

SEC PROPOSES DISCLOSURE CHANGES AND NEW FILING OBLIGATIONS FOR INVESTMENT ADVISERS

Earlier this week, the Securities and Exchange Commission moved forward on a long-anticipated revamping of Part II of Form ADV, the document that advisers registered under the Investment Advisers Act of 1940 typically use in communicating information to their clients. Under the Commission's proposal, an investment adviser would need to prepare and deliver to clients and prospective clients a narrative brochure written in "plain English." The proposal is designed to give potential clients Internet access to information about the kinds of services an investment adviser offers, the fees it charges and the conflicts of interest it faces.

The proposal would require a registered investment adviser to (i) rewrite its Form ADV, Part II as a narrative brochure drafted in plain English that would provide detailed information about the adviser's business practices, fees, conflicts of interest, how conflicts are addressed and the disciplinary history of certain key personnel, and (ii) submit the new brochure to the SEC electronically, which would make the brochure available to the general public through the SEC-sponsored Investment Adviser Public Disclosure website. Currently, an investment adviser is required to complete Form ADV Part I and Part II, but only Part I is required to be filed with the SEC and be made publicly available to prospective investors.

Under the proposal, Part II must be a narrative brochure written in plain English and would no longer be prepared using a check-the-box format and Schedule F. According to the Commission, the new brochure would provide an investment adviser with more flexibility to structure its disclosure and organize topics so as to present information in a more clear and meaningful way. The SEC modeled the proposed new brochure on current Schedule H to Form ADV, which requires a wrap fee program brochure sponsor to provide investors with a narrative brochure describing the program.

The plain English narrative brochure would provide investors with detailed information about an adviser's business practices, including the types of advisory services it provides, the fees it charges and the risks that its clients can anticipate. New information required to be disclosed under the narrative brochure would include:

1. conflicts of interest arising from the adviser's (i) side-by-side management of clients that pay performance fees (such as hedge funds) and those that do not, (ii) receipt of compensation from issuers of financial products that the adviser recommends to clients, (iii) use of affiliates to execute client transactions, (iv) use of client brokerage to obtain "soft dollars benefits," and (v) interest in certain transactions;
2. qualifications of an investment advisory firm's employees who give advice to clients; and
3. material disciplinary information of principals and employees of the adviser involved in any disciplinary action.

The full text of the detailed release concerning these proposed rule and form changes will be posted to the SEC website as soon as possible. We will provide another bulletin highlighting some of the significant details of the amendments discussed in the release. Although the SEC emphasized Internet access and plain English narrative as key themes, we anticipate that the release will provide some new and noteworthy interpretations.

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February 15, 2008

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