an adviser to describe its advisory business. The description must include the types of advisory services offered, whether the adviser holds itself out as specializing in a particular type of advisory service and the amount of client assets managed.<sup>8</sup> Advisers must update the amount of their assets under management annually as part of their annual updating amendment and make interim amendments only for material changes in assets under management when they are filing an "other than annual amendment" for a separate reason.
- *Item 5: Fees and Compensation.* This item requires an adviser to describe how it is compensated for providing advisory services, including whether the adviser bills clients or deducts fees from a client's assets, how often fees are assessed and whether fees are paid in



advance or arrears. An adviser also is required to provide its fee table, disclose whether fees are negotiable and describe other fees or expenses, such as custodian fees, mutual fund expenses, brokerage and other transaction costs, that clients may pay in connection with the receipt of advisory services. If an adviser or any of its supervised persons receive compensation for the sale of securities or other investment products, including asset-based sales charges or service fees from the sale of mutual funds, it must disclose that fact and the conflicts of interest that this practice creates. The adviser also must describe how it addresses this conflict, including procedures for disclosing the conflict to clients.<sup>9</sup> Finally, an adviser engaging in this practice must explain that clients have the option of purchasing investment products recommended by the adviser from brokers that are not affiliated with the adviser. An adviser is not required to include Item 5 information in any brochure that is provided only to “qualified purchasers” as defined in Section 2(a)(51)(A) of the Advisers Act.<sup>10</sup>

- *Item 6: Performance Fees and Side-by-Side Management.* An adviser that charges performance fees is required to disclose that fact. If the adviser also manages accounts that are not charged performance fees, the adviser is required to discuss the conflicts of interest that arise from its simultaneous management of these types of accounts, including that the adviser has an incentive to favor accounts for which it receives a performance fee, and generally describe how these conflicts are addressed.
- *Item 7: Types of Clients.* This item requires a description of the types of clients to whom the adviser generally provides investment advice, such as individuals, trusts, investment companies or pension plans. Any requirements for opening or maintaining an account, such as minimum account size, also needs to be disclosed.
- *Item 8: Methods of Analysis, Investment Strategies and Risk of Loss.* Item 8 requires an adviser to describe the methods of analysis and investment strategies used in formulating advice or managing assets. An adviser also is required to explain that investing involves risk of loss that clients should be prepared to bear. An adviser is required to explain the material risks involved in each significant investment strategy or method of analysis employed by the adviser. A method of analysis or strategy is “significant” if more than a small portion of the adviser’s clients’ assets are advised using the method or strategy. In addition, if a method of analysis or strategy involves significant or unusual risk, or the adviser recommends primarily a particular type of security that involves significant or unusual risk, those risks must be discussed in detail. An adviser employing multiple strategies, each of which pose different and specific risks, is not required to list in the brochure the risks associated with each type. Rather, the adviser is required to separately provide to each client risk disclosure with respect to the particular strategies used in managing that client’s account.
- *Item 9: Disciplinary History.* An adviser is required to disclose in its brochure facts about any legal or disciplinary event that are material to a client’s or prospective client’s evaluation of the integrity of the adviser and its management. Items 9.A, 9.B and 9.C list specific legal and disciplinary events that are presumptively material and that must be disclosed if they occurred in the last 10 years. An adviser may rebut the presumption, in which case no disclosure is required.<sup>11</sup> However, an adviser rebutting a presumption of materiality is required to prepare



and retain a memorandum of the determination. Because advisers are required to include disciplinary disclosures in their brochures, the SEC is rescinding Rule 206(4)-4, which requires disclosure of disciplinary information, but does not specify the means of delivering the disclosure. Disclosure of arbitration awards is not required.

- *Item 10: Other Financial Industry Activities and Affiliations.* An adviser is required to describe material relationships or arrangements the adviser or any of its management persons has with related financial industry participants, any material conflicts of interest such relationships or arrangements create and how the adviser addresses such conflicts. Also, if an adviser recommends or selects other investment advisers for its clients and directly or indirectly receives compensation in return, the adviser must disclose the practice and discuss the material conflicts of interest the practice creates and how the adviser addresses them.
- *Item 11: Code of Ethics, Participation or Interest in Client Transactions and Personal Trading.* Item 11 requires that an adviser briefly describe its code of ethics and explain that a copy is available upon request. An adviser is required to disclose if it or a related person recommends to clients, or buys or sells for client accounts, securities in which it has a material financial interest; invests in the same securities (or related securities) that it recommends to clients; or recommends securities to clients, or buy or sells securities for a client's account, at or about the same time that it (or a related person) buys or sells the same securities for its own account (i.e., personal trading). If an adviser engages in these practices, the brochure must describe the practice, discuss the conflicts inherent in such practices and describe how the conflicts are addressed. Advisers would not be required to provide this disclosure with respect to securities that are not "reportable securities" under Rule 204A-1.
- *Item 12: Brokerage Practices.* Item 12 requires an adviser to describe how it selects brokers for client transactions and determines the reasonableness of broker compensation. An adviser receiving soft-dollar benefits is required to describe its soft-dollar practices, disclose the conflicts that arise when it accepts soft-dollar benefits and explain how it addresses those conflicts. The disclosure must be specific enough for the client to understand the types of products and services the adviser is receiving and to permit them to evaluate possible conflicts of interest.<sup>12</sup> An adviser also is required to disclose if it uses client brokerage to reward brokers for client referrals, aggregates (or "bunches") client trades or requires or permits directed brokerage.<sup>13</sup> The brochure must disclose any conflicts of interest that arise from these practices and explain how the conflicts are addressed.
- *Item 13: Review of Accounts.* An adviser is required to disclose whether and how frequently it reviews a client's account or financial plans. If an adviser reviews accounts, but not regularly, it must explain the factors that trigger a review.
- *Item 14: Payment for Client Referrals.* Item 14 requires an adviser to describe any cash or other payment that it or a related person makes to a third party (i.e., a non-employee) for client referrals. Item 14 also requires an adviser to describe any arrangement in which a non-client provides an economic benefit to the adviser for providing investment advice or other advisory



services to a client, explain the conflicts of interest and describe how the conflicts are addressed. An economic benefit would include sales awards and other prizes.

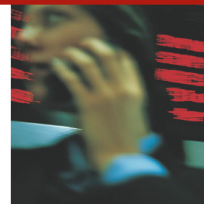
- *Item 15: Custody.* An adviser that has custody of client assets is required to explain that clients will receive account statements from their qualified custodian and clients should read the statements carefully. If an adviser also sends clients account statements, the adviser's explanation must include a statement urging clients to compare the account statements they receive from the qualified custodian with those they receive from the adviser. If clients do not receive quarterly statements from the custodian, an adviser with custody must state that it has custody and explain the risks that clients face as a result.
- *Item 16: Investment Discretion.* If an adviser accepts investment discretion to manage securities on behalf of clients, it is required to disclose this fact and describe any limitations clients may (or customarily do) place on such authority.
- *Item 17: Voting Client Securities.* If an adviser has, or will accept, authority to vote client securities, Item 17 requires the adviser to briefly describe its voting policies and procedures and explain how a client can obtain a copy of the adviser's proxy voting policies and procedures. An adviser also must describe whether and how clients can direct the adviser to vote in a particular solicitation, how the adviser addresses conflicts of interest when it votes securities, and how a client can obtain information from the adviser about how the adviser voted their securities. Advisers that do not have authority to vote client securities have to explain how clients will receive proxies and other solicitations.
- *Item 18: Financial Information.* An adviser that requires or solicits prepayment of more than \$1,200 in fees per client six or more months in advance is required to give clients an audited balance sheet as of the end of the most recent fiscal year.<sup>14</sup> An adviser with discretionary authority or custody of client assets, or that requires or solicits prepayment of more than \$1,200 in fees per client six or more months in advance, must disclose any financial condition that is reasonably likely to impair its ability to meet contractual commitments to its clients. Finally, an adviser that has been subject to a bankruptcy petition during the past 10 years must disclose this fact, the date the petition was filed and the current status.

Part 2A of Form ADV also includes Item 19, which is applicable only to state-registered investment advisers and requires disclosure of a state-registered adviser's principal executive officers and management personnel, fee structure, non-advisory business activities and legal and disciplinary history.

### ***Wrap Fee Program Brochure***

An adviser sponsoring a wrap fee program is required to prepare a separate, specialized brochure for clients of the wrap fee program. The disclosure requirements for the wrap fee program brochure are set out in Appendix 1 to Proposed Part 2A of Form ADV and are substantially similar to the requirements of current Schedule H. Advisers whose entire advisory business is sponsoring wrap fee programs will prepare a wrap brochure but are not required to prepare a standard advisory firm





brochure.<sup>15</sup> However, an adviser that sponsors a wrap fee program *and* provides other types of advisory services will have to prepare both a standard firm brochure and a wrap fee program brochure, and must deliver both brochures to a client who receives both types of services.

Wrap fee sponsors, like other advisers, would be required to provide brochure supplements to their wrap fee clients. Wrap fee sponsors also may deliver the adviser's brochures and maintain certain records as long as the sponsor can produce promptly the records for the SEC staff at the appropriate office of the adviser or the sponsor. While the adviser can delegate these responsibilities to the wrap fee sponsor, the adviser retains the legal delivery obligation and should take steps to assure itself that the sponsor is performing the tasks the adviser has delegated.

### ***Brochure Updating and Delivery Requirements***

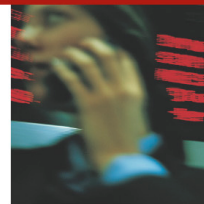
#### *Updating the Brochure*

An adviser is required to update its brochure each year at the time the adviser files its annual Form ADV updating amendment and promptly when any information in the brochure becomes materially inaccurate. Brochures do not need to be updated merely because the amount of client assets has changed or solely because a client's fee schedule has changed, unless the changes are material. If the adviser has not filed any interim amendments to its brochure since the last annual updating amendment and the brochure continues to be accurate in all material respects, the adviser does not have to prepare or deliver a summary of material changes to clients. The adviser also would not have to prepare and file an updated firm brochure as part of its annual Form ADV updating amendment. If there was an interim amendment or the brochure contains a material inaccuracy, however, the adviser would have to file a summary of material changes describing any interim amendment(s) along with an updated firm brochure as part of its annual amendment filing.

Annual and interim updates will be submitted through IARD. Although previously filed versions of an adviser's brochures remain stored as SEC records in the IARD system, only the most recent version of an adviser's brochure will be available to the public through the SEC website.

#### *Initial Delivery*

Rule 204-3 under the Advisers Act has been amended to require an adviser to deliver a current firm brochure before or at the time it enters into an advisory contract with a client.<sup>16</sup> An adviser is not required to deliver a brochure to clients who are investment companies or business development companies registered under the Investment Company Act of 1940 (the "1940 Act") or to clients who receive only impersonal investment advice for which the adviser charges less than \$500 per year. If an adviser does not have any clients to whom a brochure must be delivered, the adviser is not required to prepare or file a brochure.<sup>17</sup>



### *Annual and Interim Delivery*

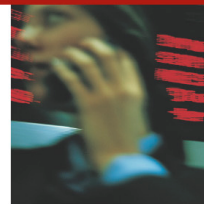
Rule 204-3 requires an adviser to annually provide to each client to whom it must deliver a brochure, if there is a material change in the brochure since the last annual Form ADV updating amendment, either a copy of the current (updated) brochure that includes or is accompanied by the summary of material changes or a summary of material changes that includes an offer to provide a copy of the current brochure.<sup>18</sup> This delivery must be made at least once per year no later than 120 days after the end of the adviser's fiscal year. Brochures can be delivered electronically or in paper form.<sup>19</sup> If the adviser has not filed any interim amendments to its brochure since the last annual updating amendment and the brochure continues to be accurate in all material respects, the adviser does not need to deliver a brochure or summary of material changes to clients.

Rule 204-3 requires advisers to deliver to clients an amended brochure along with a statement describing the material facts relating to the change in disciplinary information or a statement describing the material facts relating to the change in disciplinary information, when the adviser amends its brochure to add a disciplinary event, or to materially change information already disclosed, in response to Item 9 of Part 2A. Instruction 2 of the *Instructions for Part 2A of Form ADV* reminds advisers that as fiduciaries, they have ongoing obligations to inform clients of material information that could affect the advisory relationship and, as a result, advisers may be required to disclose material changes to clients between annual updating amendments even if those changes would not otherwise trigger delivery of any interim update.

### **PART 2B: THE BROCHURE SUPPLEMENT**

An adviser's brochure must be accompanied by a brochure supplement written in plain English that provides information about the advisory personnel on whom clients rely for investment advice. The brochure supplement, which the SEC estimates ordinarily would be less than a page long, would contain information about the educational background, business experience and disciplinary history of the supervised person who provides advisory services to a particular client.

An adviser can prepare separate brochure supplements for each supervised person, or prepare separate brochure supplements for different groups of supervised persons.<sup>20</sup> However, brochure supplements do not need to be separate documents.<sup>21</sup> If an adviser's brochure includes all the information required to be in the brochure supplement, the adviser does not need a separate supplement. In addition, if an adviser's brochure contains some, but not all, of the brochure supplement information, the brochure supplement can refer the client or prospective client to the appropriate section(s) of the brochure and describe the types of information being referred to rather than repeating that information in the brochure supplement.

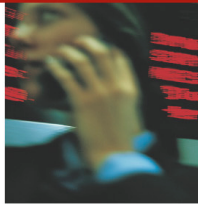


### ***Brochure Supplement Items***

The brochure supplement would consist of the following six items. The items must appear the same order, and contain the same headings, as the items appear in Form ADV, whether provided in a brochure or separately.

- *Item 1: Cover Page.* The cover page must include information identifying the supervised person and the firm, including the supervised person's name, business address and telephone number.
- *Item 2: Educational Background and Business Experience.* Item 2 requires disclosure of the supervised person's name, age (or year of birth), formal education after high school and business background for the preceding five years. If the supervised person has no high school education, no formal education after high school or no business background, that fact must be disclosed. Professional designations can be used in the supplement, but must be accompanied by a sufficient explanation of the minimum qualifications required for the designations.
- *Item 3: Disciplinary Information.* Similar to Item 9 of Part 2A, this item requires an adviser to disclose any legal or disciplinary events material to a client's or prospective client's evaluation of the supervised person's integrity. Items 3.A, 3.B and 3.C list specific legal and disciplinary events that are presumptively material and that must be disclosed for 10 years following the date of the event, unless the event was resolved in the supervised person's favor, or was reversed, suspended or vacated, or the adviser has rebutted the presumption of materiality.<sup>22</sup> Any revocation or suspension of a supervised person's professional attainment, designation or license would need to be disclosed only if the action resulted from a violation of rules relating to professional conduct. Similarly, an adviser is required to describe any event over which the supervised person resigned or relinquished a professional attainment, designation or license in anticipation of it being suspended or revoked (other than for failure to pay membership dues), if the adviser knows or should have known of the event. Advisers that send supplements electronically to clients may include hyperlinks to disciplinary information available through the FINRA BrokerCheck system as well as the Investment Adviser Public Disclosure (IAPD) system.
- *Item 4: Other Business Activities.* This item requires an adviser to describe other business activities of its supervised persons. Specifically, Item 4 requires disclosure of other capacities in which the supervised person participates in *any* investment-related business, any material conflicts that participation may create and how those conflicts are addressed. Any compensation, including bonuses and non-cash compensation, that the supervised person receives based on the sale of securities must be disclosed along with an explanation of the incentives this type of compensation creates. Finally, if a supervised person is actively engaged in any business or occupation for compensation that is not otherwise disclosed, and such activity provides a substantial source of the supervised person's income or involves a substantial amount of the supervised person's time, the adviser must disclose that fact and describe the nature of the business. Other business activities representing less than 10 percent of a supervised person's time and income are presumed not to be substantial.





- *Item 5: Additional Compensation.* An adviser is required to describe arrangements in which someone other than a client provides an economic benefit to the supervised person for providing advisory services. An economic benefit would include a sales award or other prize, but not the supervised person's regular salary. Any bonus that is based at least in part on the number or amount of sales, client referrals or new accounts would be considered an economic benefit, but other regular bonuses would not.
- *Item 6: Supervision.* Item 6 requires an adviser to explain how the firm monitors the advice provided by the supervised person. The item also requires an adviser to provide the client with the name, title and telephone number of the person responsible for supervising the advisory activities of the supervised person.

Part 2B of Form ADV also includes Item 7, which is applicable only to state-registered investment advisers and requires disclosure of a supervised person's legal and disciplinary history. It also requires that if a supervised person has been subject to a bankruptcy petition, the adviser must disclose this fact, the date the petition was filed and the current status.

### ***Brochure Supplement Updating and Delivery Requirements***

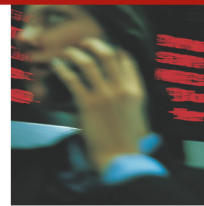
#### *Updating Requirements*

Advisers are required to deliver an updated brochure supplement to clients only when there is new disclosure of a disciplinary event, or a material change to disciplinary information already disclosed, in response to Item 3 of Part 2B. The updates can be in the form of a "sticker" that identifies the information that has become inaccurate and provides the new information. Any new clients who would be required to be given that supplement must be given the amended version.

#### *Initial Delivery*

An adviser is required to deliver to a client or prospective client, at or before the time *a particular* supervised person begins to provide advisory services to *that* client, a brochure supplement for each supervised person who formulates investment advice for the client and has direct client contact; or makes discretionary investment decisions for the client's assets, even if the supervised person has no direct client contact.<sup>23</sup> If a team comprised of more than five supervised persons provides investment advice, brochure supplements need only be provided for the five supervised persons with the most significant responsibility for the day-to-day advice provided to the client. An adviser would not have to provide a brochure supplement for a supervised person who provides discretionary advice only as part of a team and who has no direct client contact.

An adviser is not required to deliver a brochure supplement to a client to whom the adviser is not required to deliver a firm brochure (e.g., registered investment companies and business development companies); who receives only impersonal investment advice (even if they receive a firm brochure), regardless of the amount of fees paid; or who would be a qualified client of the firm



under Rule 205-3(d)(iii) under the Advisers Act.<sup>24</sup> As with the firm brochure, brochure supplements can be delivered electronically or on paper.<sup>25</sup>

### *Annual and Interim Delivery*

An adviser is not required to deliver a brochure supplement annually. However, an adviser is required to deliver an updated brochure supplement for a supervised person who provides advisory services to a client when the adviser amends the brochure supplement to add a disciplinary event, or to materially change information already disclosed, in response to Item 3 of Part 2B.

## **FILING REQUIREMENTS**

### ***Brochures***

Advisers are to file new brochures with the SEC electronically through the IARD system, which will permit the SEC to make the brochures publicly available through its website. Instead of completing Part 2A online as advisers currently do for Part 1, advisers will create brochures on their own computers and then attach a PDF version of the completed document to their filings on IARD. An adviser who does not need to file a brochure because it is not required to deliver one will be prompted by the IARD system to confirm that it is not required to file a brochure.

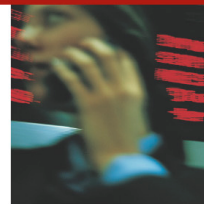
The IARD system will not accept an adviser's annual ADV updating amendment without an updated brochure. However, if no changes to the brochure are necessary when an adviser is submitting the annual ADV updating amendment, the adviser will have the option of indicating on IARD that the current brochure does not contain any materially inaccurate information.

### ***Brochure Supplements***

SEC-registered advisers are not required to file brochure supplements or supplement amendments with the SEC and these documents will not be available on the SEC's website. However, advisers are required to maintain copies of all supplements and amendments in their files. Advisers registered with one or more state securities authorities must file through IARD a copy of the brochure supplement for each supervised person doing business in that state.

## **CONCERNS FOR PRIVATE FUNDS**

In commenting on the proposed amendments to Form ADV, some advisers to private funds expressed concern that public disclosure through IARD of Part 2 of the adviser's ADV would jeopardize a private fund's ability to rely on the private offering exemption in the Securities Act of 1933 (the "1933 Act") and the safe harbor for offshore transactions from the registration provisions in Section 5 of the 1933 Act. In the release adopting amendments to Form ADV, the SEC stated its view that registrants could provide information required by Part 2 without jeopardizing reliance on those exemptions. However, it cautioned that inclusion of private fund information beyond that



required in Part 2, such as subscription instructions, performance information and financial statements, may jeopardize such reliance by constituting a public offering or conditioning the market for the securities issued by those funds.

### **TRANSITION PERIOD**

New applicants for registration filing after January 1, 2011 must include a brochure as part of their initial registration. An adviser already registered with the SEC whose fiscal year ends on or after December 31, 2010 must file an annual updating amendment with the new brochure(s) no later than March 31, 2011. Within 60 days of filing such amendment, the adviser must deliver to its existing clients a brochure and brochure supplement that meet the requirements of amended Form ADV.

### **FOR MORE INFORMATION**

For more information, please contact:

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<sup>1</sup> *Amendments to Form ADV*, Investment Advisers Act Release No. 3060 (July 28, 2010).

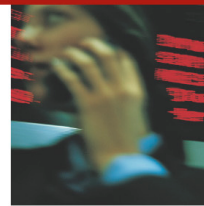
<sup>2</sup> The SEC takes pains to emphasize that Part 2A (the firm brochure) of Form ADV does not cover every possible conflict and delivering a brochure prepared in accordance with Part 2A may not fully satisfy an adviser’s disclosure obligations.

<sup>3</sup> Part 2 of Form ADV consists of two parts, the firm brochure in Part 2A and the brochure supplement in Part 2B.

<sup>4</sup> The brochure should discuss only conflicts the adviser has or is reasonably likely to have, and practices in which it engages or is reasonably likely to engage.

<sup>5</sup> Disclosure of wrap fee programs is included in an appendix to the brochure.

<sup>6</sup> Instruction 3 in the *General Instructions for Part 2 of Form ADV* explains that an adviser must provide the client with sufficiently specific facts so that the client is able to understand the conflicts of interest the adviser has and the business practices in which it



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engages, and can give his or her informed consent to the transaction or practice that gives rise to the conflict or to reject the transaction or practice.

<sup>7</sup> The SEC also is amending Rule 204-2(a) under the Advisers Act to require advisers to preserve copies of summaries of material changes that are not included in a brochure or brochure supplement. See Rule 204-2(a)(14)(i).

<sup>8</sup> In calculating the amount of client assets managed, an adviser is permitted to use a method different from the method used in Part 1A of Form ADV to report assets under management. Rule 204-2(a)(14)(ii) requires that an adviser keep documentation describing the method used to compute managed assets for purposes of Item 4.E of Part 2A of Form ADV if the method differs from the method used to compute assets under management in Item 5.F of Part 1A of Form ADV.

<sup>9</sup> An adviser that receives more than 50 percent of its revenue from commissions and other sales-based compensation is required to explain that commissions are the firm's primary form of compensation.

<sup>10</sup> "Qualified purchasers" include, among others, natural persons who own \$5 million or more in investments and persons who manage \$25 million or more in investments for their account or other accounts of other qualified purchasers.

<sup>11</sup> In determining materiality, advisers are instructed to consider all of the following factors: the proximity of the person involved in the disciplinary event to the advisory function; the nature of the infraction that led to the disciplinary event; the severity of the disciplinary sanction; and the time elapsed since the date of the disciplinary event.

<sup>12</sup> The description must be particularly detailed for products and services that do not qualify for the safe harbor in Section 28(e) of the Securities Exchange Act of 1934.

<sup>13</sup> An adviser may omit directed brokerage disclosure if the adviser only permits clients to direct brokerage subject to the adviser's ability to obtain best execution.

<sup>14</sup> Advisers that are qualified custodians or insurance companies are excluded from this requirement.

<sup>15</sup> Instruction 10 of *Instructions for Part 2A of Form ADV*.

<sup>16</sup> Currently, delivery of an adviser's Form ADV Part 2 must occur at least 48 hours before entering into an advisory contract or at the time of entering into an advisory contract if the client has the right to terminate the contract without penalty within five business days.

<sup>17</sup> See Instruction 7 to Part 2A of Form ADV.

<sup>18</sup> The offer must be accompanied by a website address, telephone number and email address for obtaining the complete brochure, as well as the website address for obtaining information about the adviser through IAPD.

<sup>19</sup> See Instruction 3 to Part 2A of Form ADV.

<sup>20</sup> A group supplement, or a firm brochure containing supplement information, must present information in a separate section for each supervised person.

<sup>21</sup> See Instruction 6 to Part 2B. If provided in the brochure, supplements must be included at the end of the brochure and be sequenced for each supervised person.

<sup>22</sup> When reviewing a legal or disciplinary event involving a supervised person for materiality, advisers are instructed to consider all of the following factors: the proximity of the supervised person to the advisory function; the nature of the infraction that led to the disciplinary event; the severity of the disciplinary sanction; and the time elapsed since the date of the disciplinary event. If an adviser concludes that an event is immaterial, it must prepare and maintain a file memorandum of the determination for its records.

<sup>23</sup> See Rule 204-3(b) and Instruction 1 to the *Instructions for Part 2B of Form ADV*.

<sup>24</sup> See Rule 204-3(c)(2) and Instruction 2 to the *Instructions for Part 2B of Form ADV*.

<sup>25</sup> See Instruction 5 to Part 2B.